

FULTON FINANCIAL CORP  
Form 10-Q  
November 04, 2016

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D. C. 20459

FORM 10-Q

(Mark One)

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 No. 0-10587

FULTON FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

PENNSYLVANIA

(State or other jurisdiction of incorporation or organization)

23-2195389

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

One Penn Square, P.O. Box 4887, Lancaster, Pennsylvania 17604

(Address of principal executive offices)

(Zip Code)

(717) 291-2411

(Registrant's telephone number, including area code)

Indicate by checkmark 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 checkmark 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 checkmark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

Common Stock, \$2.50 Par Value –173,271,000 shares outstanding as of October 28, 2016.

1

---

FULTON FINANCIAL CORPORATION  
 FORM 10-Q FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2016  
 INDEX

| Description                                                                                                          | Page      |
|----------------------------------------------------------------------------------------------------------------------|-----------|
| <b>PART I. FINANCIAL INFORMATION</b>                                                                                 |           |
| <b><u>Item 1. Financial Statements (Unaudited):</u></b>                                                              |           |
| (a) <u>Consolidated Balance Sheets - September 30, 2016 and December 31, 2015</u>                                    | <u>3</u>  |
| (b) <u>Consolidated Statements of Income - Three and nine months ended September 30, 2016 and 2015</u>               | <u>4</u>  |
| (c) <u>Consolidated Statements of Comprehensive Income - Three and nine months ended September 30, 2016 and 2015</u> | <u>5</u>  |
| (d) <u>Consolidated Statements of Shareholders' Equity - Nine months ended September 30, 2016 and 2015</u>           | <u>6</u>  |
| (e) <u>Consolidated Statements of Cash Flows - Nine months ended September 30, 2016 and 2015</u>                     | <u>7</u>  |
| (f) <u>Notes to Consolidated Financial Statements</u>                                                                | <u>8</u>  |
| Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations                        | <u>39</u> |
| <u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u>                                            | <u>65</u> |
| <u>Item 4. Controls and Procedures</u>                                                                               | <u>69</u> |
| <b><u>PART II. OTHER INFORMATION</u></b>                                                                             |           |
| <u>Item 1. Legal Proceedings</u>                                                                                     | <u>70</u> |
| <u>Item 1A. Risk Factors</u>                                                                                         | <u>70</u> |
| <u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>                                           | <u>71</u> |
| <u>Item 3. Defaults Upon Senior Securities</u>                                                                       | <u>71</u> |
| Item 4. Mine Safety Disclosures                                                                                      | <u>71</u> |
| <u>Item 5. Other Information</u>                                                                                     | <u>71</u> |
| <u>Item 6. Exhibits</u>                                                                                              | <u>71</u> |
| <u>Signatures</u>                                                                                                    | <u>72</u> |
| <u>Exhibit Index</u>                                                                                                 | <u>73</u> |



## Item 1. Financial Statements

## CONSOLIDATED BALANCE SHEETS

(in thousands, except per-share data)

|                                                                                                                                            | September 30,<br>2016<br>(unaudited) | December 31,<br>2015 |
|--------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------|----------------------|
| <b>ASSETS</b>                                                                                                                              |                                      |                      |
| Cash and due from banks                                                                                                                    | \$ 86,497                            | \$ 101,120           |
| Interest-bearing deposits with other banks                                                                                                 | 368,031                              | 230,300              |
| Federal Reserve Bank and Federal Home Loan Bank stock                                                                                      | 60,935                               | 62,216               |
| Loans held for sale                                                                                                                        | 27,836                               | 16,886               |
| Available for sale investment securities                                                                                                   | 2,508,068                            | 2,484,773            |
| Loans, net of unearned income                                                                                                              | 14,391,238                           | 13,838,602           |
| Less: Allowance for loan losses                                                                                                            | (162,526 )                           | (169,054 )           |
| Net Loans                                                                                                                                  | 14,228,712                           | 13,669,548           |
| Premises and equipment                                                                                                                     | 228,009                              | 225,535              |
| Accrued interest receivable                                                                                                                | 43,600                               | 42,767               |
| Goodwill and intangible assets                                                                                                             | 531,556                              | 531,556              |
| Other assets                                                                                                                               | 617,818                              | 550,017              |
| Total Assets                                                                                                                               | \$ 18,701,062                        | \$ 17,914,718        |
| <b>LIABILITIES</b>                                                                                                                         |                                      |                      |
| Deposits:                                                                                                                                  |                                      |                      |
| Noninterest-bearing                                                                                                                        | \$ 4,210,099                         | \$ 3,948,114         |
| Interest-bearing                                                                                                                           | 10,742,380                           | 10,184,203           |
| Total Deposits                                                                                                                             | 14,952,479                           | 14,132,317           |
| Short-term borrowings:                                                                                                                     |                                      |                      |
| Federal funds purchased                                                                                                                    | 8,444                                | 197,235              |
| Other short-term borrowings                                                                                                                | 255,598                              | 300,428              |
| Total Short-Term Borrowings                                                                                                                | 264,042                              | 497,663              |
| Accrued interest payable                                                                                                                   | 13,645                               | 10,724               |
| Other liabilities                                                                                                                          | 376,174                              | 282,578              |
| Federal Home Loan Bank advances and long-term debt                                                                                         | 965,286                              | 949,542              |
| Total Liabilities                                                                                                                          | 16,571,626                           | 15,872,824           |
| <b>SHAREHOLDERS' EQUITY</b>                                                                                                                |                                      |                      |
| Common stock, \$2.50 par value, 600 million shares authorized, 219.1 million shares issued in 2016 and 218.9 million shares issued in 2015 | 547,735                              | 547,141              |
| Additional paid-in capital                                                                                                                 | 1,457,597                            | 1,450,690            |
| Retained earnings                                                                                                                          | 710,833                              | 641,588              |
| Accumulated other comprehensive income (loss)                                                                                              | 4,491                                | (22,017 )            |
| Treasury stock, at cost, 45.9 million shares in 2016 and 44.7 million shares in 2015                                                       | (591,220 )                           | (575,508 )           |
| Total Shareholders' Equity                                                                                                                 | 2,129,436                            | 2,041,894            |
| Total Liabilities and Shareholders' Equity                                                                                                 | \$ 18,701,062                        | \$ 17,914,718        |

See Notes to Consolidated Financial Statements



## CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

| (in thousands, except per-share data)                 | Three months ended   |                      | Nine months ended    |                      |
|-------------------------------------------------------|----------------------|----------------------|----------------------|----------------------|
|                                                       | September 30<br>2016 | September 30<br>2015 | September 30<br>2016 | September 30<br>2015 |
| <b>INTEREST INCOME</b>                                |                      |                      |                      |                      |
| Loans, including fees                                 | \$ 136,639           | \$ 131,804           | \$ 405,361           | \$ 391,491           |
| Investment securities:                                |                      |                      |                      |                      |
| Taxable                                               | 10,874               | 11,252               | 34,036               | 33,478               |
| Tax-exempt                                            | 2,550                | 1,904                | 6,910                | 5,872                |
| Dividends                                             | 143                  | 190                  | 438                  | 834                  |
| Loans held for sale                                   | 210                  | 194                  | 529                  | 632                  |
| Other interest income                                 | 1,052                | 884                  | 2,814                | 3,922                |
| Total Interest Income                                 | 151,468              | 146,228              | 450,088              | 436,229              |
| <b>INTEREST EXPENSE</b>                               |                      |                      |                      |                      |
| Deposits                                              | 11,311               | 10,217               | 32,925               | 30,093               |
| Short-term borrowings                                 | 254                  | 92                   | 739                  | 272                  |
| Long-term debt                                        | 9,338                | 10,225               | 27,889               | 33,669               |
| Total Interest Expense                                | 20,903               | 20,534               | 61,553               | 64,034               |
| Net Interest Income                                   | 130,565              | 125,694              | 388,535              | 372,195              |
| Provision for credit losses                           | 4,141                | 1,000                | 8,182                | (500)                |
| Net Interest Income After Provision for Credit Losses | 126,424              | 124,694              | 380,353              | 372,695              |
| <b>NON-INTEREST INCOME</b>                            |                      |                      |                      |                      |
| Other service charges and fees                        | 14,407               | 10,965               | 38,140               | 31,316               |
| Service charges on deposit accounts                   | 13,078               | 12,982               | 38,532               | 37,188               |
| Investment management and trust services              | 11,425               | 11,237               | 33,660               | 33,137               |
| Mortgage banking income                               | 4,529                | 3,864                | 12,456               | 13,891               |
| Investment securities gains, net                      | 2                    | 1,730                | 1,025                | 8,290                |
| Other                                                 | 4,708                | 3,996                | 13,610               | 12,178               |
| Total Non-Interest Income                             | 48,149               | 44,774               | 137,423              | 136,000              |
| <b>NON-INTEREST EXPENSE</b>                           |                      |                      |                      |                      |
| Salaries and employee benefits                        | 70,696               | 65,308               | 210,097              | 195,365              |
| Net occupancy expense                                 | 11,782               | 10,710               | 35,813               | 36,211               |
| Other outside services                                | 5,783                | 7,373                | 17,347               | 21,248               |
| Data processing                                       | 4,610                | 5,105                | 15,486               | 14,767               |
| Software                                              | 4,117                | 3,984                | 11,991               | 10,678               |
| Equipment expense                                     | 3,137                | 3,595                | 9,380                | 10,888               |
| Supplies and postage                                  | 2,559                | 2,708                | 7,844                | 7,803                |
| Professional fees                                     | 2,535                | 2,828                | 8,221                | 8,430                |
| FDIC insurance expense                                | 1,791                | 2,867                | 7,700                | 8,574                |
| Marketing                                             | 1,774                | 2,102                | 5,314                | 5,570                |
| Telecommunications                                    | 1,411                | 1,587                | 4,358                | 4,920                |
| Other real estate owned and repossession expense      | 742                  | 1,016                | 1,745                | 2,507                |
| Operating risk loss                                   | 556                  | 1,136                | 2,082                | 2,637                |
| Loss on redemption of trust preferred securities      | —                    | 5,626                | —                    | 5,626                |
| Intangible amortization                               | —                    | 5                    | —                    | 241                  |
| Other                                                 | 8,355                | 8,939                | 24,520               | 26,256               |
| Total Non-Interest Expense                            | 119,848              | 124,889              | 361,898              | 361,721              |
| Income Before Income Taxes                            | 54,725               | 44,579               | 155,878              | 146,974              |

Edgar Filing: FULTON FINANCIAL CORP - Form 10-Q

|              |          |          |           |           |
|--------------|----------|----------|-----------|-----------|
| Income taxes | 13,257   | 10,328   | 36,403    | 36,007    |
| Net Income   | \$41,468 | \$34,251 | \$119,475 | \$110,967 |

PER SHARE:

|                      |        |        |        |        |
|----------------------|--------|--------|--------|--------|
| Net Income (Basic)   | \$0.24 | \$0.20 | \$0.69 | \$0.63 |
| Net Income (Diluted) | 0.24   | 0.20   | 0.69   | 0.63   |
| Cash Dividends       | 0.10   | 0.09   | 0.29   | 0.27   |

See Notes to Consolidated Financial Statements

4

---



## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

(in thousands)

|                                                                                                 | Three months<br>ended September<br>30 |          | Nine months ended<br>September 30 |           |
|-------------------------------------------------------------------------------------------------|---------------------------------------|----------|-----------------------------------|-----------|
|                                                                                                 | 2016                                  | 2015     | 2016                              | 2015      |
| Net Income                                                                                      | \$41,468                              | \$34,251 | \$119,475                         | \$110,967 |
| Other Comprehensive Income (Loss), net of tax:                                                  |                                       |          |                                   |           |
| Unrealized (loss) gain on securities                                                            | (3,580 )                              | 7,857    | 26,285                            | 5,841     |
| Reclassification adjustment for securities gains included in net income                         | (1 )                                  | (1,124 ) | (666 )                            | (5,388 )  |
| Reclassification adjustment for loss on derivative financial instruments included in net income | —                                     | 2,456    | —                                 | 2,456     |
| Non-credit related unrealized gain on other-than-temporarily impaired debt securities           | —                                     | —        | —                                 | 125       |
| Amortization of unrealized loss on derivative financial instruments                             | 4                                     | 3        | 12                                | 71        |
| Amortization of net unrecognized pension and postretirement items                               | 379                                   | 466      | 877                               | 1,398     |
| Other Comprehensive (Loss) Income                                                               | (3,198 )                              | 9,658    | 26,508                            | 4,503     |
| Total Comprehensive Income                                                                      | \$38,270                              | \$43,909 | \$145,983                         | \$115,470 |

See Notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (UNAUDITED)  
NINE MONTHS ENDED SEPTEMBER 30, 2016 AND 2015

(in thousands, except per-share data)

|                                                      | Common Stock          |           | Additional<br>Paid-in<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income (Loss) | Treasury<br>Stock | Total       |
|------------------------------------------------------|-----------------------|-----------|----------------------------------|----------------------|--------------------------------------------------------|-------------------|-------------|
|                                                      | Shares<br>Outstanding | Amount    |                                  |                      |                                                        |                   |             |
| Balance at December 31, 2015                         | 174,176               | \$547,141 | \$1,450,690                      | \$641,588            | \$ (22,017 )                                           | \$(575,508)       | \$2,041,894 |
| Net income                                           |                       |           |                                  | 119,475              |                                                        |                   | 119,475     |
| Other comprehensive income                           |                       |           |                                  |                      | 26,508                                                 |                   | 26,508      |
| Stock issued, including related tax benefits         | 454                   | 594       | 2,099                            |                      |                                                        | 2,833             | 5,526       |
| Stock-based compensation awards                      |                       |           | 4,808                            |                      |                                                        |                   | 4,808       |
| Acquisition of treasury stock                        | (1,486 )              |           |                                  |                      |                                                        | (18,545 )         | (18,545 )   |
| Common stock cash dividends - \$0.29 per share       |                       |           |                                  | (50,230 )            |                                                        |                   | (50,230 )   |
| Balance at September 30, 2016                        | 173,144               | \$547,735 | \$1,457,597                      | \$710,833            | \$ 4,491                                               | \$(591,220)       | \$2,129,436 |
| Balance at December 31, 2014                         | 178,924               | \$545,555 | \$1,420,523                      | \$558,810            | \$ (17,722 )                                           | \$(510,501)       | \$1,996,665 |
| Net income                                           |                       |           |                                  | 110,967              |                                                        |                   | 110,967     |
| Other comprehensive loss                             |                       |           |                                  |                      | 4,503                                                  |                   | 4,503       |
| Stock issued, including related tax benefits         | 613                   | 889       | 2,675                            |                      |                                                        | 3,374             | 6,938       |
| Stock-based compensation awards                      |                       |           | 4,371                            |                      |                                                        |                   | 4,371       |
| Acquisition of treasury stock                        | (3,976 )              |           |                                  |                      |                                                        | (50,000 )         | (50,000 )   |
| Settlement of accelerated stock repurchase agreement | (1,790 )              |           | 20,000                           |                      |                                                        | -(20,000 )        | —           |
| Common stock cash dividends - \$0.27 per share       |                       |           |                                  | (47,540 )            |                                                        |                   | (47,540 )   |
| Balance at September 30, 2015                        | 173,771               | \$546,444 | \$1,447,569                      | \$622,237            | \$ (13,219 )                                           | \$(577,127)       | \$2,025,904 |

See Notes to Consolidated  
Financial Statements

## CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(in thousands)

|                                                                                    | Nine months ended<br>September 30 |            |
|------------------------------------------------------------------------------------|-----------------------------------|------------|
|                                                                                    | 2016                              | 2015       |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                                       |                                   |            |
| Net Income                                                                         | \$ 119,475                        | \$ 110,967 |
| Adjustments to reconcile net income to net cash provided by operating activities:  |                                   |            |
| Provision for credit losses                                                        | 8,182                             | (500 )     |
| Depreciation and amortization of premises and equipment                            | 20,547                            | 20,302     |
| Net amortization of investment securities premiums                                 | 7,434                             | 5,369      |
| Investment securities gains, net                                                   | (1,025 )                          | (8,290 )   |
| Gain on sales of mortgage loans held for sale                                      | (11,967 )                         | (10,588 )  |
| Proceeds from sales of mortgage loans held for sale                                | 493,457                           | 599,557    |
| Originations of mortgage loans held for sale                                       | (492,440 )                        | (598,384 ) |
| Amortization of intangible assets                                                  | —                                 | 241        |
| Amortization of issuance costs on long-term debt                                   | 347                               | 432        |
| Stock-based compensation                                                           | 4,808                             | 4,371      |
| Excess tax benefits from stock-based compensation                                  | (58 )                             | (86 )      |
| Loss on redemption of trust preferred securities                                   | —                                 | 5,626      |
| Increase in accrued interest receivable                                            | (833 )                            | (1,028 )   |
| Increase in other assets                                                           | (9,075 )                          | (10,926 )  |
| Increase (decrease) in accrued interest payable                                    | 2,921                             | (3,318 )   |
| Increase in other liabilities                                                      | 2,061                             | 21,604     |
| Total adjustments                                                                  | 24,359                            | 24,382     |
| Net cash provided by operating activities                                          | 143,834                           | 135,349    |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                                       |                                   |            |
| Proceeds from sales of securities available for sale                               | 84,978                            | 29,309     |
| Proceeds from principal repayments and maturities of securities available for sale | 426,932                           | 317,813    |
| Purchase of securities available for sale                                          | (484,164 )                        | (444,111 ) |
| Increase in short-term investments                                                 | (136,450 )                        | (156,837 ) |
| Net increase in loans                                                              | (567,061 )                        | (440,681 ) |
| Net purchases of premises and equipment                                            | (23,021 )                         | (19,980 )  |
| Net cash used in investing activities                                              | (698,786 )                        | (714,487 ) |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                                       |                                   |            |
| Net increase in demand and savings deposits                                        | 880,795                           | 852,611    |
| Net decrease in time deposits                                                      | (60,633 )                         | (135,723 ) |
| (Decrease) increase in short-term borrowings                                       | (233,621 )                        | 101,912    |
| Additions to long-term debt                                                        | 16,000                            | 347,778    |
| Repayments of long-term debt                                                       | (603 )                            | (510,038 ) |
| Net proceeds from issuance of common stock                                         | 5,468                             | 6,852      |
| Excess tax benefits from stock-based compensation                                  | 58                                | 86         |
| Dividends paid                                                                     | (48,590 )                         | (46,239 )  |
| Acquisition of treasury stock                                                      | (18,545 )                         | (50,000 )  |
| Net cash provided by financing activities                                          | 540,329                           | 567,239    |
| Net Decrease in Cash and Due From Banks                                            | (14,623 )                         | (11,899 )  |
| Cash and Due From Banks at Beginning of Period                                     | 101,120                           | 105,702    |
| Cash and Due From Banks at End of Period                                           | \$ 86,497                         | \$ 93,803  |

Supplemental Disclosures of Cash Flow Information:

Cash paid during the period for:

|              |          |          |
|--------------|----------|----------|
| Interest     | \$58,632 | \$67,352 |
| Income taxes | 9,404    | 9,168    |

See Notes to Consolidated Financial Statements

7

---

FULTON FINANCIAL CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1 – Basis of Presentation

The accompanying unaudited consolidated financial statements of Fulton Financial Corporation (the "Corporation") have been prepared in conformity with U.S. generally accepted accounting principles ("U.S. GAAP") for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and notes required by U.S. GAAP for complete financial statements. The preparation of financial statements in accordance with U.S. GAAP requires management to make estimates and assumptions that affect the amounts of assets and liabilities as of the date of the financial statements as well as revenues and expenses during the period. Actual results could differ from those estimates. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2015. Operating results for the three and nine months ended September 30, 2016 are not necessarily indicative of the results that may be expected for the year ending December 31, 2016. The Corporation evaluates subsequent events through the date of filing of this Form 10-Q with the Securities and Exchange Commission ("SEC").

Recently Issued Accounting Standards

In May 2014, the Financial Accounting Standards Board ("FASB") issued ASC Update 2014-09, "Revenue from Contracts with Customers." This standards update establishes a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The core principle prescribed by this standards update is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The standard applies to all contracts with customers, except those that are within the scope of other topics in the FASB ASC. The standard also requires significantly expanded disclosures about revenue recognition. During 2016, the FASB issued amendments to this standard (ASC Updates 2016-08, 2016-10, 2016-11 and 2016-12). These amendments provide further clarification to the standard. For public business entities, ASC Update 2014-09 is effective for interim and annual reporting periods beginning after December 15, 2017. Early application is not permitted. For the Corporation, this standards update is effective with its March 31, 2018 quarterly report on Form 10-Q. The Corporation is currently evaluating the impact of the adoption of ASC Update 2014-09 on its consolidated financial statements.

In January 2016, the FASB issued ASC Update 2016-01, "Financial Instruments - Overall: Recognition and Measurement of Financial Assets and Financial Liabilities." ASC Update 2016-01 provides guidance regarding the income statement impact of equity investments held by an entity and the recognition of changes in fair value of financial liabilities when the fair value option is elected. ASC Update 2016-01 is effective for public business entities' annual and interim reporting periods beginning after December 15, 2017, with earlier adoption permitted. The Corporation intends to adopt this standards update effective with its March 31, 2018 quarterly report on Form 10-Q and does not expect the adoption of ASC Update 2016-01 to have a material impact on its consolidated financial statements.

In February 2016, the FASB issued ASC Update 2016-02, "Leases." This standards update states that a lessee should recognize the assets and liabilities that arise from all leases with a term greater than 12 months. The core principle requires the lessee to recognize a liability to make lease payments and a "right-of-use" asset. The accounting applied by the lessor is relatively unchanged. The standards update also requires expanded qualitative and quantitative

disclosures. For public business entities, ASC Update 2016-02 is effective for interim and annual reporting periods beginning after December 15, 2018. ASC Update 2016-02 mandates a modified retrospective transition for all entities. Early application is permitted. The Corporation intends to adopt this standards update effective with its March 31, 2019 quarterly report on Form 10-Q. The Corporation is currently evaluating the impact of the adoption of ASC Update 2016-02 on its consolidated financial statements.

In March 2016, the FASB issued ASC Update 2016-09, "Stock Compensation: Improvements to Employee Share-Based Payment Accounting." The purpose of this standards update is to simplify several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liability, and classification on the statement of cash flows. ASC Update 2016-09 is effective for interim and annual reporting periods beginning after December 15, 2016. Early application is permitted. For the Corporation, this standards update is effective with its March 31, 2017 quarterly report on Form 10-Q. The Corporation is currently evaluating the impact of the adoption of ASC Update 2016-09 on its consolidated financial statements and does not expect the adoption of ASC Update 2016-09 to have a material impact on its consolidated financial statements.

In June 2016, the FASB issued ASC Update 2016-13, "Financial Instruments - Credit Losses." The new impairment model prescribed by this standards update is a single impairment model for all financial assets (i.e., loans and investments). The recognition of credit losses would be based on an entity's current estimate of expected losses (referred to as the Current Expected Credit Loss model, or "CECL"), as opposed to recognition of losses only when they are probable (current practice). ASC Update 2016-13 is effective for interim and annual reporting periods beginning after December 15, 2019. Early adoption is permitted. The Corporation intends to adopt this standards update effective with its March 31, 2020 quarterly report on Form 10-Q. The Corporation is currently evaluating the impact of the adoption of ASC Update 2016-13 on its consolidated financial statements.

In August 2016, the FASB issued ASC Update 2016-15, "Statement of Cash Flows - Classification of Certain Cash Receipts and Cash Payments." This standards update provides guidance regarding the presentation of certain cash receipts and cash payments in the statement of cash flows, addressing eight specific cash flow classification issues, in order to reduce existing diversity in practice. ASC Update 2016-15 is effective for interim and annual reporting periods beginning after December 15, 2017. Early adoption is permitted. The Corporation intends to adopt this standards update effective with its March 31, 2018 quarterly report on Form 10-Q and does not expect the adoption of ASC Update 2016-15 to have a material impact on its consolidated financial statements.

#### Reclassifications

Certain amounts in the 2015 consolidated financial statements and notes have been reclassified to conform to the 2016 presentation.

#### NOTE 2 – Net Income Per Share

Basic net income per share is calculated as net income divided by the weighted average number of shares outstanding. Diluted net income per share is calculated as net income divided by the weighted average number of shares outstanding plus the incremental number of shares added as a result of converting common stock equivalents, calculated using the treasury stock method. The Corporation's common stock equivalents consist of outstanding stock options, restricted stock, restricted stock units ("RSUs") and performance-based restricted stock units ("PSUs"). PSUs are required to be included in weighted average shares outstanding if performance measures, as defined in each PSU award agreement, are met as of the end of the period.

A reconciliation of weighted average shares outstanding used to calculate basic net income per share and diluted net income per share follows:

|                                               | Three months<br>ended September<br>30 |         | Nine months<br>ended September<br>30 |         |
|-----------------------------------------------|---------------------------------------|---------|--------------------------------------|---------|
|                                               | 2016                                  | 2015    | 2016                                 | 2015    |
|                                               | (in thousands)                        |         |                                      |         |
| Weighted average shares outstanding (basic)   | 173,020                               | 174,338 | 173,248                              | 176,399 |
| Impact of common stock equivalents            | 1,044                                 | 1,004   | 1,017                                | 1,029   |
| Weighted average shares outstanding (diluted) | 174,064                               | 175,342 | 174,265                              | 177,428 |

For the three and nine months ended September 30, 2016, 447,000 and 712,000 stock options, respectively, were excluded from the diluted net income per share computation as their effect would have been anti-dilutive. For the three and nine months ended September 30, 2015, 1.5 million and 1.8 million stock options, respectively, were excluded from the diluted net income per share computation as their effect would have been anti-dilutive.





## NOTE 3 – Accumulated Other Comprehensive Income

The following table presents changes in other comprehensive income:

|                                                                                                                | Before-Tax<br>Amount | Tax<br>Effect | Net of<br>Tax<br>Amount |
|----------------------------------------------------------------------------------------------------------------|----------------------|---------------|-------------------------|
|                                                                                                                | (in thousands)       |               |                         |
| Three months ended September 30, 2016                                                                          |                      |               |                         |
| Unrealized loss on securities                                                                                  | \$(5,505 )           | \$ 1,925      | \$(3,580 )              |
| Reclassification adjustment for securities gains included in net income <sup>(1)</sup>                         | (2 )                 | 1             | (1 )                    |
| Amortization of unrealized loss on derivative financial instruments <sup>(2)</sup>                             | 6                    | (2 )          | 4                       |
| Amortization of net unrecognized pension and postretirement items <sup>(3)</sup>                               | 583                  | (204 )        | 379                     |
| Total Other Comprehensive Loss                                                                                 | \$(4,918 )           | \$ 1,720      | \$(3,198 )              |
| Three months ended September 30, 2015                                                                          |                      |               |                         |
| Unrealized gain on securities                                                                                  | \$ 12,088            | \$(4,231 )    | \$ 7,857                |
| Reclassification adjustment for securities gains included in net income <sup>(1)</sup>                         | (1,730 )             | 606           | (1,124 )                |
| Reclassification adjustment for loss on derivative financial instruments included in net income <sup>(2)</sup> | 3,778                | (1,322 )      | 2,456                   |
| Amortization of unrealized loss on derivative financial instruments <sup>(2)</sup>                             | 5                    | (2 )          | 3                       |
| Amortization of net unrecognized pension and postretirement items <sup>(3)</sup>                               | 717                  | (251 )        | 466                     |
| Total Other Comprehensive Income                                                                               | \$ 14,858            | \$(5,200 )    | \$ 9,658                |
| Nine months ended September 30, 2016                                                                           |                      |               |                         |
| Unrealized gain on securities                                                                                  | \$ 40,441            | \$(14,156 )   | \$ 26,285               |
| Reclassification adjustment for securities gains included in net income <sup>(1)</sup>                         | (1,025 )             | 359           | (666 )                  |
| Amortization of unrealized loss on derivative financial instruments <sup>(2)</sup>                             | 18                   | (6 )          | 12                      |
| Amortization of net unrecognized pension and postretirement items <sup>(3)</sup>                               | 1,349                | (472 )        | 877                     |
| Total Other Comprehensive Income                                                                               | \$ 40,783            | \$(14,275 )   | \$ 26,508               |
| Nine months ended September 30, 2015                                                                           |                      |               |                         |
| Unrealized gain on securities                                                                                  | \$ 8,987             | \$(3,146 )    | \$ 5,841                |
| Reclassification adjustment for securities gains included in net income <sup>(1)</sup>                         | (8,290 )             | 2,902         | (5,388 )                |
| Reclassification adjustment for loss on derivative financial instruments included in net income <sup>(2)</sup> | 3,778                | (1,322 )      | 2,456                   |
| Non-credit related unrealized gains on other-than-temporarily impaired debt securities                         | 192                  | (67 )         | 125                     |
| Amortization of unrealized loss on derivative financial instruments <sup>(2)</sup>                             | 110                  | (39 )         | 71                      |
| Amortization of net unrecognized pension and postretirement items <sup>(3)</sup>                               | 2,151                | (753 )        | 1,398                   |
| Total Other Comprehensive Income                                                                               | \$ 6,928             | \$(2,425 )    | \$ 4,503                |

Amounts reclassified out of accumulated other comprehensive income. Before-tax amounts included in

(1) "Investment securities gains, net" on the consolidated statements of income. See Note 4, "Investment Securities," for additional details.

(2) Amounts reclassified out of accumulated other comprehensive income. Before-tax amounts included in "Interest expense" on the consolidated statements of income.

Amounts reclassified out of accumulated other comprehensive income. Before-tax amounts included in "Salaries and employee benefits" on the consolidated statements of income. See Note 8, "Employee Benefit Plans," for additional details.



The following table presents changes in each component of accumulated other comprehensive income, net of tax:

|                                                                                                 | Unrealized<br>Gains<br>(Losses)<br>on<br>Investment<br>Securities<br>Not<br>Other-Than-<br>Temporarily<br>Impaired<br>(in thousands) | Unrealized<br>Non-Credit<br>(Losses) on<br>Other-Than-<br>Temporarily<br>Impaired<br>Debt<br>Securities | Unrealized<br>Gains<br>on<br>Forward-Starting<br>Interest Rate<br>Swaps | Unrealized<br>Effective<br>Portions of<br>Losses on<br>Forward-Starting<br>Interest Rate<br>Swaps | Unrecognized<br>Pension and<br>Postretirement<br>Plan Income<br>(Costs) | Total        |
|-------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------|--------------|
| Three months ended September 30, 2016                                                           |                                                                                                                                      |                                                                                                         |                                                                         |                                                                                                   |                                                                         |              |
| Balance at June 30, 2016                                                                        | \$22,701                                                                                                                             | \$ 458                                                                                                  | \$ (7                                                                   | )                                                                                                 | \$ (15,463                                                              | ) \$7,689    |
| Other comprehensive loss before reclassifications                                               | (3,580                                                                                                                               | ) —                                                                                                     | —                                                                       | —                                                                                                 | —                                                                       | (3,580 )     |
| Amounts reclassified from accumulated other comprehensive income (loss)                         | (1                                                                                                                                   | ) —                                                                                                     | 4                                                                       | —                                                                                                 | 379                                                                     | 382          |
| Balance at September 30, 2016                                                                   | \$19,120                                                                                                                             | \$ 458                                                                                                  | \$ (3                                                                   | )                                                                                                 | \$ (15,084                                                              | ) \$4,491    |
| Three months ended September 30, 2015                                                           |                                                                                                                                      |                                                                                                         |                                                                         |                                                                                                   |                                                                         |              |
| Balance at June 30, 2015                                                                        | \$830                                                                                                                                | \$ 344                                                                                                  | \$ (2,478                                                               | )                                                                                                 | \$ (21,573                                                              | ) \$(22,877) |
| Other comprehensive income before reclassifications                                             | 7,857                                                                                                                                | —                                                                                                       | —                                                                       | —                                                                                                 | —                                                                       | 7,857        |
| Amounts reclassified from accumulated other comprehensive income (loss)                         | (1,124                                                                                                                               | ) —                                                                                                     | 3                                                                       | —                                                                                                 | 466                                                                     | (655 )       |
| Reclassification adjustment for loss on derivative financial instruments included in net income | —                                                                                                                                    | —                                                                                                       | 2,456                                                                   | —                                                                                                 | —                                                                       | 2,456        |
| Balance at September 30, 2015                                                                   | \$7,563                                                                                                                              | \$ 344                                                                                                  | \$ (19                                                                  | )                                                                                                 | \$ (21,107                                                              | ) \$(13,219) |
| Nine months ended September 30, 2016                                                            |                                                                                                                                      |                                                                                                         |                                                                         |                                                                                                   |                                                                         |              |
| Balance at December 31, 2015                                                                    | \$(6,499                                                                                                                             | ) \$ 458                                                                                                | \$ (15                                                                  | )                                                                                                 | \$ (15,961                                                              | ) \$(22,017) |
| Other comprehensive income before reclassifications                                             | 26,285                                                                                                                               | —                                                                                                       | —                                                                       | —                                                                                                 | —                                                                       | 26,285       |
| Amounts reclassified from accumulated other comprehensive income (loss)                         | (666                                                                                                                                 | ) —                                                                                                     | 12                                                                      | —                                                                                                 | 877                                                                     | 223          |
| Balance at September 30, 2016                                                                   | \$19,120                                                                                                                             | \$ 458                                                                                                  | \$ (3                                                                   | )                                                                                                 | \$ (15,084                                                              | ) \$4,491    |
| Nine months ended September 30, 2015                                                            |                                                                                                                                      |                                                                                                         |                                                                         |                                                                                                   |                                                                         |              |
| Balance at December 31, 2014                                                                    | \$5,980                                                                                                                              | \$ 1,349                                                                                                | \$ (2,546                                                               | )                                                                                                 | \$ (22,505                                                              | ) \$(17,722) |
| Other comprehensive income before reclassifications                                             | 5,841                                                                                                                                | 125                                                                                                     | —                                                                       | —                                                                                                 | —                                                                       | 5,966        |
| Amounts reclassified from accumulated other comprehensive income (loss)                         | (4,258                                                                                                                               | ) (1,130                                                                                                | )                                                                       | 71                                                                                                | 1,398                                                                   | (3,919 )     |
| Reclassification adjustment for loss on derivative financial instruments included in net income | —                                                                                                                                    | —                                                                                                       | 2,456                                                                   | —                                                                                                 | —                                                                       | 2,456        |
| Balance at September 30, 2015                                                                   | \$7,563                                                                                                                              | \$ 344                                                                                                  | \$ (19                                                                  | )                                                                                                 | \$ (21,107                                                              | ) \$(13,219) |



## NOTE 4 – Investment Securities

The following table presents the amortized cost and estimated fair values of investment securities, which were all classified as available for sale:

|                                             | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estimated<br>Fair<br>Value |
|---------------------------------------------|-------------------|------------------------------|-------------------------------|----------------------------|
| (in thousands)                              |                   |                              |                               |                            |
| September 30, 2016                          |                   |                              |                               |                            |
| U.S. Government sponsored agency securities | \$ 137            | \$ 3                         | \$—                           | \$ 140                     |
| State and municipal securities              | 394,162           | 8,145                        | (735 )                        | 401,572                    |
| Corporate debt securities                   | 109,495           | 3,096                        | (5,350 )                      | 107,241                    |
| Collateralized mortgage obligations         | 651,060           | 4,070                        | (2,771 )                      | 652,359                    |
| Mortgage-backed securities                  | 1,201,771         | 24,790                       | (14 )                         | 1,226,547                  |
| Auction rate securities                     | 107,107           | —                            | (9,381 )                      | 97,726                     |
| Total debt securities                       | 2,463,732         | 40,104                       | (18,251 )                     | 2,485,585                  |
| Equity securities                           | 14,206            | 8,277                        | —                             | 22,483                     |
| Total                                       | \$ 2,477,938      | \$ 48,381                    | \$(18,251 )                   | \$ 2,508,068               |
|                                             | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estimated<br>Fair<br>Value |
| (in thousands)                              |                   |                              |                               |                            |
| December 31, 2015                           |                   |                              |                               |                            |
| U.S. Government sponsored agency securities | \$ 25,154         | \$ 35                        | \$(53 )                       | \$ 25,136                  |
| State and municipal securities              | 256,746           | 6,019                        | —                             | 262,765                    |
| Corporate debt securities                   | 100,336           | 2,695                        | (6,076 )                      | 96,955                     |
| Collateralized mortgage obligations         | 835,439           | 3,042                        | (16,972 )                     | 821,509                    |
| Mortgage-backed securities                  | 1,154,935         | 10,104                       | (6,204 )                      | 1,158,835                  |
| Auction rate securities                     | 106,772           | —                            | (8,713 )                      | 98,059                     |
| Total debt securities                       | 2,479,382         | 21,895                       | (38,018 )                     | 2,463,259                  |
| Equity securities                           | 14,677            | 6,845                        | (8 )                          | 21,514                     |
| Total                                       | \$ 2,494,059      | \$ 28,740                    | \$(38,026 )                   | \$ 2,484,773               |

Securities carried at \$1.8 billion as of September 30, 2016 and \$1.7 billion as of December 31, 2015 were pledged as collateral to secure public and trust deposits and customer repurchase agreements.

Equity securities include common stocks of financial institutions (estimated fair value of \$21.6 million at September 30, 2016 and \$20.6 million at December 31, 2015) and other equity investments (estimated fair value of \$901,000 at September 30, 2016 and \$914,000 at December 31, 2015).

As of September 30, 2016, the financial institutions stock portfolio had a cost basis of \$13.4 million and an estimated fair value of \$21.6 million, including an investment in a single financial institution with a cost basis of \$7.4 million and an estimated fair value of \$11.4 million. The estimated fair value of this investment accounted for 52.7% of the estimated fair value of the Corporation's investments in the common stocks of publicly traded financial institutions. No other investment in a single financial institution in the financial institutions stock portfolio exceeded 10% of the portfolio's estimated fair value.

The amortized cost and estimated fair values of debt securities as of September 30, 2016, by contractual maturity, are shown in the following table. Actual maturities may differ from contractual maturities as certain investment securities are subject to call or prepayment with or without call or prepayment penalties.

|                                     | Amortized<br>Cost | Estimated<br>Fair Value |
|-------------------------------------|-------------------|-------------------------|
|                                     | (in thousands)    |                         |
| Due in one year or less             | \$50,521          | \$51,020                |
| Due from one year to five years     | 34,278            | 35,356                  |
| Due from five years to ten years    | 96,172            | 99,187                  |
| Due after ten years                 | 429,930           | 421,116                 |
|                                     | 610,901           | 606,679                 |
| Collateralized mortgage obligations | 651,060           | 652,359                 |
| Mortgage-backed securities          | 1,201,771         | 1,226,547               |
| Total debt securities               | \$2,463,732       | \$2,485,585             |

The following table presents information related to the gross realized gains and losses on the sales of equity and debt securities:

|                                       | Gross<br>Realized<br>Gains | Gross<br>Realized<br>Losses | Net Gains<br>(Losses) |
|---------------------------------------|----------------------------|-----------------------------|-----------------------|
|                                       | (in thousands)             |                             |                       |
| Three months ended September 30, 2016 |                            |                             |                       |
| Equity securities                     | \$2                        | \$ —                        | \$ 2                  |
| Debt securities                       | —                          | —                           | —                     |
| Total                                 | \$2                        | \$ —                        | \$ 2                  |
| Three months ended September 30, 2015 |                            |                             |                       |
| Equity securities                     | \$1,730                    | \$ —                        | \$ 1,730              |
| Debt securities                       | —                          | —                           | —                     |
| Total                                 | \$1,730                    | \$ —                        | \$ 1,730              |
| Nine months ended September 30, 2016  |                            |                             |                       |
| Equity securities                     | \$739                      | \$ (10 )                    | \$ 729                |
| Debt securities                       | 322                        | (26 )                       | 296                   |
| Total                                 | \$1,061                    | \$ (36 )                    | \$ 1,025              |
| Nine months ended September 30, 2015  |                            |                             |                       |
| Equity securities                     | \$5,990                    | \$ —                        | \$ 5,990              |
| Debt securities                       | 2,300                      | —                           | 2,300                 |
| Total                                 | \$8,290                    | \$ —                        | \$ 8,290              |

The following table presents a summary of the cumulative credit related other-than-temporary impairment charges, recognized as components of earnings, for debt securities held by the Corporation at September 30, 2016 and 2015:

|                                                                                                                             | Three months ended   |            | Nine months ended    |            |
|-----------------------------------------------------------------------------------------------------------------------------|----------------------|------------|----------------------|------------|
|                                                                                                                             | September 30<br>2016 | 2015       | September 30<br>2016 | 2015       |
|                                                                                                                             | (in thousands)       |            |                      |            |
| Balance of cumulative credit losses on debt securities, beginning of period                                                 | \$(11,510)           | \$(11,510) | \$(11,510)           | \$(16,242) |
| Reductions for securities sold during the period                                                                            | —                    | —          | —                    | 4,730      |
| Reductions for increases in cash flows expected to be collected that are recognized over the remaining life of the security | —                    | —          | —                    | 2          |
| Balance of cumulative credit losses on debt securities, end of period                                                       | \$(11,510)           | \$(11,510) | \$(11,510)           | \$(11,510) |

The following table presents the gross unrealized losses and estimated fair values of investments, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at September 30, 2016:

|                                     | Less than 12 months  |                   | 12 months or longer  |                   | Total                |                   |
|-------------------------------------|----------------------|-------------------|----------------------|-------------------|----------------------|-------------------|
|                                     | Estimated Fair Value | Unrealized Losses | Estimated Fair Value | Unrealized Losses | Estimated Fair Value | Unrealized Losses |
|                                     | (in thousands)       |                   |                      |                   |                      |                   |
| State and municipal securities      | \$91,790             | \$(735 )          | \$—                  | \$—               | \$91,790             | \$(735 )          |
| Corporate debt securities           | 4,000                | (35 )             | 33,766               | (5,315 )          | 37,766               | (5,350 )          |
| Collateralized mortgage obligations | 124,739              | (376 )            | 266,062              | (2,395 )          | 390,801              | (2,771 )          |
| Mortgage-backed securities          | 6,171                | (14 )             | —                    | —                 | 6,171                | (14 )             |
| Auction rate securities             | —                    | —                 | 97,726               | (9,381 )          | 97,726               | (9,381 )          |
| Total debt securities               | 226,700              | (1,160 )          | 397,554              | (17,091 )         | 624,254              | (18,251 )         |
| Equity securities                   | —                    | —                 | —                    | —                 | —                    | —                 |
| Total                               | \$226,700            | \$(1,160 )        | \$397,554            | \$(17,091 )       | \$624,254            | \$(18,251 )       |

The decline in market value of these securities is attributable to changes in interest rates and not credit quality, and the Corporation does not have the intent to sell and does not believe it will more likely than not be required to sell any of these securities prior to a recovery of their fair value to amortized cost, therefore the Corporation does not consider these investments to be other-than-temporarily impaired as of September 30, 2016.

As of September 30, 2016, all of the auction rate securities (auction rate certificates, or "ARCs"), were rated above investment grade. All of the loans underlying the ARCs have principal payments which are guaranteed by the federal government. As of September 30, 2016, all ARCs were current and making scheduled interest payments. Based on management's evaluations, ARCs with an estimated fair value of \$97.7 million were not subject to any other-than-temporary impairment charges as of September 30, 2016. The Corporation does not have the intent to sell and does not believe it will more likely than not be required to sell any of these securities prior to a recovery of their fair value to amortized cost, which may be at maturity.

For its investments in equity securities, particularly its investments in stocks of financial institutions, management evaluates the near-term prospects of the issuers in relation to the severity and duration of the impairment. Based on that evaluation and the Corporation's ability and intent to hold those investments for a reasonable period of time sufficient for a recovery of fair value, the Corporation does not consider those investments with unrealized holding losses as of September 30, 2016 to be other-than-temporarily impaired.

The majority of the Corporation's available for sale corporate debt securities are issued by financial institutions. The following table presents the amortized cost and estimated fair value of corporate debt securities:

|                                                            | September 30, 2016 |                      | December 31, 2015 |                      |
|------------------------------------------------------------|--------------------|----------------------|-------------------|----------------------|
|                                                            | Amortized cost     | Estimated fair value | Amortized cost    | Estimated fair value |
|                                                            | (in thousands)     |                      |                   |                      |
| Single-issuer trust preferred securities                   | \$43,720           | \$39,253             | \$44,648          | \$39,106             |
| Subordinated debt                                          | 43,715             | 44,660               | 39,610            | 40,779               |
| Senior debt                                                | 18,039             | 18,601               | 12,043            | 12,329               |
| Pooled trust preferred securities                          | —                  | 706                  | —                 | 706                  |
| Corporate debt securities issued by financial institutions | 105,474            | 103,220              | 96,301            | 92,920               |
| Other corporate debt securities                            | 4,021              | 4,021                | 4,035             | 4,035                |
| Available for sale corporate debt securities               | \$109,495          | \$107,241            | \$100,336         | \$96,955             |

Single-issuer trust preferred securities had an unrealized loss of \$4.5 million at September 30, 2016. Six of the 19 single-issuer trust preferred securities, with an amortized cost of \$11.5 million and an estimated fair value of \$10.1 million at September 30, 2016, were rated below investment grade by at least one ratings agency. All of the single-issuer trust preferred securities rated below investment grade were rated "BB" and "Ba". Two single-issuer trust preferred securities with an amortized cost of \$3.7 million and an estimated fair value of \$2.4 million at September 30, 2016 were not rated by any ratings agency.

Based on management's evaluations, corporate debt securities with a fair value of \$107.2 million were not subject to any other-than-temporary impairment charges as of September 30, 2016. The Corporation does not have the intent to sell and does not believe it will more likely than not be required to sell any of these securities prior to a recovery of their fair value to amortized cost, which may be at maturity.

#### NOTE 5 – Loans and Allowance for Credit Losses

##### Loans, Net of Unearned Income

Loans, net of unearned income are summarized as follows:

|                                                     | September 30, December |              |
|-----------------------------------------------------|------------------------|--------------|
|                                                     | 2016                   | 31, 2015     |
|                                                     | (in thousands)         |              |
| Real-estate - commercial mortgage                   | \$5,818,915            | \$5,462,330  |
| Commercial - industrial, financial and agricultural | 4,024,119              | 4,088,962    |
| Real-estate - home equity                           | 1,640,421              | 1,684,439    |
| Real-estate - residential mortgage                  | 1,542,696              | 1,376,160    |
| Real-estate - construction                          | 861,634                | 799,988      |
| Consumer                                            | 283,673                | 268,588      |
| Leasing and other                                   | 235,793                | 170,914      |
| Overdrafts                                          | 2,320                  | 2,737        |
| Loans, gross of unearned income                     | 14,409,571             | 13,854,118   |
| Unearned income                                     | (18,333 )              | (15,516 )    |
| Loans, net of unearned income                       | \$14,391,238           | \$13,838,602 |

##### Allowance for Credit Losses

The allowance for credit losses consists of the allowance for loan losses and the reserve for unfunded lending commitments. The allowance for loan losses represents management's estimate of incurred losses in the loan portfolio as of the balance sheet date and is recorded as a reduction to loans. The reserve for unfunded lending commitments represents management's estimate of incurred losses in its unfunded loan commitments and is recorded in other



liabilities on the consolidated balance sheets. The allowance for credit losses is increased by charges to expense, through the provision for credit losses, and decreased by charge-offs, net of recoveries.

The Corporation's allowance for credit losses includes: (1) specific allowances allocated to loans evaluated for impairment under the FASB's ASC Section 310-10-35; and (2) allowances calculated for pools of loans measured for impairment under FASB ASC Subtopic 450-20.

The Corporation segments its loan portfolio by general loan type, or "portfolio segments," as presented in the table under the heading, "Loans, Net of Unearned Income," above. Certain portfolio segments are further disaggregated and evaluated collectively for impairment based on "class segments," which are largely based on the type of collateral underlying each loan. Commercial loans include both secured and unsecured loans. Construction loan class segments include loans secured by commercial real estate, loans to commercial borrowers secured by residential real estate and loans to individuals secured by residential real estate. Consumer loan class segments include direct consumer installment loans and indirect vehicle loans.

The following table presents the components of the allowance for credit losses:

|                                          | September 30, 2016 |           | December 31, 2015 |           |
|------------------------------------------|--------------------|-----------|-------------------|-----------|
|                                          | (in thousands)     |           |                   |           |
| Allowance for loan losses                | \$162,526          | \$162,526 | \$169,054         | \$169,054 |
| Reserve for unfunded lending commitments | 2,643              | 2,643     | 2,358             | 2,358     |
| Allowance for credit losses              | \$165,169          | \$165,169 | \$171,412         | \$171,412 |

The following table presents the activity in the allowance for credit losses:

|                                            | Three months ended<br>September 30, 2016 |           | Nine months ended<br>September 30, 2015 |           |
|--------------------------------------------|------------------------------------------|-----------|-----------------------------------------|-----------|
|                                            | (in thousands)                           |           |                                         |           |
| Balance at beginning of period             | \$165,108                                | \$169,453 | \$171,412                               | \$185,931 |
| Loans charged off                          | (7,672 )                                 | (5,561 )  | (29,573 )                               | (26,697 ) |
| Recoveries of loans previously charged off | 3,592                                    | 4,503     | 15,148                                  | 10,661    |
| Net loans charged off                      | (4,080 )                                 | (1,058 )  | (14,425 )                               | (16,036 ) |
| Provision for credit losses                | 4,141                                    | 1,000     | 8,182                                   | (500 )    |
| Balance at end of period                   | \$165,169                                | \$169,395 | \$165,169                               | \$169,395 |

Edgar Filing: FULTON FINANCIAL CORP - Form 10-Q

The following table presents the activity in the allowance for loan losses by portfolio segment:

|                                            | Real Estate<br>Commercial<br>Mortgage | Commercial-<br>Industrial,<br>Financial and<br>Agricultural | Real Estate<br>Home<br>Equity | Real Estate<br>Residential<br>Mortgage | Real<br>Estate -<br>Construction | Consumer | Leasing,<br>other<br>and<br>overdrafts | Unallocated | Total     |
|--------------------------------------------|---------------------------------------|-------------------------------------------------------------|-------------------------------|----------------------------------------|----------------------------------|----------|----------------------------------------|-------------|-----------|
| (in thousands)                             |                                       |                                                             |                               |                                        |                                  |          |                                        |             |           |
| Three months ended September 30, 2016      |                                       |                                                             |                               |                                        |                                  |          |                                        |             |           |
| Balance at June 30, 2016                   | \$43,740                              | \$51,755                                                    | \$26,170                      | \$21,226                               | \$5,772                          | \$2,984  | \$2,518                                | \$8,381     | \$162,546 |
| Loans charged off                          | (1,350 )                              | (3,144 )                                                    | (709 )                        | (802 )                                 | (150 )                           | (685 )   | (832 )                                 | —           | (7,672 )  |
| Recoveries of loans previously charged off | 296                                   | 1,539                                                       | 241                           | 228                                    | 898                              | 222      | 168                                    | —           | 3,592     |
| Net loans charged off                      | (1,054 )                              | (1,605 )                                                    | (468 )                        | (574 )                                 | 748                              | (463 )   | (664 )                                 | —           | (4,080 )  |
| Provision for loan losses (1)              | 3,171                                 | (1,871 )                                                    | 1,419                         | 1,452                                  | 23                               | 852      | 1,075                                  | (2,061 )    | 4,060     |
| Balance at September 30, 2016              | \$45,857                              | \$48,279                                                    | \$27,121                      | \$22,104                               | \$6,543                          | \$3,373  | \$2,929                                | \$6,320     | \$162,526 |
| Three months ended September 30, 2015      |                                       |                                                             |                               |                                        |                                  |          |                                        |             |           |
| Balance at June 30, 2015                   | \$50,680                              | \$49,170                                                    | \$22,506                      | \$22,787                               | \$7,749                          | \$2,608  | \$1,615                                | \$10,370    | \$167,485 |
| Loans charged off                          | (660 )                                | (1,640 )                                                    | (940 )                        | (1,035 )                               | (114 )                           | (650 )   | (522 )                                 | —           | (5,561 )  |
| Recoveries of loans previously charged off | 842                                   | 1,598                                                       | 304                           | 201                                    | 898                              | 314      | 346                                    | —           | 4,503     |
| Net loans charged off                      | 182                                   | (42 )                                                       | (636 )                        | (834 )                                 | 784                              | (336 )   | (176 )                                 | —           | (1,058 )  |
| Provision for loan losses (1)              | 825                                   | (405 )                                                      | 180                           | (609 )                                 | (964 )                           | 282      | 223                                    | 1,177       | 709       |
| Balance at September 30, 2015              | \$51,687                              | \$48,723                                                    | \$22,050                      | \$21,344                               | \$7,569                          | \$2,554  | \$1,662                                | \$11,547    | \$167,136 |
| Nine months ended September 30, 2016       |                                       |                                                             |                               |                                        |                                  |          |                                        |             |           |
| Balance at December 31, 2015               | \$47,866                              | \$57,098                                                    | \$22,405                      | \$21,375                               | \$6,529                          | \$2,585  | \$2,468                                | \$8,728     | \$169,054 |
| Loans charged off                          | (3,406 )                              | (13,957 )                                                   | (3,295 )                      | (2,210 )                               | (1,218 )                         | (2,261 ) | (3,226 )                               | —           | (29,573 ) |
| Recoveries of loans previously charged off | 2,488                                 | 6,789                                                       | 929                           | 784                                    | 2,844                            | 957      | 357                                    | —           | 15,148    |
|                                            | (918 )                                | (7,168 )                                                    | (2,366 )                      | (1,426 )                               | 1,626                            | (1,304 ) | (2,869 )                               | —           | (14,425 ) |

|                                            |          |           |          |          |          |          |          |          |           |
|--------------------------------------------|----------|-----------|----------|----------|----------|----------|----------|----------|-----------|
| Net loans charged off                      |          |           |          |          |          |          |          |          |           |
| Provision for loan losses (1)              | (1,091 ) | (1,651 )  | 7,082    | 2,155    | (1,612 ) | 2,092    | 3,330    | (2,408 ) | 7,897     |
| Balance at September 30, 2016              | \$45,857 | \$48,279  | \$27,121 | \$22,104 | \$6,543  | \$3,373  | \$2,929  | \$6,320  | \$162,526 |
| Nine months ended September 30, 2015       |          |           |          |          |          |          |          |          |           |
| Balance at December 31, 2014               | \$53,493 | \$51,378  | \$28,271 | \$29,072 | \$9,756  | \$3,015  | \$1,799  | \$7,360  | \$184,144 |
| Loans charged off                          | (3,011 ) | (14,669 ) | (2,578 ) | (3,099 ) | (201 )   | (1,787 ) | (1,352 ) | —        | (26,697 ) |
| Recoveries of loans previously charged off | 1,729    | 3,855     | 744      | 547      | 2,276    | 923      | 587      | —        | 10,661    |
| Net loans charged off                      | (1,282 ) | (10,814 ) | (1,834 ) | (2,552 ) | 2,075    | (864 )   | (765 )   | —        | (16,036 ) |
| Provision for loan losses (1)              | (524 )   | 8,159     | (4,387 ) | (5,176 ) | (4,262 ) | 403      | 628      | 4,187    | (972 )    |
| Balance at September 30, 2015              | \$51,687 | \$48,723  | \$22,050 | \$21,344 | \$7,569  | \$2,554  | \$1,662  | \$11,547 | \$167,136 |

The provision for loan losses excluded an \$81,000 and \$285,000 increase, respectively, in the reserve for unfunded lending commitments for the three and nine months ended September 30, 2016 and a \$291,000 and \$472,000 increase, respectively, in the reserve for unfunded lending commitments for the three and nine months ended (1) September 30, 2015. The total provision for credit losses, comprised of allocations for both funded and unfunded loans, was \$4.1 million and \$8.2 million for the three and nine months ended September 30, 2016, respectively, and \$1.0 million and a negative \$500,000 for the three and nine months ended September 30, 2015.

Edgar Filing: FULTON FINANCIAL CORP - Form 10-Q

The following table presents loans, net of unearned income and their related allowance for loan losses, by portfolio segment:

|                                                           | Real Estate<br>-<br>Commercial<br>Mortgage<br>(in thousands) | Commercial<br>Industrial,<br>Financial and<br>Agricultural | Real Estate<br>-<br>Home<br>Equity | Real Estate<br>-<br>Residential<br>Mortgage | Real<br>Estate -<br>Construction | Consumer  | Leasing,<br>other<br>and<br>overdrafts | Unallocated | Total        |
|-----------------------------------------------------------|--------------------------------------------------------------|------------------------------------------------------------|------------------------------------|---------------------------------------------|----------------------------------|-----------|----------------------------------------|-------------|--------------|
| Allowance for loan losses at September 30, 2016:          |                                                              |                                                            |                                    |                                             |                                  |           |                                        |             |              |
| Measured for impairment under FASB ASC Subtopic 450-20    | \$36,151                                                     | \$38,858                                                   | \$17,828                           | \$10,410                                    | \$4,422                          | \$3,346   | \$2,929                                | \$6,320     | \$120,264    |
| Evaluated for impairment under FASB ASC Section 310-10-35 | 9,706                                                        | 9,421                                                      | 9,293                              | 11,694                                      | 2,121                            | 27        | —                                      | N/A         | 42,262       |
|                                                           | \$45,857                                                     | \$48,279                                                   | \$27,121                           | \$22,104                                    | \$6,543                          | \$3,373   | \$2,929                                | \$6,320     | \$162,526    |
| Loans, net of unearned income at September 30, 2016:      |                                                              |                                                            |                                    |                                             |                                  |           |                                        |             |              |
| Measured for impairment under FASB ASC Subtopic 450-20    | \$5,763,863                                                  | \$3,972,461                                                | \$1,621,731                        | \$1,496,461                                 | \$850,315                        | \$283,633 | \$219,780                              | N/A         | \$14,208,244 |
| Evaluated for impairment under FASB ASC Section 310-10-35 | 55,052                                                       | 51,658                                                     | 18,690                             | 46,235                                      | 11,319                           | 40        | —                                      | N/A         | 182,994      |
|                                                           | \$5,818,915                                                  | \$4,024,119                                                | \$1,640,421                        | \$1,542,696                                 | \$861,634                        | \$283,673 | \$219,780                              | N/A         | \$14,391,238 |
| Allowance for loan losses at September 30, 2015:          |                                                              |                                                            |                                    |                                             |                                  |           |                                        |             |              |
| Measured for impairment under FASB ASC Subtopic 450-20    | \$38,490                                                     | \$36,002                                                   | \$14,867                           | \$7,921                                     | \$5,119                          | \$2,535   | \$1,662                                | \$11,547    | \$118,143    |
| Evaluated for impairment under FASB ASC Section 310-10-35 | 13,197                                                       | 12,721                                                     | 7,183                              | 13,423                                      | 2,450                            | 19        | —                                      | N/A         | 48,993       |
|                                                           | \$51,687                                                     | \$48,723                                                   | \$22,050                           | \$21,344                                    | \$7,569                          | \$2,554   | \$1,662                                | \$11,547    | \$167,136    |
| Loans, net of unearned income at September 30, 2015:      |                                                              |                                                            |                                    |                                             |                                  |           |                                        |             |              |
| Measured for impairment under FASB ASC Subtopic 450-20    | \$5,273,819                                                  | \$3,885,956                                                | \$1,679,471                        | \$1,330,778                                 | \$750,629                        | \$271,667 | \$149,530                              | N/A         | \$13,341,850 |

|                                                                    |             |             |             |             |           |           |           |     |              |
|--------------------------------------------------------------------|-------------|-------------|-------------|-------------|-----------|-----------|-----------|-----|--------------|
| Evaluated for<br>impairment under<br>FASB ASC<br>Section 310-10-35 | 66,109      | 43,952      | 14,178      | 51,307      | 18,936    | 29        | —         | N/A | 194,511      |
|                                                                    | \$5,339,928 | \$3,929,908 | \$1,693,649 | \$1,382,085 | \$769,565 | \$271,696 | \$149,530 | N/A | \$13,536,361 |

N/A - Not applicable.

#### Impaired Loans

A loan is considered to be impaired if it is probable that all amounts will not be collected according to the contractual terms of the loan agreement. Impaired loans consist of all loans on non-accrual status and accruing troubled debt restructurings ("TDRs"). An allowance for loan losses is established for an impaired loan if its carrying value exceeds its estimated fair value. Impaired loans to borrowers with total outstanding commitments greater than or equal to \$1.0 million are evaluated individually for impairment. Impaired loans to borrowers with total outstanding commitments less than \$1.0 million are pooled and measured for impairment collectively.

Based on an evaluation of all relevant credit quality factors, the Corporation recorded a \$4.1 million provision for credit losses during the three months ended September 30, 2016, compared to a \$1.0 million provision for credit losses for the same period in 2015.

All loans individually evaluated for impairment under FASB ASC Section 310-10-35 are measured for losses on a quarterly basis. As of September 30, 2016 and December 31, 2015, substantially all of the Corporation's individually evaluated impaired loans with total outstanding balances greater than or equal to \$1.0 million were measured based on the estimated fair value of each loan's collateral. Collateral could be in the form of real estate, in the case of impaired commercial mortgages and construction loans, or business assets, such as accounts receivable or inventory, in the case of commercial and industrial loans. Commercial and industrial loans may also be secured by real property.

As of September 30, 2016 and 2015, approximately 73% and 77%, respectively, of impaired loans with principal balances greater than or equal to \$1.0 million, whose primary collateral is real estate, were measured at estimated fair value using state certified third-party appraisals that had been updated in the preceding 12 months.

When updated appraisals are not obtained for loans evaluated for impairment under FASB ASC Section 310-10-35 that are secured by real estate, fair values are estimated based on the original appraisal values, as long as the original appraisal indicated an acceptable loan-to-value position and, in the opinion of the Corporation's internal credit administration staff, there has not been a significant deterioration in the collateral value since the original appraisal was performed. Original appraisals are typically used only when

the estimated collateral value, as adjusted for the age of the appraisal, results in a current loan-to-value ratio that is lower than the Corporation's loan-to-value requirements for new loans, generally less than 70%.

The following table presents total impaired loans by class segment:

|                                       | September 30, 2016             |                        |                      | December 31, 2015              |                        |                      |
|---------------------------------------|--------------------------------|------------------------|----------------------|--------------------------------|------------------------|----------------------|
|                                       | Unpaid<br>Principal<br>Balance | Recorded<br>Investment | Related<br>Allowance | Unpaid<br>Principal<br>Balance | Recorded<br>Investment | Related<br>Allowance |
| (in thousands)                        |                                |                        |                      |                                |                        |                      |
| With no related allowance recorded:   |                                |                        |                      |                                |                        |                      |
| Real estate - commercial mortgage     | \$30,913                       | \$27,594               | \$ —                 | \$27,872                       | \$22,596               | \$ —                 |
| Commercial - secured                  | 33,225                         | 29,535                 | —                    | 18,012                         | 13,702                 | —                    |
| Real estate - residential mortgage    | 6,312                          | 6,131                  | —                    | 4,790                          | 4,790                  | —                    |
| Construction - commercial residential | 6,393                          | 4,923                  | —                    | 9,916                          | 8,865                  | —                    |
|                                       | 76,843                         | 68,183                 |                      | 60,590                         | 49,953                 |                      |
| With a related allowance recorded:    |                                |                        |                      |                                |                        |                      |
| Real estate - commercial mortgage     | 37,212                         | 27,458                 | 9,706                | 45,189                         | 35,698                 | 12,471               |
| Commercial - secured                  | 26,900                         | 21,192                 | 8,906                | 39,659                         | 33,629                 | 14,085               |
| Commercial - unsecured                | 1,228                          | 931                    | 515                  | 971                            | 821                    | 498                  |
| Real estate - home equity             | 23,580                         | 18,690                 | 9,293                | 20,347                         | 15,766                 | 7,993                |
| Real estate - residential mortgage    | 47,746                         | 40,104                 | 11,694               | 55,242                         | 45,635                 | 13,422               |
| Construction - commercial residential | 8,053                          | 4,850                  | 1,560                | 9,949                          | 6,290                  | 2,110                |
| Construction - commercial             | 687                            | 450                    | 145                  | 820                            | 638                    | 217                  |
| Construction - other                  | 1,096                          | 1,096                  | 416                  | 331                            | 193                    | 68                   |
| Consumer - direct                     | 21                             | 21                     | 15                   | 19                             | 19                     | 14                   |
| Consumer - indirect                   | 19                             | 19                     | 12                   | 14                             | 14                     | 8                    |
| Leasing, other and overdrafts         | —                              | —                      | —                    | 1,658                          | 1,425                  | 704                  |
|                                       | 146,542                        | 114,811                | 42,262               | 174,199                        | 140,128                | 51,590               |
| Total                                 | \$223,385                      | \$182,994              | \$42,262             | \$234,789                      | \$190,081              | \$51,590             |

As of September 30, 2016 and December 31, 2015, there were \$68.2 million and \$50.0 million, respectively, of impaired loans that did not have a related allowance for loan loss. The estimated fair values of the collateral securing these loans exceeded their carrying amount, or they were previously charged down to realizable collateral values.

Accordingly, no specific valuation allowance was considered to be necessary.

The following table presents average impaired loans by class segment:

|                                       | Three months ended September 30 |                    |                             |                    | Nine months ended September 30 |                    |                             |                    |
|---------------------------------------|---------------------------------|--------------------|-----------------------------|--------------------|--------------------------------|--------------------|-----------------------------|--------------------|
|                                       | 2016                            |                    | 2015                        |                    | 2016                           |                    | 2015                        |                    |
|                                       | Average Recorded Investment     | Interest Income(1) | Average Recorded Investment | Interest Income(1) | Average Recorded Investment    | Interest Income(1) | Average Recorded Investment | Interest Income(1) |
|                                       | (in thousands)                  |                    |                             |                    |                                |                    |                             |                    |
| With no related allowance recorded:   |                                 |                    |                             |                    |                                |                    |                             |                    |
| Real estate - commercial mortgage     | \$25,048                        | \$ 78              | \$25,216                    | \$ 68              | \$23,929                       | \$219              | \$26,033                    | 246                |
| Commercial - secured                  | 23,836                          | 32                 | 17,609                      | 28                 | 18,400                         | 68                 | 16,142                      | 74                 |
| Commercial - unsecured                | —                               | —                  | 43                          | —                  | —                              | —                  | 22                          | —                  |
| Real estate - residential mortgage    | 6,151                           | 33                 | 6,212                       | 34                 | 5,826                          | 96                 | 5,539                       | 94                 |
| Construction - commercial residential | 5,734                           | 10                 | 10,558                      | 28                 | 6,658                          | 45                 | 12,390                      | 124                |
| Construction - commercial             | —                               | —                  | 1,150                       | —                  | —                              | —                  | 1,144                       | —                  |
|                                       | 60,769                          | 153                | 60,788                      | 158                | 54,813                         | 428                | 61,270                      | 538                |
| With a related allowance recorded:    |                                 |                    |                             |                    |                                |                    |                             |                    |
| Real estate - commercial mortgage     | 29,139                          | 91                 | 40,572                      | 110                | 32,310                         | 303                | 40,116                      | 368                |
| Commercial - secured                  | 21,688                          | 29                 | 22,386                      | 36                 | 26,665                         | 100                | 23,668                      | 111                |
| Commercial - unsecured                | 953                             | 1                  | 2,788                       | 1                  | 903                            | 3                  | 1,981                       | 4                  |
| Real estate - home equity             | 18,283                          | 76                 | 13,728                      | 37                 | 17,589                         | 203                | 13,417                      | 101                |
| Real estate - residential mortgage    | 40,913                          | 221                | 46,039                      | 254                | 42,399                         | 683                | 46,406                      | 797                |
| Construction - commercial residential | 4,947                           | 8                  | 5,746                       | 15                 | 5,568                          | 37                 | 6,496                       | 64                 |
| Construction - commercial             | 476                             | —                  | 1,210                       | —                  | 546                            | —                  | 1,005                       | —                  |
| Construction - other                  | 756                             | —                  | 281                         | —                  | 579                            | —                  | 281                         | —                  |
| Consumer - direct                     | 19                              | —                  | 15                          | —                  | 17                             | 1                  | 18                          | —                  |
| Consumer - indirect                   | 11                              | —                  | 15                          | —                  | 14                             | —                  | 17                          | —                  |
| Leasing, other and overdrafts         | —                               | —                  | —                           | —                  | 712                            | —                  | —                           | —                  |
|                                       | 117,185                         | 426                | 132,780                     | 453                | 127,302                        | 1,330              | 133,405                     | 1,445              |
| Total                                 | \$177,954                       | \$ 579             | \$193,568                   | \$ 611             | \$182,115                      | \$1,758            | \$194,675                   | 1,983              |

(1) All impaired loans, excluding accruing TDRs, were non-accrual loans. Interest income recognized for the three and nine months ended September 30, 2016 and 2015 represents amounts earned on accruing TDRs.

#### Credit Quality Indicators and Non-performing Assets

The following table presents internal credit risk ratings for real estate - commercial mortgages, commercial - secured loans, commercial - unsecured loans, construction - commercial residential loans and construction - commercial loans:

|                                   | Pass                   |                   | Special Mention    |                   | Substandard or Lower |                   | Total              |                   |
|-----------------------------------|------------------------|-------------------|--------------------|-------------------|----------------------|-------------------|--------------------|-------------------|
|                                   | September 30, 2016     | December 31, 2015 | September 30, 2016 | December 31, 2015 | September 30, 2016   | December 31, 2015 | September 30, 2016 | December 31, 2015 |
|                                   | (dollars in thousands) |                   |                    |                   |                      |                   |                    |                   |
| Real estate - commercial mortgage | \$5,555,760            | \$5,204,263       | \$131,941          | \$102,625         | \$131,214            | \$155,442         | \$5,818,915        | \$5,462,330       |
| Commercial - secured              | 3,648,221              | 3,696,692         | 106,701            | 92,711            | 121,611              | 136,710           | 3,876,533          | 3,926,113         |
| Commercial - unsecured            | 139,673                | 156,742           | 5,009              | 2,761             | 2,904                | 3,346             | 147,586            | 162,849           |
|                                   | 3,787,894              | 3,853,434         | 111,710            | 95,472            | 124,515              | 140,056           | 4,024,119          | 4,088,962         |



|                                                                                     |               |              |            |            |            |            |               |               |
|-------------------------------------------------------------------------------------|---------------|--------------|------------|------------|------------|------------|---------------|---------------|
| Total commercial - industrial, financial and agricultural Construction - commercial | 131,875       | 140,337      | 15,853     | 17,154     | 14,180     | 21,812     | 161,908       | 179,303       |
| residential Construction - commercial                                               | 629,314       | 552,710      | 2,530      | 3,684      | 5,048      | 3,597      | 636,892       | 559,991       |
| Total construction (excluding Construction - other)                                 | 761,189       | 693,047      | 18,383     | 20,838     | 19,228     | 25,409     | 798,800       | 739,294       |
|                                                                                     | \$ 10,104,843 | \$ 9,750,744 | \$ 262,034 | \$ 218,935 | \$ 274,957 | \$ 320,907 | \$ 10,641,834 | \$ 10,290,586 |
| % of Total                                                                          | 95.0          | % 94.8       | % 2.4      | % 2.1      | % 2.6      | % 3.1      | % 100.0       | % 100.0       |

The following is a summary of the Corporation's internal risk rating categories:

**Pass:** These loans do not currently pose undue credit risk and can range from the highest to average quality, depending on the degree of potential risk.

**Special Mention:** These loans constitute an undue and unwarranted credit risk, but not to a point of justifying a classification of substandard. Loans in this category are currently acceptable, but are nevertheless potentially weak.

**Substandard or Lower:** These loans are inadequately protected by current sound worth and paying capacity of the borrower. There exists a well-defined weakness or weaknesses that jeopardize the normal repayment of the debt.

The risk rating process allows management to identify credits that potentially carry more risk in a timely manner and to allocate resources to managing troubled accounts. The Corporation believes that internal risk ratings are the most relevant credit quality indicator for the class segments presented above. The migration of loans through the various internal risk rating categories is a significant component of the allowance for credit loss methodology, which bases the probability of default on this migration. Assigning risk ratings involves judgment. The Corporation's loan review officers provide an independent assessment of risk rating accuracy. Ratings may be changed based on the ongoing monitoring procedures performed by loan officers or credit administration staff, or if specific loan review activities identify a deterioration or an improvement in the loan.

The Corporation does not assign internal risk ratings to smaller balance, homogeneous loans, such as home equity, residential mortgage, construction loans to individuals secured by residential real estate, consumer and lease receivables. For these loans, the most relevant credit quality indicator is delinquency status. The migration of loans through the various delinquency status categories is a significant component of the allowance for credit losses methodology for those loans, which bases the probability of default on this migration.

The following table presents a summary of performing, delinquency and non-performing status for home equity, real estate - residential mortgages, construction loans to individuals and consumer, leasing and other loans by class segment:

|                                    | Performing         |                   | Delinquent (1)     |                   | Non-performing (2) |                   | Total              |                   |   |
|------------------------------------|--------------------|-------------------|--------------------|-------------------|--------------------|-------------------|--------------------|-------------------|---|
|                                    | September 30, 2016 | December 31, 2015 | September 30, 2016 | December 31, 2015 | September 30, 2016 | December 31, 2015 | September 30, 2016 | December 31, 2015 |   |
| (dollars in thousands)             |                    |                   |                    |                   |                    |                   |                    |                   |   |
| Real estate - home equity          | \$1,615,657        | \$1,660,773       | \$10,504           | \$8,983           | \$14,260           | \$14,683          | \$1,640,421        | \$1,684,439       |   |
| Real estate - residential mortgage | 1,501,486          | 1,329,371         | 17,759             | 18,305            | 23,451             | 28,484            | 1,542,696          | 1,376,160         |   |
| Construction - other               | 61,738             | 59,997            | —                  | 88                | 1,096              | 609               | 62,834             | 60,694            |   |
| Consumer - direct                  | 91,164             | 94,262            | 1,675              | 2,254             | 1,943              | 2,203             | 94,782             | 98,719            |   |
| Consumer - indirect                | 185,873            | 166,823           | 2,795              | 2,809             | 223                | 237               | 188,891            | 169,869           |   |
| Total consumer                     | 277,037            | 261,085           | 4,470              | 5,063             | 2,166              | 2,440             | 283,673            | 268,588           |   |
| Leasing                            | 218,275            | 155,870           | 1,454              | 759               | 51                 | 1,506             | 219,780            | 158,135           |   |
|                                    | \$3,674,193        | \$3,467,096       | \$34,187           | \$33,198          | \$41,024           | \$47,722          | \$3,749,404        | \$3,548,016       |   |
| % of Total                         | 98.0               | % 97.7            | % 0.9              | % 1.0             | % 1.1              | % 1.3             | % 100.0            | % 100.0           | % |

(1)Includes all accruing loans 30 days to 89 days past due.

(2)Includes all accruing loans 90 days or more past due and all non-accrual loans.

The following table presents non-performing assets:

|                                                   | September 30,<br>2016 | December 31,<br>2015 |
|---------------------------------------------------|-----------------------|----------------------|
|                                                   | (in thousands)        |                      |
| Non-accrual loans                                 | \$124,017             | \$ 129,523           |
| Loans 90 days or more past due and still accruing | 14,095                | 15,291               |
| Total non-performing loans                        | 138,112               | 144,814              |
| Other real estate owned (OREO)                    | 11,981                | 11,099               |
| Total non-performing assets                       | \$150,093             | \$ 155,913           |

Edgar Filing: FULTON FINANCIAL CORP - Form 10-Q

The following table presents past due status and non-accrual loans by portfolio segment and class segment:

|                                                           | September 30, 2016                             |                              |                                          |                 |                    |                      |              |              |
|-----------------------------------------------------------|------------------------------------------------|------------------------------|------------------------------------------|-----------------|--------------------|----------------------|--------------|--------------|
|                                                           | 30-59<br>Days<br>Past<br>Due<br>(in thousands) | 60-89<br>Days<br>Past<br>Due | ≥ 90 Days<br>Past Due<br>and<br>Accruing | Non-<br>accrual | Total ≥ 90<br>Days | Total<br>Past<br>Due | Current      | Total        |
| Real estate - commercial mortgage                         | \$9,268                                        | \$1,447                      | \$664                                    | \$38,967        | \$39,631           | \$50,346             | \$5,768,569  | \$5,818,915  |
| Commercial - secured                                      | 8,369                                          | 3,622                        | 3,023                                    | 43,304          | 46,327             | 58,318               | 3,818,215    | 3,876,533    |
| Commercial - unsecured                                    | 234                                            | 53                           | 137                                      | 866             | 1,003              | 1,290                | 146,296      | 147,586      |
| Total commercial - industrial, financial and agricultural | 8,603                                          | 3,675                        | 3,160                                    | 44,170          | 47,330             | 59,608               | 3,964,511    | 4,024,119    |
| Real estate - home equity                                 | 6,016                                          | 4,488                        | 3,237                                    | 11,023          | 14,260             | 24,764               | 1,615,657    | 1,640,421    |
| Real estate - residential mortgage                        | 12,920                                         | 4,839                        | 4,070                                    | 19,381          | 23,451             | 41,210               | 1,501,486    | 1,542,696    |
| Construction - commercial residential                     | 2,004                                          | 629                          | 72                                       | 8,930           | 9,002              | 11,635               | 150,273      | 161,908      |
| Construction - commercial                                 | —                                              | 9                            | 675                                      | 450             | 1,125              | 1,134                | 635,758      | 636,892      |
| Construction - other                                      | —                                              | —                            | —                                        | 1,096           | 1,096              | 1,096                | 61,738       | 62,834       |
| Total real estate - construction                          | 2,004                                          | 638                          | 747                                      | 10,476          | 11,223             | 13,865               | 847,769      | 861,634      |
| Consumer - direct                                         | 1,147                                          | 528                          | 1,943                                    | —               | 1,943              | 3,618                | 91,164       | 94,782       |
| Consumer - indirect                                       | 2,466                                          | 329                          | 223                                      | —               | 223                | 3,018                | 185,873      | 188,891      |
| Total consumer                                            | 3,613                                          | 857                          | 2,166                                    | —               | 2,166              | 6,636                | 277,037      | 283,673      |
| Leasing, other and overdrafts                             | 998                                            | 456                          | 51                                       | —               | 51                 | 1,505                | 218,275      | 219,780      |
| Total                                                     | \$43,422                                       | \$16,400                     | \$14,095                                 | \$124,017       | \$138,112          | \$197,934            | \$14,193,304 | \$14,391,238 |
|                                                           | December 31, 2015                              |                              |                                          |                 |                    |                      |              |              |
|                                                           | 30-59<br>Days<br>Past<br>Due<br>(in thousands) | 60-89<br>Days<br>Past<br>Due | ≥ 90 Days<br>Past Due<br>and<br>Accruing | Non-<br>accrual | Total ≥ 90<br>Days | Total<br>Past<br>Due | Current      | Total        |
| Real estate - commercial mortgage                         | \$6,469                                        | \$1,312                      | \$439                                    | \$40,731        | \$41,170           | \$48,951             | \$5,413,379  | \$5,462,330  |
| Commercial - secured                                      | 5,654                                          | 2,615                        | 1,853                                    | 41,498          | 43,351             | 51,620               | 3,874,493    | 3,926,113    |
| Commercial - unsecured                                    | 510                                            | 83                           | 19                                       | 701             | 720                | 1,313                | 161,536      | 162,849      |
| Total commercial - industrial, financial and agricultural | 6,164                                          | 2,698                        | 1,872                                    | 42,199          | 44,071             | 52,933               | 4,036,029    | 4,088,962    |
| Real estate - home equity                                 | 6,438                                          | 2,545                        | 3,473                                    | 11,210          | 14,683             | 23,666               | 1,660,773    | 1,684,439    |
| Real estate - residential mortgage                        | 15,141                                         | 3,164                        | 6,570                                    | 21,914          | 28,484             | 46,789               | 1,329,371    | 1,376,160    |
| Construction - commercial residential                     | 1,366                                          | 494                          | —                                        | 11,213          | 11,213             | 13,073               | 166,230      | 179,303      |
| Construction - commercial                                 | 50                                             | 176                          | —                                        | 638             | 638                | 864                  | 559,127      | 559,991      |
| Construction - other                                      | 88                                             | —                            | 416                                      | 193             | 609                | 697                  | 59,997       | 60,694       |
| Total real estate - construction                          | 1,504                                          | 670                          | 416                                      | 12,044          | 12,460             | 14,634               | 785,354      | 799,988      |
| Consumer - direct                                         | 1,687                                          | 567                          | 2,203                                    | —               | 2,203              | 4,457                | 94,262       | 98,719       |
| Consumer - indirect                                       | 2,308                                          | 501                          | 237                                      | —               | 237                | 3,046                | 166,823      | 169,869      |
| Total consumer                                            | 3,995                                          | 1,068                        | 2,440                                    | —               | 2,440              | 7,503                | 261,085      | 268,588      |

Edgar Filing: FULTON FINANCIAL CORP - Form 10-Q

|                               |          |          |          |           |           |           |              |              |
|-------------------------------|----------|----------|----------|-----------|-----------|-----------|--------------|--------------|
| Leasing, other and overdrafts | 483      | 276      | 81       | 1,425     | 1,506     | 2,265     | 155,870      | 158,135      |
| Total                         | \$40,194 | \$11,733 | \$15,291 | \$129,523 | \$144,814 | \$196,741 | \$13,641,861 | \$13,838,602 |

The following table presents TDRs, by class segment:

|                                       | September 30,<br>2016 | December 31,<br>2015 |
|---------------------------------------|-----------------------|----------------------|
|                                       | (in thousands)        |                      |
| Real-estate - residential mortgage    | \$26,854              | \$ 28,511            |
| Real-estate - commercial mortgage     | 16,085                | 17,563               |
| Real estate - home equity             | 7,668                 | 4,556                |
| Commercial - secured                  | 7,422                 | 5,833                |
| Construction - commercial residential | 843                   | 3,942                |
| Commercial - unsecured                | 66                    | 120                  |
| Consumer - indirect                   | 20                    | 14                   |
| Consumer - direct                     | 19                    | 19                   |
| Total accruing TDRs                   | 58,977                | 60,558               |
| Non-accrual TDRs <sup>(1)</sup>       | 27,904                | 31,035               |
| Total TDRs                            | \$86,881              | \$ 91,593            |

(1) Included in non-accrual loans in the preceding table detailing non-performing assets.

As of September 30, 2016 and December 31, 2015, there were \$3.5 million and \$5.3 million, respectively, of commitments to lend additional funds to borrowers whose loans were modified under TDRs.



The following table presents TDRs, by class segment as of September 30, 2016 and 2015, that were modified during the three and nine months ended September 30, 2016 and 2015:

|                                               | Three months ended September 30 |                                                     | Nine months ended September 30 |                                                     |
|-----------------------------------------------|---------------------------------|-----------------------------------------------------|--------------------------------|-----------------------------------------------------|
|                                               | 2016                            | 2015                                                | 2016                           | 2015                                                |
|                                               | Number of Recorded Loans        | Post-Modification Investment (dollars in thousands) | Number of Recorded Loans       | Post-Modification Investment (dollars in thousands) |
| <b>Commercial – secured:</b>                  |                                 |                                                     |                                |                                                     |
| Extend maturity with rate concession          | —                               | \$ —                                                | 2                              | \$ 1,374                                            |
| Extend maturity without rate concession       | 4                               | 1,826                                               | 1                              | 6                                                   |
| <b>Commercial – unsecured:</b>                |                                 |                                                     |                                |                                                     |
| Extend maturity without rate concession       | —                               | —                                                   | 2                              | 103                                                 |
| <b>Real estate - commercial mortgage:</b>     |                                 |                                                     |                                |                                                     |
| Extend maturity with rate concession          | —                               | —                                                   | 2                              | 188                                                 |
| Extend maturity without rate concession       | —                               | —                                                   | —                              | —                                                   |
| <b>Real estate - home equity:</b>             |                                 |                                                     |                                |                                                     |
| Extend maturity without rate concession       | 24                              | 1,063                                               | 5                              | 341                                                 |
| Bankruptcy                                    | 11                              | 563                                                 | 9                              | 221                                                 |
| <b>Real estate – residential mortgage:</b>    |                                 |                                                     |                                |                                                     |
| Extend maturity with rate concession          | —                               | —                                                   | 1                              | 171                                                 |
| Extend maturity without rate concession       | —                               | —                                                   | —                              | —                                                   |
| Bankruptcy                                    | 2                               | 350                                                 | 1                              | 58                                                  |
| <b>Construction - commercial residential:</b> |                                 |                                                     |                                |                                                     |
| Extend maturity without rate concession       | —                               | —                                                   | —                              | —                                                   |
| <b>Consumer - direct:</b>                     |                                 |                                                     |                                |                                                     |
| Bankruptcy                                    | —                               | —                                                   | 1                              | 2                                                   |
| <b>Consumer - indirect:</b>                   |                                 |                                                     |                                |                                                     |
| Bankruptcy                                    | 1                               | 21                                                  | —                              | —                                                   |
| <b>Total</b>                                  | <b>42</b>                       | <b>\$ 3,823</b>                                     | <b>21</b>                      | <b>\$ 2,359</b>                                     |
|                                               |                                 |                                                     | <b>115</b>                     | <b>\$ 10,302</b>                                    |
|                                               |                                 |                                                     | <b>72</b>                      | <b>\$ 16,051</b>                                    |

The following table presents TDRs, by class segment, as of September 30, 2016 and 2015, that were modified in the previous 12 months and had a post-modification payment default during the nine months ended September 30, 2016 and 2015. The Corporation defines a payment default as a single missed payment.

|  | 2016                                   | 2015                                   |
|--|----------------------------------------|----------------------------------------|
|  | Number of Recorded Loans of Investment | Number of Recorded Loans of Investment |



Edgar Filing: FULTON FINANCIAL CORP - Form 10-Q

|                                    | Loans                  |          | Loans |          |
|------------------------------------|------------------------|----------|-------|----------|
|                                    | (dollars in thousands) |          |       |          |
| Commercial - secured               | 6                      | \$ 2,593 | 6     | \$ 3,855 |
| Commercial - unsecured             | 1                      | 26       | —     | —        |
| Real estate - commercial mortgage  | 2                      | 129      | 2     | 233      |
| Real estate - home equity          | 29                     | 1,902    | 9     | 459      |
| Real estate - residential mortgage | 7                      | 1,395    | 4     | 500      |
| Total                              | 45                     | \$ 6,045 | 21    | \$ 5,047 |

## NOTE 6 – Mortgage Servicing Rights

The following table summarizes the changes in mortgage servicing rights ("MSRs"), which are included in other assets on the consolidated balance sheets:

|                                           | Three months ended September 30 |          | Nine months ended September 30 |          |
|-------------------------------------------|---------------------------------|----------|--------------------------------|----------|
|                                           | 2016                            | 2015     | 2016                           | 2015     |
|                                           | (in thousands)                  |          |                                |          |
| Amortized cost:                           |                                 |          |                                |          |
| Balance at beginning of period            | \$39,874                        | \$41,598 | \$40,944                       | \$42,148 |
| Originations of mortgage servicing rights | 1,499                           | 1,463    | 3,927                          | 4,976    |
| Amortization                              | (2,064 )                        | (1,829 ) | (5,562 )                       | (5,892 ) |
| Balance at end of period                  | \$39,309                        | \$41,232 | \$39,309                       | \$41,232 |
| Valuation allowance:                      |                                 |          |                                |          |
| Balance at beginning of period            | \$(1,721 )                      | \$—      | \$—                            | \$—      |
| Additions                                 | (1,280 )                        | —        | (3,001 )                       | —        |
| Balance at end of period                  | \$(3,001 )                      | \$—      | \$(3,001 )                     | \$—      |
| Net MSRs at end of period                 | \$36,308                        | \$41,232 | \$36,308                       | \$41,232 |

MSRs represent the economic value of existing contractual rights to service mortgage loans that have been sold. Accordingly, actual and expected prepayments of the underlying mortgage loans can impact the value of MSRs. The Corporation accounts for MSRs at the lower of amortized cost or fair value.

The fair value of MSRs is estimated by discounting the estimated cash flows from servicing income, net of expense, over the expected life of the underlying loans at a discount rate commensurate with the risk associated with these assets. Expected life is based on the contractual terms of the loans, as adjusted for prepayment projections. Based on its fair value analysis, the Corporation determined that additions to the valuation allowance of \$1.3 million and \$3.0 million were necessary for the three and nine months ended September 30, 2016, respectively. No valuation allowance was necessary as of September 30, 2015.

## NOTE 7 – Stock-Based Compensation

The Corporation grants equity awards to employees, consisting of stock options, restricted stock, RSUs and PSUs under its Amended and Restated Equity and Cash Incentive Compensation Plan ("Employee Equity Plan"). In addition, employees may purchase stock under the Corporation's Employee Stock Purchase Plan. The fair value of equity awards granted to employees is recognized as compensation expense over the period during which employees are required to provide service in exchange for such awards. Compensation expense for PSUs is also recognized over the period during which employees are required to provide service in exchange for such awards, however, compensation expense may vary based on the expectations for actual performance relative to defined performance measures.

The Corporation also grants equity awards to non-employee members of its board of directors under the 2011 Directors' Equity Participation Plan ("Directors' Plan"). Under the Directors' Plan, the Corporation can grant equity awards to non-employee holding company and subsidiary bank directors in the form of stock options, restricted stock or common stock.

Equity awards issued under the Employee Equity Plan are generally granted annually and become fully vested over or after a three-year vesting period. The vesting period for non-performance-based awards represents the period during which employees are required to provide service in exchange for such awards. Equity awards under the Directors' Plan generally vest immediately upon grant. Certain events, as defined in the Employee Equity Plan and the Directors' Plan, result in the acceleration of the vesting of equity awards.

The following table presents compensation expense and the related tax benefits for equity awards recognized in the consolidated statements of income:

|                                              | Three months<br>ended September<br>30 |         | Nine months<br>ended September<br>30 |          |
|----------------------------------------------|---------------------------------------|---------|--------------------------------------|----------|
|                                              | 2016                                  | 2015    | 2016                                 | 2015     |
|                                              | (in thousands)                        |         |                                      |          |
| Stock-based compensation expense             | \$1,552                               | \$1,533 | \$4,808                              | \$4,371  |
| Tax benefit                                  | (536 )                                | (489 )  | (1,611 )                             | (1,403 ) |
| Stock-based compensation expense, net of tax | \$1,016                               | \$1,044 | \$3,197                              | \$2,968  |

Stock option fair values are estimated through the use of the Black-Scholes valuation methodology as of the date of grant. Stock options carry terms of up to ten years. Fair values for restricted stock, RSUs and a majority of PSUs are based on the trading price of the Corporation's stock on the date of grant and earn dividends during the vesting period, which are forfeitable if the awards do not vest. The fair value of certain PSUs are estimated through the use of the Monte Carlo valuation methodology as of the date of grant.

As of September 30, 2016, the Employee Equity Plan had 11.4 million shares reserved for future grants through 2023, and the Directors' Plan had approximately 384,000 shares reserved for future grants through 2021.

#### NOTE 8 – Employee Benefit Plans

The Corporation maintains a defined benefit pension plan ("Pension Plan") for certain employees, which was curtailed in 2008. Contributions to the Pension Plan are actuarially determined and funded annually, if required. The Corporation made contributions totaling \$4.6 million during the first nine months of 2016. Pension Plan assets are invested in: money markets; fixed income securities, including corporate bonds, U.S. Treasury securities and common trust funds; and equity securities, including common stocks and common stock mutual funds.

The net periodic benefit cost for the Corporation's Pension Plan consisted of the following components:

|                                | Three months<br>ended September<br>30 |         | Nine months<br>ended September<br>30 |          |
|--------------------------------|---------------------------------------|---------|--------------------------------------|----------|
|                                | 2016                                  | 2015    | 2016                                 | 2015     |
|                                | (in thousands)                        |         |                                      |          |
| Service cost <sup>(1)</sup>    | \$172                                 | \$145   | \$516                                | \$435    |
| Interest cost                  | 880                                   | 851     | 2,640                                | 2,553    |
| Expected return on plan assets | (580 )                                | (752 )  | (1,739 )                             | (2,256 ) |
| Net amortization and deferral  | 605                                   | 782     | 1,815                                | 2,346    |
| Net periodic benefit cost      | \$1,077                               | \$1,026 | \$3,232                              | \$3,078  |

<sup>(1)</sup> Service cost was related to administrative costs associated with the plan and was not due to the accrual of additional participant benefits.

The Corporation provides benefits under a postretirement benefits plan ("Postretirement Plan") to certain retirees who were employees of the Corporation prior to January 1, 1998 and retired from employment with the Corporation prior to February 1, 2014.

The net periodic cost (benefit) of the Corporation's Postretirement Plan consisted of the following components:

|                                | Three months<br>ended<br>September 30<br>2016 |        | Nine months<br>ended<br>September 30<br>2015 |        |
|--------------------------------|-----------------------------------------------|--------|----------------------------------------------|--------|
|                                | 2016                                          | 2015   | 2016                                         | 2015   |
|                                | (in thousands)                                |        |                                              |        |
| Interest cost                  | 21                                            | 52     | 64                                           | 156    |
| Expected return on plan assets | —                                             | —      | (1)                                          | —      |
| Net accretion and deferral     | (138)                                         | (65)   | (413)                                        | (195)  |
| Net periodic benefit           | \$(117)                                       | \$(13) | \$(350)                                      | \$(39) |

The Corporation recognizes the funded status of its Pension Plan and Postretirement Plan on the consolidated balance sheets and recognizes the change in that funded status through other comprehensive income.

#### NOTE 9 – Derivative Financial Instruments

The Corporation manages its exposure to certain interest rate and foreign currency risks through the use of derivatives. None of the Corporation's outstanding derivative contracts are designated as hedges, and none are entered into for speculative purposes. Derivative instruments are carried at fair value, with changes in fair values recognized in earnings as components of non-interest income and non-interest expense on the consolidated statements of income.

Derivative contracts create counterparty credit risk with both the Corporation's customers and with institutional derivative counterparties. The Corporation manages counterparty credit risk through its credit approval processes, monitoring procedures and obtaining adequate collateral, when the Corporation determines it is appropriate to do so and in accordance with counterparty contracts.

#### Mortgage Banking Derivatives

In connection with its mortgage banking activities, the Corporation enters into commitments to originate certain residential mortgage loans for customers, also referred to as interest rate locks. In addition, the Corporation enters into forward commitments for the future sales or purchases of mortgage-backed securities to or from third-party counterparties to hedge the effect of changes in interest rates on the values of both the interest rate locks and mortgage loans held for sale. Forward sales commitments may also be in the form of commitments to sell individual mortgage loans at a fixed price at a future date. The amount necessary to settle each interest rate lock is based on the price that secondary market investors would pay for loans with similar characteristics, including interest rate and term, as of the date fair value is measured. Gross derivative assets and liabilities are recorded in other assets and other liabilities, respectively, on the consolidated balance sheets, and changes in fair values during the period are recorded in mortgage banking income on the consolidated statements of income.

#### Interest Rate Swaps

The Corporation enters into interest rate swaps with certain qualifying commercial loan customers to meet their interest rate risk management needs. The Corporation simultaneously enters into interest rate swaps with dealer counterparties, with identical notional amounts and terms. The net result of these interest rate swaps is that the customer pays a fixed rate of interest and the Corporation receives a floating rate. These interest rate swaps are derivative financial instruments and the gross fair values are recorded in other assets and other liabilities on the consolidated balance sheets, with changes in fair values during the period recorded in other non-interest expense on the consolidated statements of income.

### Foreign Exchange Contracts

The Corporation enters into foreign exchange contracts to accommodate the needs of its customers. Foreign exchange contracts are commitments to buy or sell foreign currency on a future date at a contractual price. The Corporation offsets its foreign exchange contract exposure with customers by entering into contracts with third-party correspondent financial institutions to mitigate its exposure to fluctuations in foreign currency exchange rates. The Corporation also holds certain amounts of foreign currency with international correspondent banks. The Corporation's policy limits the total net foreign currency open positions, which includes all outstanding contracts and foreign account balances, to \$500,000. Gross fair values are recorded in other assets and other liabilities on the consolidated balance sheets, with changes in fair values during the period recorded within other service charges and fees on the consolidated statements of income.

The following table presents a summary of the notional amounts and fair values of derivative financial instruments:

|                                                         | September 30, 2016 |                              | December 31, 2015 |                              |
|---------------------------------------------------------|--------------------|------------------------------|-------------------|------------------------------|
|                                                         | Notional Amount    | Asset (Liability) Fair Value | Notional Amount   | Asset (Liability) Fair Value |
|                                                         | (in thousands)     |                              |                   |                              |
| Interest Rate Locks with Customers                      |                    |                              |                   |                              |
| Positive fair values                                    | \$188,543          | \$ 3,199                     | \$87,781          | \$ 1,291                     |
| Negative fair values                                    | 611                | (2 )                         | 267               | (16 )                        |
| Net interest rate locks with customers                  |                    | 3,197                        |                   | 1,275                        |
| Forward Commitments                                     |                    |                              |                   |                              |
| Positive fair values                                    | 22,037             | 5                            | 69,045            | 205                          |
| Negative fair values                                    | 137,181            | (866 )                       | 16,193            | (24 )                        |
| Net forward commitments                                 |                    | (861 )                       |                   | 181                          |
| Interest Rate Swaps with Customers                      |                    |                              |                   |                              |
| Positive fair values                                    | 1,307,072          | 80,930                       | 846,490           | 32,915                       |
| Negative fair values                                    | 8,000              | (18 )                        | 8,757             | (55 )                        |
| Net interest rate swaps with customers                  |                    | 80,912                       |                   | 32,860                       |
| Interest Rate Swaps with Dealer Counterparties          |                    |                              |                   |                              |
| Positive fair values                                    | 8,000              | 18                           | 8,757             | 55                           |
| Negative fair values                                    | 1,307,072          | (80,930 )                    | 846,490           | (32,915 )                    |
| Net interest rate swaps with dealer counterparties      |                    | (80,912 )                    |                   | (32,860 )                    |
| Foreign Exchange Contracts with Customers               |                    |                              |                   |                              |
| Positive fair values                                    | 10,904             | 464                          | 4,897             | 114                          |
| Negative fair values                                    | 1,763              | (32 )                        | 8,050             | (184 )                       |
| Net foreign exchange contracts with customers           |                    | 432                          |                   | (70 )                        |
| Foreign Exchange Contracts with Correspondent Banks     |                    |                              |                   |                              |
| Positive fair values                                    | 5,619              | 59                           | 9,728             | 428                          |
| Negative fair values                                    | 7,376              | (391 )                       | 6,899             | (147 )                       |
| Net foreign exchange contracts with correspondent banks |                    | (332 )                       |                   | 281                          |
| Net derivative fair value asset                         |                    | \$ 2,436                     |                   | \$ 1,667                     |

The following table presents a summary of the fair value gains (losses) on derivative financial instruments:

|                                                                   | Three months ended |                   | Nine months ended |                   |
|-------------------------------------------------------------------|--------------------|-------------------|-------------------|-------------------|
|                                                                   | September 30 2016  | September 30 2015 | September 30 2016 | September 30 2015 |
|                                                                   | (in thousands)     |                   |                   |                   |
| Interest rate locks with customers                                | \$178              | \$1,041           | \$1,922           | \$ 876            |
| Forward commitments                                               | 970                | (3,183 )          | (1,042 )          | (338 )            |
| Interest rate swaps with customers                                | (1,948)            | 18,266            | 48,052            | 17,831            |
| Interest rate swaps with dealer counterparties                    | 1,948              | (18,266 )         | (48,052)          | (17,831)          |
| Foreign exchange contracts with customers                         | 47                 | (197 )            | 502               | (378 )            |
| Foreign exchange contracts with correspondent banks               | (266 )             | 323               | (613 )            | 710               |
| Net fair value gains (losses) on derivative financial instruments | \$929              | \$(2,016)         | \$769             | \$ 870            |

Fair Value Option

U.S. GAAP permits entities to measure many financial instruments and certain other items at fair value and requires certain disclosures for amounts for which the fair value option is applied. The Corporation has elected to measure mortgage loans held for sale at fair value to more accurately reflect the financial results of its mortgage banking activities in its consolidated financial statements. Derivative financial instruments related to these activities are also recorded at fair value, as noted above. The Corporation



determines fair value for its mortgage loans held for sale based on the price that secondary market investors would pay for loans with similar characteristics, including interest rate and term, as of the date fair value is measured. Changes in fair values during the period are recorded as components of mortgage banking income on the consolidated statements of income. Interest income earned on mortgage loans held for sale is classified in interest income on the consolidated statements of income.

The following table presents a summary of the Corporation's mortgage loans held for sale:

|            | September 30, 2016 |          | December 31, 2015 |      |
|------------|--------------------|----------|-------------------|------|
|            | 2016               | 2015     | 2016              | 2015 |
|            | (in thousands)     |          |                   |      |
| Cost       | \$27,030           | \$16,584 |                   |      |
| Fair value | 27,836             | 16,886   |                   |      |

During the three months ended September 30, 2016, the Corporation recorded losses related to changes in fair values of mortgage loans held for sale of \$360,000 compared to gains of \$531,000 for the same period in 2015. During the nine months ended September 30, 2016 and 2015, the Corporation recorded gains related to changes in fair values of mortgage loans held for sale of \$504,000 and \$309,000, respectively.

#### Balance Sheet Offsetting

Certain financial assets and liabilities may be eligible for offset on the consolidated balance sheets because they are subject to master netting arrangements or similar agreements. The Corporation elects to not offset assets and liabilities subject to such arrangements on the consolidated financial statements.

The Corporation is a party to interest rate swap transactions with financial institution counterparties and customers, disclosed in detail above. Under these agreements, the Corporation has the right to net-settle multiple contracts with the same counterparty in the event of default on, or termination of, any one contract. Cash collateral is posted by the party with a net liability position in accordance with contract thresholds and can be used to settle the fair value of the interest rate swap agreements in the event of default.

The Corporation is also a party to foreign currency exchange contracts with financial institution counterparties, under which the Corporation has the right to net-settle multiple contracts with the same counterparty in the event of default on, or termination of, any one contract. As with interest rate swap contracts, collateral is posted by the party with a net liability position in accordance with contract thresholds and can be used to settle the fair value of the foreign currency exchange contracts in the event of default.

The Corporation also enters into agreements with customers in which it sells securities subject to an obligation to repurchase the same or similar securities, referred to as repurchase agreements. Under these agreements, the Corporation may transfer legal control over the assets but still maintain effective control through agreements that both entitle and obligate the Corporation to repurchase the assets. Therefore, repurchase agreements are reported as secured borrowings, classified in short-term borrowings on the consolidated balance sheets, while the securities underlying the repurchase agreements remain classified with investment securities on the consolidated balance sheets. The Corporation has no intention of setting off these amounts. Therefore, these repurchase agreements are not eligible for offset.



The following table presents the Corporation's financial instruments that are eligible for offset, and the effects of offsetting, on the consolidated balance sheets:

|                                                                  | Gross Amounts Recognized on the Consolidated Balance Sheets | Gross Amounts Not Offset on the Consolidated Balance Sheets | Financial Instruments <sup>(2)</sup> | Cash Collateral <sup>(1)</sup> | Net Amount |
|------------------------------------------------------------------|-------------------------------------------------------------|-------------------------------------------------------------|--------------------------------------|--------------------------------|------------|
| (in thousands)                                                   |                                                             |                                                             |                                      |                                |            |
| September 30, 2016                                               |                                                             |                                                             |                                      |                                |            |
| Interest rate swap derivative assets                             | \$80,948                                                    | \$(18 )                                                     | \$—                                  |                                | \$80,930   |
| Foreign exchange derivative assets with correspondent banks      | 59                                                          | (59 )                                                       | —                                    |                                | —          |
| Total                                                            | \$81,007                                                    | \$(77 )                                                     | \$—                                  |                                | \$80,930   |
| Interest rate swap derivative liabilities                        | \$80,948                                                    | \$(18 )                                                     | \$(80,930)                           | \$—                            |            |
| Foreign exchange derivative liabilities with correspondent banks | 391                                                         | (59 )                                                       | (260 )                               | 72                             |            |
| Total                                                            | \$81,339                                                    | \$(77 )                                                     | \$(81,190)                           | \$72                           |            |
| December 31, 2015                                                |                                                             |                                                             |                                      |                                |            |
| Interest rate swap derivative assets                             | \$32,970                                                    | \$(55 )                                                     | \$—                                  |                                | \$32,915   |
| Foreign exchange derivative assets with correspondent banks      | 428                                                         | (147 )                                                      | —                                    |                                | 281        |
| Total                                                            | \$33,398                                                    | \$(202 )                                                    | \$—                                  |                                | \$33,196   |
| Interest rate swap derivative liabilities                        | \$32,970                                                    | \$(55 )                                                     | \$(31,130)                           | \$1,785                        |            |
| Foreign exchange derivative liabilities with correspondent banks | 147                                                         | (147 )                                                      | —                                    |                                | —          |
| Total                                                            | \$33,117                                                    | \$(202 )                                                    | \$(31,130)                           | \$1,785                        |            |

For derivative assets, amounts represent any derivative liability fair values that could be offset in the event of (1) counterparty or customer default. For derivative liabilities, amounts represent any derivative asset fair values that could be offset in the event of counterparty or customer default.

(2) Amounts represent collateral received from the counterparty or posted by the Corporation.

#### NOTE 10 – Commitments and Contingencies

##### Commitments

The Corporation is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers.

Those financial instruments include commitments to extend credit and letters of credit, which involve, to varying degrees, elements of credit risk and interest rate risk in excess of the amounts recognized on the Corporation's consolidated balance sheets. Exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and letters of credit is represented by the outstanding amount of those instruments.

The outstanding amounts of commitments to extend credit and letters of credit as of the dates indicated were as follows:

|                              | September 30,  | December 31, |
|------------------------------|----------------|--------------|
|                              | 2016           | 2015         |
|                              | (in thousands) |              |
| Commitments to extend credit | \$6,073,712    | \$ 5,784,138 |
| Standby letters of credit    | 365,562        | 374,729      |
| Commercial letters of credit | 35,532         | 39,529       |

The Corporation records a reserve for unfunded lending commitments, which represents management's estimate of losses associated with unused commitments to extend credit. See Note 5, "Loans and Allowance for Credit Losses," for additional details.

## Residential Lending

Residential mortgages originated and sold by the Corporation consist primarily of conforming, prime loans sold to government sponsored agencies, such as the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac"). The Corporation also sells certain prime loans it originates to non-government sponsored agency investors.

The Corporation provides customary representations and warranties to government sponsored entities and investors that specify, among other things, that the loans have been underwritten to the standards established by the government sponsored entity or investor. The Corporation may be required to repurchase a loan, or reimburse the government sponsored entity or investor for a credit loss incurred on a loan, if it is determined that the representations and warranties have not been met. Such repurchases or reimbursements generally result from an underwriting or documentation deficiency. As of both September 30, 2016 and December 31, 2015, total outstanding repurchase requests totaled approximately \$543,000.

From 2000 to 2011, the Corporation sold loans to the Federal Home Loan Bank of Pittsburgh under its Mortgage Partnership Finance Program ("MPF Program"). The Corporation provided a "credit enhancement" for residential mortgage loans sold under the MPF Program whereby it would assume credit losses in excess of a defined "First Loss Account," or "FLA" balance, up to specified amounts. The FLA is funded by the Federal Home Loan Bank of Pittsburgh based on a percentage of the outstanding principal balance of loans sold. As of September 30, 2016, the unpaid principal balance of loans sold under the MPF Program was approximately \$108 million. As of September 30, 2016 and December 31, 2015, the reserve for estimated credit losses related to loans sold under the MPF Program was \$1.7 million and \$1.8 million, respectively. Required reserves are calculated based on delinquency status and estimated loss rates established through the Corporation's existing allowance for credit losses methodology for residential mortgage loans.

As of September 30, 2016 and December 31, 2015, the total reserve for losses on residential mortgage loans sold was \$2.5 million and \$2.6 million, respectively, including both reserves for credit losses under the MPF Program and reserves for representation and warranty exposures. Management believes that the reserves recorded as of September 30, 2016 are adequate. However, declines in collateral values, the identification of additional loans to be repurchased, or a deterioration in the credit quality of loans sold under the MPF Program could necessitate additional reserves, established through charges to earnings, in the future.

## Legal Proceedings

The Corporation and its subsidiaries are involved in various legal proceedings in the ordinary course of business of the Corporation. The Corporation periodically evaluates the possible impact of pending litigation matters based on, among other factors, the advice of counsel, available insurance coverage and recorded liabilities and reserves for probable legal liabilities and costs. In addition, from time to time, the Corporation is the subject of investigations or other forms of regulatory or governmental inquiry covering a range of possible issues and, in some cases, these may be part of similar reviews of the specified activities of other industry participants. These inquiries could lead to administrative, civil or criminal proceedings, and could possibly result in fines, penalties, restitution or the need to alter the Corporation's business practices, and cause the Corporation to incur additional costs. The Corporation's practice is to cooperate fully with regulatory and governmental investigations.

As of the date of this report, the Corporation believes that any liabilities, individually or in the aggregate, which may result from the final outcomes of pending proceedings will not have a material adverse effect on the financial condition of the Corporation. However, legal proceedings are often unpredictable, and it is possible that the ultimate resolution of any such matters, if unfavorable, may be material to the Corporation's results of operations for any

particular period, depending, in part, upon the size of the loss or liability imposed and the operating results for the applicable period.

#### BSA/AML Enforcement Orders

The Corporation and each of its bank subsidiaries are subject to regulatory enforcement orders issued during 2014 and 2015 by their respective federal and state bank regulatory agencies relating to identified deficiencies in the Corporation's centralized Bank Secrecy Act and anti-money laundering compliance program (the "BSA/AML Compliance Program"), which was designed to comply with the requirements of the Bank Secrecy Act, the USA Patriot Act of 2001 and related anti-money laundering regulations (collectively, the "BSA/AML Requirements"). The regulatory enforcement orders, which are in the form of consent orders or orders to cease and desist issued upon consent ("Consent Orders"), generally require, among other things, that the Corporation and its bank subsidiaries undertake a number of required actions to strengthen and enhance the BSA/AML Compliance Program, and, in some cases, conduct retrospective reviews of past account activity and transactions, as well as certain reports filed in accordance with the BSA/AML Requirements, to determine whether suspicious activity and certain transactions in currency were properly identified and reported in accordance with the BSA/AML Requirements. In addition to requiring strengthening and

enhancement of the BSA/AML Compliance Program, while the Consent Orders remain in effect, the Corporation is subject to certain restrictions on expansion activities of the Corporation and its bank subsidiaries. Further, any failure to comply with the requirements of any of the Consent Orders involving the Corporation or its bank subsidiaries could result in further enforcement actions, the imposition of material restrictions on the activities of the Corporation or its bank subsidiaries, or the assessment of fines or penalties.

#### Fair Lending Investigation

During the second quarter of 2015, Fulton Bank, N.A., the Corporation's largest bank subsidiary, received a letter from the U.S. Department of Justice (the "Department") indicating that the Department had initiated an investigation regarding potential violations of the fair lending laws (specifically, the Equal Credit Opportunity Act and the Fair Housing Act) by Fulton Bank, N.A. in certain geographies. Fulton Bank, N.A. has been and is cooperating with the Department and responding to the Department's requests for information. During the third quarter of 2016, the Department informed the Corporation, Fulton Bank, N.A., and three of the Corporation's other bank subsidiaries, Fulton Bank of New Jersey, The Columbia Bank and Lafayette Ambassador Bank, that the Department was expanding its investigation of potential lending discrimination on the basis of race and national origin to encompass additional geographies that were not included in the initial letter from the Department. In addition to requesting information concerning the lending activities of these bank subsidiaries, the Department also requested information concerning the Corporation and the residential mortgage lending activities conducted under the Fulton Mortgage Company brand, the trade name used by all of the Corporation's bank subsidiaries for residential mortgage lending. The investigation relates to lending activities during the period January 1, 2009 to the present. The Corporation and the identified bank subsidiaries are cooperating with the Department and responding to the Department's requests for information. The Corporation and its bank subsidiaries are not able at this time to determine the terms on which this investigation will be resolved or the timing of such resolution, or to reliably estimate the amounts or range of possible amounts of any settlement, fines or other penalties or, the cost of any other remedial actions, if enforcement action is taken. In addition, should the investigation result in an enforcement action against the Corporation or its bank subsidiaries, or a settlement with the Department, the ability of the Corporation and its bank subsidiaries to engage in certain expansion or other other activities may be restricted.

#### Agostino, et al. Litigation

Fulton Bank, N.A. (the "Bank"), the Corporation's largest bank subsidiary, and two unrelated, third-party defendants, Ameriprise Financial Services, Inc. and Riverview Bank, have been named as defendants in a lawsuit brought on behalf of a group of 58 plaintiffs filed on March 31, 2016 in the Court of Common Pleas for Dauphin County, Pennsylvania (Agostino, et al. v. Ameriprise Financial Services, Inc., et al., No. 2016-CV-2048-CV). The plaintiffs in this action, who are individuals, trustees of certain irrevocable trusts or the executors of the estates of deceased individuals, were clients of Jeffrey M. Mottern, a now deceased attorney, who is alleged to have operated a Ponzi scheme which defrauded the plaintiffs over a period of years through the sale of fictitious, high-yielding investments or by otherwise misappropriating funds entrusted to Mr. Mottern. Mr. Mottern is alleged to have used the proceeds of these activities to engage in speculative securities trading, which incurred significant losses, and for Mr. Mottern's personal expenses. The allegations against the Bank relate to a commercial checking account at the Bank maintained by Mr. Mottern in connection with Mr. Mottern's law practice. The lawsuit alleges that the Bank is liable to the plaintiffs for failing to properly monitor Mr. Mottern's checking account and detect Mr. Mottern's fraudulent activity, and specifically alleges that the Bank aided and abetted Mr. Mottern's: (1) fraud; (2) breach of fiduciary duty; (3) violations of the Pennsylvania Unfair Trade Practices and Consumer Protection Law; and (4) conversion. Similar claims have been asserted against Ameriprise Financial Services, Inc. and Riverview Bank, which allegedly maintained a personal brokerage account and a trust account for client or other third-party funds, respectively, for Mr. Mottern. The lawsuit seeks damages from the defendants, including the Bank, alleged to be in excess of \$11.3 million, treble damages and attorneys' fees with respect to alleged violations of the Pennsylvania Unfair Trade Practices and

Consumer Protection Law, punitive damages, plus interest and costs. On April 29, 2016, the Bank filed a Notice of Removal to remove this lawsuit to the United States District Court for the Middle District of Pennsylvania. On May 31, 2016, the plaintiffs filed a motion to remand the lawsuit to the Court of Common Pleas for Dauphin County, Pennsylvania. On October 24, 2016, the District Court granted the plaintiffs' motion and the lawsuit was remanded back to the Court of Common Pleas for Dauphin County.



## NOTE 11 – Fair Value Measurements

FASB ASC Topic 820 establishes a fair value hierarchy for the inputs to valuation techniques used to measure assets and liabilities at fair value using the following three categories (from highest to lowest priority):

Level 1 – Inputs that represent quoted prices for identical instruments in active markets.

Level 2 – Inputs that represent quoted prices for similar instruments in active markets, or quoted prices for identical instruments in non-active markets. Also includes valuation techniques whose inputs are derived principally from observable market data other than quoted prices, such as interest rates or other market-corroborated means.

Level 3 – Inputs that are largely unobservable, as little or no market data exists for the instrument being valued.

The Corporation has categorized all assets and liabilities measured at fair value on both a recurring and nonrecurring basis into the above three levels.

The following tables present summaries of the Corporation's assets and liabilities measured at fair value on a recurring basis and reported on the consolidated balance sheets:

|                                                | September 30, 2016 |             |           |             |
|------------------------------------------------|--------------------|-------------|-----------|-------------|
|                                                | Level 1            | Level 2     | Level 3   | Total       |
|                                                | (in thousands)     |             |           |             |
| Mortgage loans held for sale                   | \$—                | \$27,836    | \$—       | \$27,836    |
| Available for sale investment securities:      |                    |             |           |             |
| Equity securities                              | 22,483             | —           | —         | 22,483      |
| U.S. Government sponsored agency securities    | —                  | 140         | —         | 140         |
| State and municipal securities                 | —                  | 401,572     | —         | 401,572     |
| Corporate debt securities                      | —                  | 104,100     | 3,141     | 107,241     |
| Collateralized mortgage obligations            | —                  | 652,359     | —         | 652,359     |
| Mortgage-backed securities                     | —                  | 1,226,547   | —         | 1,226,547   |
| Auction rate securities                        | —                  | —           | 97,726    | 97,726      |
| Total available for sale investment securities | 22,483             | 2,384,718   | 100,867   | 2,508,068   |
| Other assets                                   | 16,903             | 84,152      | —         | 101,055     |
| Total assets                                   | \$39,386           | \$2,496,706 | \$100,867 | \$2,636,959 |
| Other liabilities                              | \$16,800           | \$81,815    | \$—       | \$98,615    |
|                                                | December 31, 2015  |             |           |             |
|                                                | Level 1            | Level 2     | Level 3   | Total       |
|                                                | (in thousands)     |             |           |             |
| Mortgage loans held for sale                   | \$—                | \$16,886    | \$—       | \$16,886    |
| Available for sale investment securities:      |                    |             |           |             |
| Equity securities                              | 21,514             | —           | —         | 21,514      |
| U.S. Government sponsored agency securities    | —                  | 25,136      | —         | 25,136      |
| State and municipal securities                 | —                  | 262,765     | —         | 262,765     |
| Corporate debt securities                      | —                  | 93,619      | 3,336     | 96,955      |
| Collateralized mortgage obligations            | —                  | 821,509     | —         | 821,509     |
| Mortgage-backed securities                     | —                  | 1,158,835   | —         | 1,158,835   |
| Auction rate securities                        | —                  | —           | 98,059    | 98,059      |
| Total available for sale investment securities | 21,514             | 2,361,864   | 101,395   | 2,484,773   |
| Other assets                                   | 16,129             | 34,465      | —         | 50,594      |
| Total assets                                   | \$37,643           | \$2,413,215 | \$101,395 | \$2,552,253 |
| Other liabilities                              | \$15,914           | \$33,010    | \$—       | \$48,924    |

The valuation techniques used to measure fair value for the items in the preceding tables are as follows:

Mortgage loans held for sale – This category consists of mortgage loans held for sale that the Corporation has elected to measure at fair value. Fair values as of September 30, 2016 and December 31, 2015 were measured based on the

price

33

---

that secondary market investors were offering for loans with similar characteristics. See Note 9, "Derivative Financial Instruments" for details related to the Corporation's election to measure assets and liabilities at fair value.

Available for sale investment securities – Included in this asset category are both equity and debt securities. Level 2 available for sale debt securities are valued by a third-party pricing service commonly used in the banking industry. The pricing service uses pricing models that vary based on asset class and incorporate available market information, including quoted prices of investment securities with similar characteristics. Because many fixed income securities do not trade on a daily basis, pricing models use available information, as applicable, through processes such as benchmark yield curves, benchmarking of like securities, sector groupings, and matrix pricing. Standard market inputs include: benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers and reference data, including market research publications. For certain security types, additional inputs may be used, or some of the standard market inputs may not be applicable.

Management tests the values provided by the pricing service by obtaining securities prices from an alternative third-party source and comparing the results. This test is done for approximately 94% of the securities valued by the pricing service. Generally, differences by security in excess of 5% are researched to reconcile the difference.

Equity securities – Equity securities consist of common stocks of financial institutions (\$21.6 million at September 30, 2016 and \$20.6 million at December 31, 2015) and other equity investments (\$901,000 at September 30, 2016 and \$914,000 at December 31, 2015). These Level 1 investments are measured at fair value based on quoted prices for identical securities in active markets.

U.S. Government securities/U.S. Government sponsored agency securities/State and municipal securities/Collateralized mortgage obligations/Mortgage-backed securities – These debt securities are classified as Level 2 investments. Fair values are determined by a third-party pricing service, as detailed above.

Corporate debt securities – This category consists of subordinated debt issued by financial institutions (\$44.7 million at September 30, 2016 and \$40.8 million at December 31, 2015), senior debt (\$18.6 million at September 30, 2016 and \$12.3 million at December 31, 2015), single-issuer trust preferred securities issued by financial institutions (\$39.3 million at September 30, 2016 and \$39.1 million at December 31, 2015), pooled trust preferred securities issued by financial institutions (\$706,000 at both September 30, 2016 and December 31, 2015) and other corporate debt issued by non-financial institutions (\$4.0 million at both September 30, 2016 and December 31, 2015).

Level 2 investments include the Corporation's holdings of subordinated debt, other corporate debt issued by non-financial institutions and \$36.8 million and \$36.5 million of single-issuer trust preferred securities held at September 30, 2016 and December 31, 2015, respectively. The fair values for these corporate debt securities are determined by a third-party pricing service, as detailed above.

Level 3 investments include the Corporation's investments in pooled trust preferred securities (\$706,000 at both September 30, 2016 and December 31, 2015) and certain single-issuer trust preferred securities (\$2.4 million at September 30, 2016 and \$2.6 million at December 31, 2015). The fair values of these securities were determined based on quotes provided by third-party brokers who determined fair values based predominantly on internal valuation models which were not indicative prices or binding offers. The Corporation's third-party pricing service cannot derive fair values for these securities primarily due to inactive markets for similar investments. Level 3 values are tested by management primarily through trend analysis, by comparing current values to those reported at the end of the preceding calendar quarter, and determining if they are reasonable based on price and spread movements for this asset class.

Auction rate securities – Due to their illiquidity, ARCs are classified as Level 3 investments and are valued through the use of an expected cash flows model prepared by a third-party valuation expert. The assumptions used in preparing the expected cash flows model include estimates for coupon rates, time to maturity and market rates of return. The most significant unobservable input to the expected cash flows model is an assumed return to market liquidity sometime in the next five years. If the assumed return to market liquidity was lengthened beyond the next five years, this would result in a decrease in the fair value of these ARCs. The Corporation believes that the trusts underlying the ARCs will self-liquidate as student loans are repaid. Level 3 fair values are tested by management through the performance of a trend analysis of the market price and discount rate. Changes in the price and discount rates are

compared to changes in market data, including bond ratings, parity ratios, balances and delinquency levels.

34

---

Other assets – Included in this category are the following:

Level 1 assets include mutual funds that are held in trust for employee deferred compensation plans (\$16.4 million at September 30, 2016 and \$15.6 million at December 31, 2015) and the fair value of foreign currency exchange contracts (\$527,000 at September 30, 2016 and \$547,000 at December 31, 2015). The mutual funds and foreign exchange prices used to measure these items at fair value are based on quoted prices for identical instruments in active markets.

Level 2 assets include the fair value of mortgage banking derivatives in the form of interest rate locks and forward commitments with secondary market investors (\$3.2 million at September 30, 2016 and \$1.5 million at December 31, 2015) and the fair value of interest rate swaps (\$80.9 million at September 30, 2016 and \$33.0 million at December 31, 2015). The fair values of the Corporation's interest rate locks, forward commitments and interest rate swaps represent the amounts that would be required to settle the derivative financial instruments at the balance sheet date. See Note 9, "Derivative Financial Instruments," for additional information.

Other liabilities – Included in this category are the following:

Level 1 liabilities include employee deferred compensation liabilities which represent amounts due to employees under deferred compensation plans (\$16.4 million at September 30, 2016 and \$15.6 million at December 31, 2015) and the fair value of foreign currency exchange contracts (\$424,000 at September 30, 2016 and \$331,000 at December 31, 2015). The fair value of these liabilities are determined in the same manner as the related assets, as described under the heading "Other assets" above.

Level 2 liabilities include the fair value of mortgage banking derivatives in the form of interest rate locks and forward commitments with secondary market investors (\$868,000 at September 30, 2016 and \$40,000 at December 31, 2015) and the fair value of interest rate swaps (\$80.9 million at September 30, 2016 and \$33.0 million at December 31, 2015). The fair values of these liabilities are determined in the same manner as the related assets, as described under the heading "Other assets" above.

The following table presents the changes in the Corporation's available for sale investment securities measured at fair value on a recurring basis using unobservable inputs (Level 3):

|                                                    | Three months ended September 30,<br>2016 |                                          |                |
|----------------------------------------------------|------------------------------------------|------------------------------------------|----------------|
|                                                    | Pooled Trust Securities                  | Single-issuer Preferred Trust Securities | Preferred ARCs |
|                                                    | (in thousands)                           |                                          |                |
| Balance at June 30, 2016                           | \$706                                    | \$ 2,425                                 | \$97,886       |
| Unrealized adjustment to fair value <sup>(1)</sup> | —                                        | 7                                        | (318 )         |
| Discount accretion <sup>(2)</sup>                  | —                                        | 3                                        | 158            |
| Balance at September 30, 2016                      | \$706                                    | \$ 2,435                                 | \$97,726       |

|                                                    | Three months ended September 30,<br>2015 |          |          |
|----------------------------------------------------|------------------------------------------|----------|----------|
| Balance at June 30, 2015                           | \$530                                    | \$ 3,820 | \$98,606 |
| Unrealized adjustment to fair value <sup>(1)</sup> | —                                        | (203 )   | (890 )   |
| Settlements - calls                                | —                                        | (970 )   | —        |
| Discount accretion <sup>(2)</sup>                  | —                                        | 3        | 157      |
| Balance at September 30, 2015                      | \$530                                    | \$ 2,650 | \$97,873 |

|                                                    | Nine months ended September 30,<br>2016 |                                          |                |
|----------------------------------------------------|-----------------------------------------|------------------------------------------|----------------|
|                                                    | Pooled Trust Securities                 | Single-issuer Preferred Trust Securities | Preferred ARCs |
|                                                    | (in thousands)                          |                                          |                |
| Balance at December 31, 2015                       | \$706                                   | \$ 2,630                                 | \$98,059       |
| Unrealized adjustment to fair value <sup>(1)</sup> | —                                       | (204 )                                   | (668 )         |
| Discount accretion <sup>(2)</sup>                  | —                                       | 9                                        | 335            |
| Balance at September 30, 2016                      | \$706                                   | \$ 2,435                                 | \$97,726       |

|                                                    | Nine months ended September 30,<br>2015 |          |           |
|----------------------------------------------------|-----------------------------------------|----------|-----------|
| Balance at December 31, 2014                       | \$4,088                                 | \$ 3,820 | \$100,941 |
| Sales                                              | (3,633 )                                | —        | —         |
| Unrealized adjustment to fair value <sup>(1)</sup> | 190                                     | (207 )   | (978 )    |
| Settlements - calls                                | (117 )                                  | (970 )   | (2,446 )  |
| Discount accretion <sup>(2)</sup>                  | 2                                       | 7        | 356       |
| Balance at September 30, 2015                      | \$530                                   | \$ 2,650 | \$97,873  |

Pooled trust preferred securities, single-issuer trust preferred securities and ARCs are classified as available for sale investment securities; as such, the unrealized adjustment to fair value was recorded as an unrealized holding gain (loss) and included as a component of available for sale investment securities on the consolidated balance sheets.

(1) Included as a component of net interest income on the consolidated statements of income.



Certain financial assets are not measured at fair value on an ongoing basis, but are subject to fair value measurement in certain circumstances, such as upon their acquisition or when there is evidence of impairment. The following table presents the Corporation's financial assets measured at fair value on a nonrecurring basis and reported on the Corporation's consolidated balance sheets:

|                        | September 30, 2016 |         |             |            |
|------------------------|--------------------|---------|-------------|------------|
|                        | Level 1            | Level 2 | Level 3     | Total      |
|                        | (in thousands)     |         |             |            |
| Net loans              | \$-                | \$-     | —\$ 140,732 | \$ 140,732 |
| Other financial assets | —                  | —       | 48,288      | 48,288     |
| Total assets           | \$-                | \$-     | —\$ 189,020 | \$ 189,020 |
|                        | December 31, 2015  |         |             |            |
|                        | Level 1            | Level 2 | Level 3     | Total      |
|                        | (in thousands)     |         |             |            |
| Net loans              | \$-                | \$-     | —\$ 138,491 | \$ 138,491 |
| Other financial assets | —                  | —       | 52,043      | 52,043     |
| Total assets           | \$-                | \$-     | —\$ 190,534 | \$ 190,534 |

The valuation techniques used to measure fair value for the items in the table above are as follows:

Net loans – This category consists of loans that were evaluated for impairment under FASB ASC Section 310-10-35 and have been classified as Level 3 assets. The amount shown is the balance of impaired loans, net of the related allowance for loan losses. See Note 5, "Loans and Allowance for Credit Losses," for additional details.

Other financial assets – This category includes OREO (\$12.0 million at September 30, 2016 and \$11.1 million at December 31, 2015) and MSR's (\$36.3 million at September 30, 2016 and \$40.9 million at December 31, 2015), both classified as Level 3 assets.

Fair values for OREO were based on estimated selling prices less estimated selling costs for similar assets in active markets.

MSR's are initially recorded at fair value upon the sale of residential mortgage loans to secondary market investors. MSR's are amortized as a reduction to servicing income over the estimated lives of the underlying loans. MSR's are stratified and evaluated for impairment by comparing each stratum's carrying amount to its estimated fair value. Fair values are determined at the end of each quarter through a discounted cash flows valuation performed by a third-party valuation expert. Significant inputs to the valuation included expected net servicing income, the discount rate and the expected life of the underlying loans. Expected life is based on the contractual terms of the loans, as adjusted for prepayment projections. The weighted average annual constant prepayment rate and the weighted average discount rate used in the September 30, 2016 valuation were 14.4% and 10.1%, respectively. Management tests the reasonableness of the significant inputs to the third-party valuation in comparison to market data.



As required by FASB ASC Section 825-10-50, the following table details the book values and estimated fair values of the Corporation's financial instruments as of September 30, 2016 and December 31, 2015. In addition, a general description of the methods and assumptions used to estimate such fair values is also provided.

|                                                         | September 30, 2016 |                      | December 31, 2015 |                      |
|---------------------------------------------------------|--------------------|----------------------|-------------------|----------------------|
|                                                         | Book Value         | Estimated Fair Value | Book Value        | Estimated Fair Value |
| (in thousands)                                          |                    |                      |                   |                      |
| <b>FINANCIAL ASSETS</b>                                 |                    |                      |                   |                      |
| Cash and due from banks                                 | \$86,497           | \$86,497             | \$101,120         | \$101,120            |
| Interest-bearing deposits with other banks              | 368,031            | 368,031              | 230,300           | 230,300              |
| Federal Reserve Bank and Federal Home Loan Bank stock   | 60,935             | 60,935               | 62,216            | 62,216               |
| Loans held for sale <sup>(1)</sup>                      | 27,836             | 27,836               | 16,886            | 16,886               |
| Available for sale investment securities <sup>(1)</sup> | 2,508,068          | 2,508,068            | 2,484,773         | 2,484,773            |
| Net Loans <sup>(1)</sup>                                | 14,228,712         | 14,155,453           | 13,669,548        | 13,540,903           |
| Accrued interest receivable                             | 43,600             | 43,600               | 42,767            | 42,767               |
| Other financial assets <sup>(1)</sup>                   | 227,310            | 227,310              | 166,920           | 166,920              |
| <b>FINANCIAL LIABILITIES</b>                            |                    |                      |                   |                      |
| Demand and savings deposits                             | \$12,148,162       | \$12,148,162         | \$11,267,367      | \$11,267,367         |
| Time deposits                                           | 2,804,317          | 2,824,653            | 2,864,950         | 2,862,868            |
| Short-term borrowings                                   | 264,042            | 264,042              | 497,663           | 497,663              |
| Accrued interest payable                                | 13,645             | 13,645               | 10,724            | 10,724               |
| Other financial liabilities <sup>(1)</sup>              | 263,489            | 263,489              | 190,927           | 190,927              |
| Federal Home Loan Bank advances and long-term debt      | 965,286            | 986,323              | 949,542           | 959,315              |

These financial instruments, or certain financial instruments in these categories, are measured at fair value on the (1) Corporation's consolidated balance sheets. Descriptions of the fair value determinations for these financial instruments are disclosed above.

Fair values of financial instruments are significantly affected by the assumptions used, principally the timing of future cash flows and discount rates. Because assumptions are inherently subjective in nature, the estimated fair values cannot be substantiated by comparison to independent market quotes and, in many cases, the estimated fair values could not necessarily be realized in an immediate sale or settlement of the instrument. The aggregate fair value amounts presented do not necessarily represent management's estimate of the underlying value of the Corporation. For short-term financial instruments, defined as those with remaining maturities of 90 days or less, and excluding those recorded at fair value on the Corporation's consolidated balance sheets, book value was considered to be a reasonable estimate of fair value.

The following instruments are predominantly short-term:

| Assets                                     | Liabilities                 |
|--------------------------------------------|-----------------------------|
| Cash and due from banks                    | Demand and savings deposits |
| Interest-bearing deposits with other banks | Short-term borrowings       |
| Accrued interest receivable                | Accrued interest payable    |

Federal Reserve Bank and Federal Home Loan Bank ("FHLB") stock represent restricted investments and are carried at cost on the consolidated balance sheets.

Fair values for loans and time deposits were estimated by discounting future cash flows using the current rates at which similar loans would be made to borrowers and similar deposits would be issued to customers for the same remaining maturities. Fair values estimated in this manner do not fully incorporate an exit price approach to fair value, as defined in FASB ASC Topic 820.

The fair values of FHLB advances and long-term debt were estimated by discounting the remaining contractual cash flows using a rate at which the Corporation could issue debt with similar remaining maturities as of the balance sheet date. These borrowings would be categorized in Level 2 liabilities under FASB ASC Topic 820.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Management's Discussion and Analysis of Financial Condition and Results of Operations ("Management's Discussion") relates to Fulton Financial Corporation (the "Corporation"), a financial holding company registered under the Bank Holding Company Act of 1956 and incorporated under the laws of the Commonwealth of Pennsylvania in 1982, and its wholly owned subsidiaries. Management's Discussion should be read in conjunction with the consolidated financial statements and notes presented in this report.

### FORWARD-LOOKING STATEMENTS

The Corporation has made, and may continue to make, certain forward-looking statements with respect to its financial condition and results of operations. Do not unduly rely on forward-looking statements. Forward-looking statements can be identified by the use of words such as "may," "should," "will," "could," "estimates," "predicts," "potential," "continue," "anticipates," "believes," "plans," "expects," "future," "intends" and similar expressions which are intended to identify forward-looking statements. Statements relating to the "outlook" or "2016 outlook" contained herein are forward-looking statements.

These forward-looking statements are not guarantees of future performance and are subject to risks and uncertainties, some of which are beyond the Corporation's control and ability to predict, that could cause actual results to differ materially from those expressed in the forward-looking statements. The Corporation undertakes no obligation, other than as required by law, to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. Many factors could affect future financial results including, without limitation:

- the impact of adverse conditions in the economy and capital markets on the performance of the Corporation's loan portfolio and demand for the Corporation's products and services;
- increases in non-performing assets, which may require the Corporation to increase the allowance for credit losses, charge off loans and incur elevated collection and carrying costs related to such non-performing assets;
- investment securities gains and losses, including other-than-temporary declines in the value of securities which may result in charges to earnings;
- the effects of market interest rates, and the relative balances of rate-sensitive assets to rate-sensitive liabilities, on net interest margin and net interest income;
- the effects of changes in interest rates on demand for the Corporation's products and services;
- the effects of changes in interest rates or disruptions in liquidity markets on the Corporation's sources of funding;
- the Corporation's ability to manage liquidity, both at the holding company level and at its bank subsidiaries;
- the impact of increased regulatory scrutiny of the banking industry;
- the effects of the increasing amounts of time and expense associated with regulatory compliance and risk management;
- the potential for negative consequences from regulatory violations and investigations, including potential supervisory actions and the assessment of fines and penalties;
- the additional time, expense and investment required to comply with, and the restrictions on potential growth and investment activities resulting from, the existing enforcement orders applicable to the Corporation and its bank subsidiaries by federal and state bank regulatory agencies requiring improvement in compliance functions and other remedial actions, or any future enforcement orders;
- the Corporation's ability to manage the uncertainty associated with the delay in implementing many of the regulations mandated by the Dodd-Frank Act;
- the effects of negative publicity on the Corporation's reputation;
- the effects of adverse outcomes in litigation and governmental or administrative proceedings;
- the Corporation's ability to successfully transform its business model;

- the Corporation's ability to achieve its growth plans;
- the effects of competition on deposit rates and growth, loan rates and growth and net interest margin;
- the Corporation's ability to manage the level of non-interest expenses, including salaries and employee benefits expenses, operating risk losses and goodwill impairment;
- the impact of operational risks, including the risk of human error, inadequate or failed internal processes and systems, computer and telecommunications systems failures, faulty or incomplete data and an inadequate risk management framework;
- the impact of failures of third parties upon which the Corporation relies to perform in accordance with contractual arrangements;
- the failure or circumvention of the Corporation's system of internal controls;
- the loss of, or failure to safeguard, confidential or proprietary information;
- the Corporation's failure to identify and to address cyber-security risks;

- the Corporation's ability to keep pace with technological changes;
- the Corporation's ability to attract and retain talented personnel;
- capital and liquidity strategies, including the Corporation's ability to comply with applicable capital and liquidity requirements, and the Corporation's ability to generate capital internally or raise capital on favorable terms;
- the Corporation's reliance on its subsidiaries for substantially all of its revenues and its ability to pay dividends or other distributions;
- the effects of any downgrade in the Corporation's credit ratings on its borrowing costs or access to capital markets; and
- the effects of changes in accounting policies, standards, and interpretations on the Corporation's financial condition and results of operations.

## RESULTS OF OPERATIONS

### Overview and Outlook

Fulton Financial Corporation is a financial holding company comprised of six wholly owned bank subsidiaries which provide a full range of retail and commercial financial services in Pennsylvania, Delaware, Maryland, New Jersey and Virginia and eight wholly owned non-bank subsidiaries. The Corporation generates the majority of its revenue through net interest income, or the difference between interest earned on loans, investments and other interest-earning assets, and interest paid on deposits and borrowings. Growth in net interest income is dependent upon balance sheet growth and maintaining or increasing the net interest margin, which is net interest income (fully taxable-equivalent, or "FTE") as a percentage of average interest-earning assets. The Corporation also generates revenue through fees earned on the various services and products offered to its customers and through gains on sales of assets, such as loans, investments, or properties. Offsetting these revenue sources are provisions for credit losses on loans, non-interest expenses and income taxes.

The following table presents a summary of the Corporation's earnings and selected performance ratios:

|                                                  | As of or for the<br>Three months ended<br>September 30 |          | As of or for the<br>Nine months ended<br>September 30 |           |   |  |
|--------------------------------------------------|--------------------------------------------------------|----------|-------------------------------------------------------|-----------|---|--|
|                                                  | 2016                                                   | 2015     | 2016                                                  | 2015      |   |  |
| Net income (in thousands)                        | \$41,468                                               | \$34,251 | \$119,475                                             | \$110,967 |   |  |
| Diluted net income per share                     | \$0.24                                                 | \$0.20   | \$0.69                                                | \$0.63    |   |  |
| Return on average assets                         | 0.89                                                   | % 0.78   | % 0.87                                                | % 0.86    | % |  |
| Return on average equity                         | 7.78                                                   | % 6.72   | % 7.64                                                | % 7.33    | % |  |
| Return on average tangible equity <sup>(1)</sup> | 10.38                                                  | % 9.11   | % 10.24                                               | % 9.96    | % |  |
| Net interest margin <sup>(2)</sup>               | 3.14                                                   | % 3.18   | % 3.19                                                | % 3.22    | % |  |
| Efficiency ratio <sup>(1)</sup>                  | 65.16                                                  | % 68.82  | % 67.01                                               | % 69.30   | % |  |
| Non-performing assets to total assets            | 0.80                                                   | % 0.87   | % 0.80                                                | % 0.87    | % |  |
| Annualized net charge-offs to average loans      | 0.11                                                   | % 0.03   | % 0.14                                                | % 0.16    | % |  |

Ratio represents a financial measure derived by methods other than Generally Accepted Accounting Principles ("GAAP"). See reconciliation of this non-GAAP financial measure to the most comparable GAAP measure under <sup>(1)</sup>the heading, "Supplemental Reporting of Non-GAAP Based Financial Measures" at the end of this "Overview and Outlook" section.

<sup>(2)</sup>Presented on an FTE basis, using a 35% federal tax rate and statutory interest expense disallowances. See also the "Net Interest Income" section of Management's Discussion.

Net income for the three and nine months ended September 30, 2016 increased \$7.2 million, or 21.1%, and \$8.5 million, or 7.7%, respectively, compared to the same periods in 2015. These increases were mainly due to higher net

interest income and non-interest income, excluding investment securities gains, partially offset by increases in the provision for credit losses, decreases in investment securities gains and increases in non-interest expenses, excluding the loss on redemption of trust preferred securities that occurred in the third quarter of 2015.

The following is a summary of financial highlights for the three and nine months ended September 30, 2016:

**FTE Net Interest Income and Net Interest Margin** - For the three and nine months ended September 30, 2016, FTE net interest income increased \$5.5 million, or 4.2%, and \$17.9 million, or 4.6%, respectively, in comparison to the same periods in 2015. These increases were driven by growth in interest-earning assets, partially offset by the impact of net interest margin compression.

Average interest-earning assets increased \$940.4 million, or 5.8%, in the third quarter of 2016 in comparison to the same period in 2015, mainly due to a \$842.4 million, or 6.3%, increase in average loans, a \$71.7 million, or 3.0%, increase in average investment securities and a \$24.5 million, or 5.1%, increase in average other interest-earning assets. Average interest-bearing liabilities increased \$571.7 million, or 5.1%, primarily due to a \$501.1 million, or 5.0%, increase in average interest-bearing deposits and a \$101.7 million, or 31.3%, increase in average short-term borrowings, partially offset by a \$31.0 million, or 3.1%, decrease in average FHLB advances and average long-term debt. Additional funding to support the increase in average interest-earning assets was provided by a \$323.5 million, or 8.3%, increase in average noninterest-bearing deposits.

During the first nine months of 2016, average interest-earning assets increased \$871.1 million, or 5.4%, compared to the same period in 2015, mainly due to a \$791.0 million, or 6.0%, increase in average loans and a \$140.7 million, or 6.1%, increase in average investment securities, partially offset by a \$57.4 million, or 12.4%, decrease in average other interest-earning assets. Average interest-bearing liabilities increased \$522.7 million, or 4.7%, the result of \$521.2 million, or 5.3%, increase in average interest-bearing deposits, and a \$87.1 million, or 25.8%, increase in average short-term borrowings, partially offset by a \$85.6 million, or 8.2%, decrease in average FHLB advances and average long-term debt. Additional funding to support the increase in average interest-earning assets was provided by a \$323.6 million, or 8.6%, increase in average noninterest-bearing deposits.

**Asset Quality** - The Corporation recorded a \$4.1 million provision for credit losses for the three months ended September 30, 2016, compared to a \$1.0 million provision for the same period in 2015. For the nine months ended September 30, 2016, the Corporation recorded an \$8.2 million provision for credit losses compared to a \$500,000 negative provision in the same period of 2015. The increase in provision for credit losses in 2016 was largely due to growth in the loan portfolio. In 2015, the negative provision was driven by an improvement in net charge-off levels, particularly among pooled impaired loans across all portfolio segments.

Overall asset quality improved for both the three and nine months ended September 30, 2016 as compared to the same periods of 2015 with the exception of annualized net charge-offs for the third quarter. Annualized net charge-offs to average loans outstanding were 0.11% for the third quarter of 2016, compared to 0.03% for the third quarter of 2015. Annualized net charge-offs to average loans outstanding were 0.14% for the first nine months of 2016, compared to 0.16% for the nine months of 2015. Non-performing assets decreased \$5.5 million, or 3.5%, as of September 30, 2016 compared to September 30, 2015 and were 0.80% and 0.87% of total assets as of September 30, 2016 and September 30, 2015, respectively. The total delinquency rate was 1.38% as of September 30, 2016, compared to 1.49% as of September 30, 2015.

**Non-interest Income** - For the three and nine months ended September 30, 2016, non-interest income, excluding investment securities gains, increased \$5.1 million, or 11.9%, and \$8.7 million, or 6.8%, respectively, in comparison to the same periods in 2015. The increase during the third quarter of 2016 was primarily the result of increases in commercial loan interest rate swap fees and an increase in mortgage banking income. The increase in year to date results was driven by higher commercial loan interest rate swap fees and an increase in service charges on deposit accounts, partially offset by a decrease in mortgage banking income. During 2016, \$3.0 million of impairment charges on MSRs were recorded as a reduction to mortgage banking income. See Note 6, "Mortgage Servicing Rights," in the Notes to Consolidated Financial Statements for additional details regarding the impairment charge.

Investment securities gains for the three and nine months ended September 30, 2016 were \$2,000 and \$1.0 million, respectively, as compared to \$1.7 million and \$8.3 million for the same periods in 2015.

Non-interest Expense - For the three months ended September 30, 2016, non-interest expense, excluding the on loss redemption of trust preferred securities incurred in the third quarter of 2015, increased \$585,000, or 0.5%, in comparison to the third quarter of 2015. For the three months ended September 30, 2016, all expense categories were lower with the exception of salaries and employee benefits, net occupancy expense and software.

For the nine months ended September 30, 2016, non-interest expense, excluding the loss on redemption of trust preferred securities incurred in the third quarter of 2015, increased \$5.8 million, or 1.6%, in comparison to the same period in 2015. Increases in salaries and employee benefits was the primary driver, partially offset by decreases in most other expense categories.



## 2016 Outlook

Originally the Corporation provided its outlook for 2016 results in its Annual Report on Form 10-K for the year ended December 31, 2015. The following outlook for 2016 remains unchanged:

- annual mid- to high- single digit growth rate in average loans and deposits;
- provision for credit losses driven primarily by loan growth;
- annual mid- to high- single digit growth rate in non-interest income, excluding the impact of securities gains;
- annual low- to mid- single digit growth rate in non-interest expense (excluding, for comparison purposes, the impact of the loss on redemption of Trust Preferred Securities (TruPS) incurred in the third quarter of 2015); and
- focus on utilizing capital to support growth and provide appropriate returns to shareholders.

The Corporation's original outlook expected net interest margin to be stable on an annual basis with modest quarterly volatility of plus or minus 0 to 3 basis points. This outlook was updated during the second quarter of 2016 as follows:

- absent further market interest rate increases, low-single digit quarterly compression in net interest margin.



## Supplemental Reporting of Non-GAAP Based Financial Measures

This Quarterly Report on Form 10-Q contains supplemental financial information, as detailed below, which has been derived by methods other than GAAP. The Corporation has presented these non-GAAP financial measures because it believes that these measures provide useful and comparative information to assess trends in the Corporation's results of operations. Presentation of these non-GAAP financial measures is consistent with how the Corporation evaluates its performance internally, and these non-GAAP financial measures are frequently used by securities analysts, investors and other interested parties in the evaluation of companies in the Corporation's industry. Management believes that these non-GAAP financial measures, in addition to GAAP measures, are also useful to investors to evaluate the Corporation's results. Investors should recognize that the Corporation's presentation of these non-GAAP financial measures might not be comparable to similarly-titled measures of other companies. These non-GAAP financial measures should not be considered a substitute for GAAP basis measures, and the Corporation strongly encourages a review of its consolidated financial statements in their entirety. Following are reconciliations of these non-GAAP financial measures to the most directly comparable GAAP measure as of and for the three and nine months ended September 30:

|                                                               | As of or for the<br>Three months ended<br>September 30 |             | As of or for the<br>Nine months ended<br>September 30 |             |   |
|---------------------------------------------------------------|--------------------------------------------------------|-------------|-------------------------------------------------------|-------------|---|
|                                                               | 2016                                                   | 2015        | 2016                                                  | 2015        |   |
|                                                               | (in thousands)                                         |             |                                                       |             |   |
| Return on average tangible equity                             |                                                        |             |                                                       |             |   |
| Net income                                                    | \$41,468                                               | \$34,251    | \$119,475                                             | \$110,967   |   |
| Plus: Intangible amortization, net of tax                     | —                                                      | 3           | —                                                     | 153         |   |
| Numerator                                                     | \$41,468                                               | \$34,254    | \$119,475                                             | \$111,120   |   |
| Average common shareholders' equity                           | \$2,120,596                                            | \$2,022,829 | \$2,089,882                                           | \$2,023,552 |   |
| Less: Average goodwill and intangible assets                  | (531,556 )                                             | (531,564 )  | (531,556 )                                            | (531,638 )  |   |
| Average tangible shareholders' equity (denominator)           | \$1,589,040                                            | \$1,491,265 | \$1,558,326                                           | \$1,491,914 |   |
| Return on average tangible equity, annualized                 | 10.38                                                  | % 9.11      | % 10.24                                               | % 9.96      | % |
| Efficiency ratio                                              |                                                        |             |                                                       |             |   |
| Non-interest expense                                          | \$119,848                                              | \$124,889   | \$361,898                                             | \$361,721   |   |
| Less: Intangible amortization                                 | —                                                      | (5 )        | —                                                     | (241 )      |   |
| Less: Loss on redemption of trust preferred securities        | —                                                      | (5,626 )    | —                                                     | (5,626 )    |   |
| Numerator                                                     | \$119,848                                              | \$119,258   | \$361,898                                             | \$355,854   |   |
| Net interest income (fully taxable equivalent) <sup>(1)</sup> | \$135,784                                              | \$130,250   | \$403,700                                             | \$385,781   |   |
| Plus: Total Non-interest income                               | 48,149                                                 | 44,774      | 137,423                                               | 136,000     |   |
| Less: Investment securities gains, net                        | (2 )                                                   | (1,730 )    | (1,025 )                                              | (8,290 )    |   |
| Denominator                                                   | \$183,931                                              | \$173,294   | \$540,098                                             | \$513,491   |   |
| Efficiency ratio                                              | 65.16                                                  | % 68.82     | % 67.01                                               | % 69.30     | % |

<sup>(1)</sup> Presented on an FTE basis, using a 35% federal tax rate and statutory interest expense disallowances. See also the "Net Interest Income" section of Management's Discussion.



Quarter Ended September 30, 2016 compared to the Quarter Ended September 30, 2015

### Net Interest Income

FTE net interest income increased \$5.5 million, to \$135.8 million, in the third quarter of 2016, from \$130.3 million in the third quarter of 2015. The increase was due to a \$940.4 million, or 5.8%, increase in interest-earning assets. The net interest margin declined 4 basis points, to 3.14%, for the third quarter of 2016 compared to 3.18% for the third quarter of 2015. The following table provides a comparative average balance sheet and net interest income analysis for those periods. Interest income and yields are presented on an FTE basis, using a 35% federal tax rate and statutory interest expense disallowances. The discussion following this table is based on these FTE amounts.

|                                                    | Three months ended September 30 |                 |                |                    |                 |                |
|----------------------------------------------------|---------------------------------|-----------------|----------------|--------------------|-----------------|----------------|
|                                                    | 2016                            |                 |                | 2015               |                 |                |
|                                                    | Average<br>Balance              | Interest<br>(1) | Yield/<br>Rate | Average<br>Balance | Interest<br>(1) | Yield/<br>Rate |
| (dollars in thousands)                             |                                 |                 |                |                    |                 |                |
| <b>ASSETS</b>                                      |                                 |                 |                |                    |                 |                |
| Interest-earning assets:                           |                                 |                 |                |                    |                 |                |
| Loans, net of unearned income <sup>(2)</sup>       | \$14,212,250                    | \$140,434       | 3.93%          | \$13,369,874       | \$135,268       | 4.02%          |
| Taxable investment securities <sup>(3)</sup>       | 2,110,084                       | 10,872          | 2.06           | 2,148,403          | 11,252          | 2.09           |
| Tax-exempt investment securities <sup>(3)</sup>    | 344,231                         | 3,923           | 4.56           | 230,178            | 2,929           | 5.09           |
| Equity securities <sup>(3)</sup>                   | 14,209                          | 196             | 5.50           | 18,280             | 257             | 5.58           |
| Total investment securities                        | 2,468,524                       | 14,991          | 2.43           | 2,396,861          | 14,438          | 2.41           |
| Loans held for sale                                | 22,593                          | 210             | 3.72           | 20,704             | 194             | 3.74           |
| Other interest-earning assets                      | 501,666                         | 1,051           | 0.84           | 477,145            | 884             | 0.74           |
| Total interest-earning assets                      | 17,205,033                      | 156,686         | 3.63%          | 16,264,584         | 150,784         | 3.68%          |
| Noninterest-earning assets:                        |                                 |                 |                |                    |                 |                |
| Cash and due from banks                            | 101,927                         |                 |                | 104,622            |                 |                |
| Premises and equipment                             | 227,906                         |                 |                | 226,446            |                 |                |
| Other assets                                       | 1,219,844                       |                 |                | 1,097,600          |                 |                |
| Less: Allowance for loan losses                    | (163,074)                       |                 |                | (168,770)          |                 |                |
| Total Assets                                       | \$18,591,636                    |                 |                | \$17,524,482       |                 |                |
| <b>LIABILITIES AND EQUITY</b>                      |                                 |                 |                |                    |                 |                |
| Interest-bearing liabilities:                      |                                 |                 |                |                    |                 |                |
| Demand deposits                                    | \$3,602,448                     | \$1,706         | 0.19%          | \$3,316,532        | \$1,122         | 0.13%          |
| Savings deposits                                   | 4,078,942                       | 2,042           | 0.20           | 3,714,282          | 1,436           | 0.15           |
| Time deposits                                      | 2,814,258                       | 7,562           | 1.07           | 2,963,774          | 7,659           | 1.03           |
| Total interest-bearing deposits                    | 10,495,648                      | 11,310          | 0.43           | 9,994,588          | 10,217          | 0.41           |
| Short-term borrowings                              | 426,369                         | 254             | 0.23           | 324,685            | 92              | 0.11           |
| Federal Home Loan Bank advances and long-term debt | 965,228                         | 9,338           | 3.86           | 996,247            | 10,225          | 4.09           |
| Total interest-bearing liabilities                 | 11,887,245                      | 20,902          | 0.70%          | 11,315,520         | 20,534          | 0.72%          |
| Noninterest-bearing liabilities:                   |                                 |                 |                |                    |                 |                |
| Demand deposits                                    | 4,227,639                       |                 |                | 3,904,176          |                 |                |
| Other                                              | 356,156                         |                 |                | 281,957            |                 |                |
| Total Liabilities                                  | 16,471,040                      |                 |                | 15,501,653         |                 |                |
| Shareholders' equity                               | 2,120,596                       |                 |                | 2,022,829          |                 |                |
| Total Liabilities and Shareholders' Equity         | \$18,591,636                    |                 |                | \$17,524,482       |                 |                |
| Net interest income/net interest margin (FTE)      |                                 | 135,784         | 3.14%          |                    | 130,250         | 3.18%          |
| Tax equivalent adjustment                          |                                 | (5,219)         |                |                    | (4,556)         |                |
| Net interest income                                |                                 | \$130,565       |                |                    | \$125,694       |                |

- (1) Includes dividends earned on equity securities.
- (2) Includes non-performing loans.
- (3) Balances include amortized historical cost for available for sale securities; the related unrealized holding gains (losses) are included in other assets.

The following table summarizes the changes in FTE interest income and interest expense resulting from changes in average balances (volume) and changes in rates for the three months ended September 30:

|                                                    | 2016 vs. 2015                        |           |         |
|----------------------------------------------------|--------------------------------------|-----------|---------|
|                                                    | Increase (Decrease) due to change in |           |         |
|                                                    | Volume                               | Rate      | Net     |
|                                                    | (in thousands)                       |           |         |
| Interest income on:                                |                                      |           |         |
| Loans, net of unearned income                      | \$8,275                              | \$(3,109) | \$5,166 |
| Taxable investment securities                      | (210 )                               | (170 )    | (380 )  |
| Tax-exempt investment securities                   | 1,328                                | (334 )    | 994     |
| Equity securities                                  | (57 )                                | (4 )      | (61 )   |
| Loans held for sale                                | 17                                   | (1 )      | 16      |
| Other interest-earning assets                      | 46                                   | 121       | 167     |
| Total interest income                              | \$9,399                              | \$(3,497) | \$5,902 |
| Interest expense on:                               |                                      |           |         |
| Demand deposits                                    | \$92                                 | \$492     | \$584   |
| Savings deposits                                   | 137                                  | 469       | 606     |
| Time deposits                                      | (392 )                               | 295       | (97 )   |
| Short-term borrowings                              | 36                                   | 126       | 162     |
| Federal Home Loan Bank advances and long-term debt | (316 )                               | (571 )    | (887 )  |
| Total interest expense                             | \$(443 )                             | \$811     | \$368   |

Note: Changes which are partially attributable to both volume and rate are allocated to the volume and rate components presented above based on the percentage of direct changes that are attributable to each component. As summarized above, the increase in average interest-earning assets, primarily loans, resulted in an \$9.4 million increase in FTE interest income. This was partially offset by the impact of a 5 basis point, or 1.4%, decrease in yields on average interest-earning assets, which resulted in a \$3.5 million decrease in FTE interest income. Average loans and average FTE yields, by type, are summarized in the following table:

|                                                     | Three months ended September 30 |       |              |       | Increase (Decrease) in Balance |        |
|-----------------------------------------------------|---------------------------------|-------|--------------|-------|--------------------------------|--------|
|                                                     | 2016 Balance                    | Yield | 2015 Balance | Yield | \$                             | %      |
|                                                     | (dollars in thousands)          |       |              |       |                                |        |
| Real estate – commercial mortgage                   | \$5,670,888                     | 3.99% | \$5,242,021  | 4.09% | \$428,867                      | 8.2 %  |
| Commercial – industrial, financial and agricultural | 4,066,275                       | 3.76  | 3,887,161    | 3.78  | 179,114                        | 4.6    |
| Real estate – home equity                           | 1,640,913                       | 4.08  | 1,692,860    | 4.08  | (51,947 )                      | (3.1 ) |
| Real estate – residential mortgage                  | 1,503,209                       | 3.76  | 1,381,141    | 3.78  | 122,068                        | 8.8    |
| Real estate – construction                          | 837,920                         | 3.76  | 753,584      | 3.88  | 84,336                         | 11.2   |
| Consumer                                            | 281,517                         | 5.31  | 270,391      | 5.81  | 11,126                         | 4.1    |
| Leasing, other and overdrafts                       | 211,528                         | 4.74  | 142,716      | 6.79  | 68,812                         | 48.2   |
| Total                                               | \$14,212,250                    | 3.93% | \$13,369,874 | 4.02% | \$842,376                      | 6.3 %  |

Average loans increased \$842.4 million, or 6.3%, compared to the third quarter of 2015. The increase was driven largely by growth in the commercial mortgage and residential mortgage portfolios as well as the commercial loan, construction and leasing portfolios. The \$428.9 million, or 8.2%, increase in commercial mortgages occurred in both owner-occupied and investment property types and was primarily in the Pennsylvania and New Jersey markets. The \$122.1 million, or 8.8%, increase in the residential mortgages was primarily the result of a strategic decision to retain certain mortgage loans. The average yield on loans decreased 9 basis points, or 2.2%, to 3.93% in 2016 from 4.02% in 2015. The decrease in average yields on loans was attributable to repayments of higher-yielding loans, continued refinancing activity at lower rates, and new loan production at rates lower than the overall portfolio yield.





Average total interest-bearing liabilities increased \$571.7 million, or 5.1%, compared to the third quarter of 2015. Interest expense increased \$368,000, or 1.8%, to \$20.9 million in the third quarter of 2016 primarily as a result of an increase in rates, largely a result of the Federal Reserve Board's decision to raise the target range for the federal funds rate by 25 basis points in December 2015. Average deposits and average interest rates, by type, are summarized in the following table:

|                            | Three months ended September 30 |        |              |        | Increase<br>(Decrease) in<br>Balance |       |
|----------------------------|---------------------------------|--------|--------------|--------|--------------------------------------|-------|
|                            | 2016                            |        | 2015         |        | \$                                   | %     |
|                            | Balance                         | Rate   | Balance      | Rate   |                                      |       |
|                            | (dollars in thousands)          |        |              |        |                                      |       |
| Noninterest-bearing demand | \$4,227,639                     | — %    | \$3,904,176  | — %    | \$323,463                            | 8.3 % |
| Interest-bearing demand    | 3,602,448                       | 0.19   | 3,316,532    | 0.13   | 285,916                              | 8.6   |
| Savings                    | 4,078,942                       | 0.20   | 3,714,282    | 0.15   | 364,660                              | 9.8   |
| Total demand and savings   | 11,909,029                      | 0.13   | 10,934,990   | 0.09   | 974,039                              | 8.9   |
| Time deposits              | 2,814,258                       | 1.07   | 2,963,774    | 1.03   | (149,516 )                           | (5.0) |
| Total deposits             | \$14,723,287                    | 0.31 % | \$13,898,764 | 0.29 % | \$824,523                            | 5.9 % |

The \$974.0 million, or 8.9%, increase in total demand and savings accounts was primarily due to a \$516.3 million, or 10.4%, increase in personal account balances, a \$315.8 million, or 7.9%, increase in business account balances and a \$145.8 million, or 7.6%, increase in municipal account balances. The average cost of total deposits increased 2 basis points to 0.31% in the third quarter of 2016 compared to 0.29% in the third quarter of 2015.

Average borrowings and interest rates, by type, are summarized in the following table:

|                                         | Three months ended September 30 |        |             |        | Increase<br>(Decrease)<br>in Balance |        |
|-----------------------------------------|---------------------------------|--------|-------------|--------|--------------------------------------|--------|
|                                         | 2016                            |        | 2015        |        | \$                                   | %      |
|                                         | Balance                         | Rate   | Balance     | Rate   |                                      |        |
|                                         | (dollars in thousands)          |        |             |        |                                      |        |
| Short-term borrowings:                  |                                 |        |             |        |                                      |        |
| Customer repurchase agreements          | \$187,588                       | 0.10 % | \$149,415   | 0.10 % | \$38,173                             | 25.5 % |
| Customer short-term promissory notes    | 70,072                          | 0.04   | 79,308      | 0.02   | (9,236 )                             | (11.6) |
| Total short-term customer funding       | 257,660                         | 0.09   | 228,723     | 0.07   | 28,937                               | 12.7   |
| Federal funds purchased                 | 148,546                         | 0.47   | 85,092      | 0.19   | 63,454                               | 74.6   |
| Short-term FHLB advances <sup>(1)</sup> | 20,163                          | 0.41   | 10,870      | 0.34   | 9,293                                | 85.5   |
| Total short-term borrowings             | 426,369                         | 0.23   | 324,685     | 0.11   | 101,684                              | 31.3   |
| Long-term debt:                         |                                 |        |             |        |                                      |        |
| FHLB advances                           | 603,285                         | 3.17   | 618,010     | 3.49   | (14,725 )                            | (2.4 ) |
| Other long-term debt                    | 361,943                         | 5.01   | 378,237     | 5.06   | (16,294 )                            | (4.3 ) |
| Total long-term debt                    | 965,228                         | 3.86   | 996,247     | 4.09   | (31,019 )                            | (3.1 ) |
| Total borrowings                        | \$1,391,597                     | 2.75 % | \$1,320,932 | 3.11 % | \$70,665                             | 5.3 %  |

(1) Represents FHLB advances with an original maturity term of less than one year.

Total short-term borrowings increased \$101.7 million, or 31.3%, primarily as a result of increases in federal funds purchased.

Average long-term debt decreased \$31.0 million, or 3.1%, due to FHLB advance maturities and the restructuring of other long-term debt. In the third quarter of 2015, the Corporation executed two transactions to restructure its long-term FHLB advances. First, \$200 million of FHLB advances, with a weighted average rate of 4.45% and a

maturity date in the first quarter of 2017, were refinanced with new advances maturing from September 2019 to December 2020, at a weighted average rate of 2.95%. This transaction reduced interest expense on a quarterly basis by approximately \$750,000, beginning in the fourth quarter of 2015. Second, forward agreements were executed to refinance an additional \$200 million of FHLB advances when the advances mature in December 2016. These forward agreements have maturity dates from March 2021 to December 2021 and the refinancing will reduce the weighted average rate on these advances from 4.03% to 2.40% and decrease interest expense on a quarterly basis by approximately \$800,000, beginning in the first quarter of 2017.

## Provision for Credit Losses

The provision for credit losses was \$4.1 million for the third quarter of 2016, an increase of \$3.1 million from the third quarter of 2015, attributable to continued loan growth with overall credit metrics stable.

The provision for credit losses is recognized as an expense in the consolidated statements of income and is the amount necessary to adjust the allowance for credit losses to its appropriate balance, as determined through the Corporation's allowance methodology. The Corporation determines the appropriate level of the allowance for credit losses based on many quantitative and qualitative factors, including, but not limited to: the size and composition of the loan portfolio, changes in risk ratings, changes in collateral values, delinquency levels, historical losses and economic conditions. See the "Financial Condition" section of Management's Discussion under the heading "Provision for Credit Losses and Allowance for Credit Losses" for details related to the Corporation's allowance and provision for credit losses.

## Non-Interest Income

The following table presents the components of non-interest income:

|                                                   | Three months             |                          | Increase (Decrease) |        |
|---------------------------------------------------|--------------------------|--------------------------|---------------------|--------|
|                                                   | ended September 30, 2016 | ended September 30, 2015 | \$                  | %      |
|                                                   | (dollars in thousands)   |                          |                     |        |
| Service charges on deposit accounts:              |                          |                          |                     |        |
| Overdraft fees                                    | \$5,770                  | \$5,652                  | \$ 118              | 2.1 %  |
| Cash management fees                              | 3,605                    | 3,418                    | 187                 | 5.5    |
| Other                                             | 3,703                    | 3,912                    | (209)               | (5.3)  |
| Total service charges on deposit accounts         | 13,078                   | 12,982                   | 96                  | 0.7    |
| Investment management and trust services          | 11,425                   | 11,237                   | 188                 | 1.7    |
| Other service charges and fees:                   |                          |                          |                     |        |
| Commercial interest rate swap fees                | 4,359                    | 1,251                    | 3,108               | 248.4  |
| Merchant fees                                     | 4,220                    | 4,000                    | 220                 | 5.5    |
| Debit card income                                 | 2,718                    | 2,572                    | 146                 | 5.7    |
| Letter of credit fees                             | 1,078                    | 1,143                    | (65)                | (5.7)  |
| Other                                             | 2,032                    | 1,999                    | 33                  | 1.7    |
| Total other service charges and fees              | 14,407                   | 10,965                   | 3,442               | 31.4   |
| Mortgage banking income:                          |                          |                          |                     |        |
| Gains on sales of mortgage loans                  | 4,857                    | 2,627                    | 2,230               | 84.9   |
| MSR impairment charge                             | (1,280)                  | —                        | (1,280)             | N/M    |
| Mortgage servicing income                         | 952                      | 1,237                    | (285)               | (23.0) |
| Total mortgage banking income                     | 4,529                    | 3,864                    | 665                 | 17.2   |
| Credit card income                                | 2,668                    | 2,548                    | 120                 | 4.7    |
| Other income                                      | 2,040                    | 1,448                    | 592                 | 40.9   |
| Total, excluding investment securities gains, net | 48,147                   | 43,044                   | 5,103               | 11.9   |
| Investment securities gains, net                  | 2                        | 1,730                    | (1,728)             | (99.9) |
| Total                                             | \$48,149                 | \$44,774                 | \$ 3,375            | 7.5 %  |

Excluding investment securities gains, non-interest income increased \$5.1 million, or 11.9%. Other service charges and fees increased \$3.4 million, or 31.4%, driven mainly by a \$3.1 million increase in commercial loan interest rate swap fees, as borrowers executed such swaps to lock in fixed rates during the third quarter of 2016, and by a \$220,000 increase in merchant fee income resulting from higher transaction volumes in the third quarter of 2016.

Gains on sales of mortgage loans increased \$2.2 million, or 84.9%, compared to the same period in 2015, as both new loan volumes and pricing spreads increased. Mortgage servicing income recognized in the third quarter of 2016, decreased \$285,000, or 23.0%, compared to the third quarter of 2015. An \$1.3 million impairment charge on MSRs was recorded in the third quarter of 2016. See Note 6, "Mortgage Servicing Rights," in the Notes to Consolidated Financial Statements for additional details regarding the impairment charge.

Other income increased \$592,000, or 40.9%, due mainly to an increase in gains on the sale of loans guaranteed by the Small Business Administration.

Investment securities gains decreased \$1.7 million from the third quarter of 2015. See Note 4, "Investment Securities," in the Notes to Consolidated Financial Statements for additional details.

#### Non-Interest Expense

The following table presents the components of non-interest expense:

|                                                  | Three months ended     |           | Increase (Decrease) |         |
|--------------------------------------------------|------------------------|-----------|---------------------|---------|
|                                                  | September 30           |           | \$                  | %       |
|                                                  | 2016                   | 2015      |                     |         |
|                                                  | (dollars in thousands) |           |                     |         |
| Salaries and employee benefits                   | \$70,696               | \$65,308  | \$5,388             | 8.3 %   |
| Net occupancy expense                            | 11,782                 | 10,710    | 1,072               | 10.0    |
| Other outside services                           | 5,783                  | 7,373     | (1,590 )            | (21.6 ) |
| Data processing                                  | 4,610                  | 5,105     | (495 )              | (9.7 )  |
| Software                                         | 4,117                  | 3,984     | 133                 | 3.3     |
| Equipment expense                                | 3,137                  | 3,595     | (458 )              | (12.7 ) |
| Supplies and postage                             | 2,559                  | 2,708     | (149 )              | (5.5 )  |
| Professional fees                                | 2,535                  | 2,828     | (293 )              | (10.4 ) |
| FDIC insurance expense                           | 1,791                  | 2,867     | (1,076 )            | (37.5 ) |
| Marketing                                        | 1,774                  | 2,102     | (328 )              | (15.6 ) |
| Telecommunications                               | 1,411                  | 1,587     | (176 )              | (11.1 ) |
| Other real estate owned and repossession expense | 742                    | 1,016     | (274 )              | (27.0 ) |
| Operating risk loss                              | 556                    | 1,136     | (580 )              | (51.1 ) |
| Loss on redemption of trust preferred securities | —                      | 5,626     | (5,626 )            | (100.0) |
| Intangible amortization                          | —                      | 5         | (5 )                | (100.0) |
| Other                                            | 8,355                  | 8,939     | (584 )              | (6.5 )  |
| Total                                            | \$119,848              | \$124,889 | \$(5,041)           | (4.0 )% |

The \$5.4 million, or 8.3%, increase in salaries and employee benefits was primarily driven by a \$3.7 million, or 6.7%, increase in salaries, resulting from higher average salaries per full-time equivalent employee, normal merit increases and an increase in incentive compensation. Employee benefits expense increased \$1.7 million, or 17.0%, largely due to higher health care expenses.

Net occupancy expense increased \$1.1 million, or 10.0%, as a result of lower than normal expenses recognized in the third quarter of 2015. Outside services include fees paid to consultants and expenses for contracted or outsourced services. Consulting expenses can fluctuate based on the timing and need for such services. The \$1.6 million, or 21.6%, decrease in expense in comparison to the third quarter of 2015 was largely due to the timing of expenses related to the Corporation's BSA/AML compliance program remediation efforts and certain information technology and human resources initiatives.

Data processing expense decreased \$495,000, or 9.7%, due to renegotiated contracts. Equipment expense decreased \$458,000, or 12.7%, primarily due to lower depreciation expense when compared to the third quarter of 2015, as certain assets became fully depreciated. The \$293,000, or 10.4%, decrease in professional fees was driven by lower net legal expenses due to recoveries on settled non-performing loan accounts. FDIC insurance expense decreased \$1.1 million, or 37.5% as the assessment rates for banks with less than \$10 billion in assets decreased with Deposit Insurance Fund (DIF) exceeding 1.15% of the deposit base. Marketing expense decreased \$328,000, or 15.6%,

compared to the third quarter of 2015 due to the timing of various marketing promotions.

Other real estate owned and repossession expense decreased \$274,000, or 27.0%, when compared to the third quarter of 2015. This decrease was due to a \$147,000 decrease in net losses on the sales of other real estate properties. This expense category can experience fluctuations from period to period based on the timing of sales of properties and payments of expenses, such as real estate taxes.

The \$580,000, or 51.1%, decrease in operating risk loss was due to a \$426,000 decrease in debit card fraud and \$289,000 decrease in losses associated with previously sold mortgages, partially offset by increases in wire transfer fraud and other categories.

In July 2015, the Corporation redeemed \$150.0 million of TruPS. In connection with this redemption, a loss of \$5.6 million was recognized as a component of non-interest expense.

#### Income Taxes

Income tax expense for the third quarter of 2016 was \$13.3 million, a \$2.9 million, or 28.4%, increase from \$10.3 million for the third quarter of 2015.

The Corporation's effective tax rate was 24.2% in the third quarter of 2016, as compared to 23.2% in the third quarter of 2015. The effective tax rate is generally lower than the federal statutory rate of 35% due to tax-exempt interest income earned on loans, investments in tax-free municipal securities and credits earned from investments in partnerships that generate tax credits under various federal programs (Tax Credit Investments). The increase in the effective rate from the third quarter of 2015 was driven by higher income before income taxes and higher state income taxes, partially offset by an increase in net credits on Tax Credit Investments.

Nine Months Ended September 30, 2016 compared to the Nine Months Ended September 30, 2015

### Net Interest Income

FTE net interest income increased \$17.9 million, or 4.6%, to \$403.7 million in the first nine months of 2016 from \$385.8 million in the same period of 2015. Net interest margin decreased 3 basis points to 3.19% for the first nine months of 2016 from 3.22% for the same period of 2015. The increase in FTE net interest income was mainly due to an \$871.1 million, or 5.4%, increase in interest earning assets. The following table provides a comparative average balance sheet and net interest income analysis for those periods. Interest income and yields are presented on an FTE basis, using a 35% federal tax rate and statutory interest expense disallowances. The discussion following this table is based on these FTE amounts.

|                                                 | Nine months ended September 30 |                 |                |                    |                 |                |
|-------------------------------------------------|--------------------------------|-----------------|----------------|--------------------|-----------------|----------------|
|                                                 | 2016                           |                 |                | 2015               |                 |                |
|                                                 | Average<br>Balance             | Interest<br>(1) | Yield/<br>Rate | Average<br>Balance | Interest<br>(1) | Yield/<br>Rate |
| (dollars in thousands)                          |                                |                 |                |                    |                 |                |
| <b>ASSETS</b>                                   |                                |                 |                |                    |                 |                |
| Interest-earning assets:                        |                                |                 |                |                    |                 |                |
| Loans, net of unearned income <sup>(2)</sup>    | \$14,011,301                   | \$416,646       | 3.97%          | \$13,220,339       | \$401,662       | 4.06%          |
| Taxable investment securities <sup>(3)</sup>    | 2,139,378                      | 34,034          | 2.12           | 2,068,025          | 33,478          | 2.16           |
| Tax-exempt investment securities <sup>(3)</sup> | 306,298                        | 10,631          | 4.63           | 225,209            | 9,035           | 5.35           |
| Equity securities <sup>(3)</sup>                | 14,272                         | 599             | 5.60           | 25,985             | 1,086           | 5.59           |
| Total investment securities                     | 2,459,948                      | 45,264          | 2.45           | 2,319,219          | 43,599          | 2.51           |
| Loans held for sale                             | 18,114                         | 529             | 3.90           | 21,360             | 632             | 3.94           |
| Other interest-earning assets                   | 406,163                        | 2,813           | 0.92           | 463,545            | 3,922           | 1.13           |
| Total interest-earning assets                   | 16,895,526                     | 465,252         | 3.68%          | 16,024,463         | 449,815         | 3.75%          |
| Noninterest-earning assets:                     |                                |                 |                |                    |                 |                |
| Cash and due from banks                         | 100,417                        |                 |                | 104,870            |                 |                |
| Premises and equipment                          | 227,237                        |                 |                | 226,469            |                 |                |
| Other assets                                    | 1,182,260                      |                 |                | 1,101,856          |                 |                |
| Less: Allowance for loan losses                 | (164,999 )                     |                 |                | (176,205 )         |                 |                |
| Total Assets                                    | \$18,240,441                   |                 |                | \$17,281,453       |                 |                |
| <b>LIABILITIES AND EQUITY</b>                   |                                |                 |                |                    |                 |                |
| Interest-bearing liabilities:                   |                                |                 |                |                    |                 |                |
| Demand deposits                                 | \$3,498,659                    | \$4,727         | 0.18%          | \$3,202,380        | \$3,092         | 0.13%          |
| Savings deposits                                | 4,000,871                      | 5,732           | 0.19           | 3,600,695          | 3,802           | 0.14           |
| Time deposits                                   | 2,842,011                      | 22,465          | 1.06           | 3,017,271          | 23,199          | 1.03           |
| Total interest-bearing deposits                 | 10,341,541                     | 32,924          | 0.43           | 9,820,346          | 30,093          | 0.41           |
| Short-term borrowings                           | 425,151                        | 739             | 0.23           | 338,019            | 272             | 0.11           |
| FHLB advances and long-term debt                | 962,997                        | 27,889          | 3.86           | 1,048,634          | 33,669          | 4.29           |
| Total interest-bearing liabilities              | 11,729,689                     | 61,552          | 0.70%          | 11,206,999         | 64,034          | 0.76%          |
| Noninterest-bearing liabilities:                |                                |                 |                |                    |                 |                |
| Demand deposits                                 | 4,091,555                      |                 |                | 3,767,919          |                 |                |
| Other                                           | 329,315                        |                 |                | 282,983            |                 |                |
| Total Liabilities                               | 16,150,559                     |                 |                | 15,257,901         |                 |                |
| Shareholders' equity                            | 2,089,882                      |                 |                | 2,023,552          |                 |                |
| Total Liabilities and Shareholders' Equity      | \$18,240,441                   |                 |                | \$17,281,453       |                 |                |
| Net interest income/net interest margin (FTE)   |                                | 403,700         | 3.19%          |                    | 385,781         | 3.22%          |
| Tax equivalent adjustment                       |                                | (15,165 )       |                |                    | (13,586 )       |                |



|                     |           |           |
|---------------------|-----------|-----------|
| Net interest income | \$388,535 | \$372,195 |
|---------------------|-----------|-----------|

(1) Includes dividends earned on equity securities.

(2) Includes non-performing loans.

(3) Balances include amortized historical cost for available for sale securities; the related unrealized holding gains (losses) are included in other assets.

The following table summarizes the changes in FTE interest income and expense for the first nine months of 2016 as compared to the same period in 2015 due to changes in average balances (volume) and changes in rates:

|                                  | 2016 vs. 2015                        |            |           |
|----------------------------------|--------------------------------------|------------|-----------|
|                                  | Increase (Decrease) due to change in |            |           |
|                                  | Volume                               | Rate       | Net       |
|                                  | (in thousands)                       |            |           |
| Interest income on:              |                                      |            |           |
| Loans, net of unearned income    | \$23,932                             | \$(8,948 ) | \$14,984  |
| Taxable investment securities    | 1,168                                | (612 )     | 556       |
| Tax-exempt investment securities | 2,929                                | (1,333 )   | 1,596     |
| Equity securities                | (489 )                               | 2          | (487 )    |
| Loans held for sale              | (97 )                                | (6 )       | (103 )    |
| Other interest-earning assets    | (443 )                               | (666 )     | (1,109 )  |
| Total interest income            | \$27,000                             | \$(11,563) | \$15,437  |
| Interest expense on:             |                                      |            |           |
| Demand deposits                  | \$310                                | \$1,325    | \$1,635   |
| Savings deposits                 | 469                                  | 1,461      | 1,930     |
| Time deposits                    | (1,419 )                             | 685        | (734 )    |
| Short-term borrowings            | 86                                   | 381        | 467       |
| FHLB advances and long-term debt | (2,587 )                             | (3,193 )   | (5,780 )  |
| Total interest expense           | \$(3,141)                            | \$659      | \$(2,482) |

Note: Changes which are partially attributable to both volume and rate are allocated to the volume and rate components presented above based on the percentage of direct changes that are attributable to each component. As summarized above, the increase in FTE interest income was the result of an increase in average interest-earning assets, primarily loans, which resulted in a \$27.0 million increase in FTE interest income, partially offset by an \$11.6 million decrease due to lower yields on average interest-earning assets. Average loans, by type, are summarized in the following table:

|                                                     | Nine months ended September 30 |        |              |        | Increase (Decrease) in Balance |        |
|-----------------------------------------------------|--------------------------------|--------|--------------|--------|--------------------------------|--------|
|                                                     | 2016 Balance                   | Yield  | 2015 Balance | Yield  | \$                             | %      |
|                                                     | (dollars in thousands)         |        |              |        |                                |        |
| Real estate – commercial mortgage                   | \$5,572,356                    | 4.01 % | \$5,205,755  | 4.15 % | \$366,601                      | 7.0 %  |
| Commercial – industrial, financial and agricultural | 4,080,638                      | 3.79   | 3,831,678    | 3.81   | 248,960                        | 6.5    |
| Real estate – home equity                           | 1,656,969                      | 4.09   | 1,703,006    | 4.11   | (46,037 )                      | (2.7 ) |
| Real estate – residential mortgage                  | 1,428,430                      | 3.77   | 1,369,367    | 3.81   | 59,063                         | 4.3    |
| Real estate – construction                          | 817,014                        | 3.80   | 713,893      | 3.93   | 103,121                        | 14.4   |
| Consumer                                            | 272,402                        | 5.40   | 265,002      | 5.52   | 7,400                          | 2.8    |
| Leasing, other and overdrafts                       | 183,492                        | 6.01   | 131,638      | 7.33   | 51,854                         | 39.4   |
| Total                                               | \$14,011,301                   | 3.97 % | \$13,220,339 | 4.06 % | \$790,962                      | 6.0 %  |

Average loans increased \$791.0 million, or 6.0%, which contributed \$23.9 million to the increase in FTE interest income. The average yield on loans decreased 9 basis points, or 2.2%, to 3.97% in 2016 from 4.06% in 2015. The increase in average loans was driven largely by growth in the commercial mortgage and residential mortgage portfolios as well as the commercial loan, construction and leasing portfolios. The commercial mortgage growth was realized in all geographical markets. The decrease in average yields on loans was attributable to repayments of higher-yielding loans, continued refinancing activity at lower rates, and new loan production at rates lower than the

overall portfolio yield.

51

---

Average investment securities increased \$140.7 million, or 6.1%. The yield on average investments decreased 6 basis points, or 2.4%, to 2.45% in 2016 from 2.51% in 2015. The increase in average investment securities was partially offset by a \$57.4 million, or 12.4%, decrease in other interest-earning assets.

Interest expense decreased \$2.5 million, or 3.9%, to \$61.6 million in the first nine months of 2016 from \$64.0 million in the first nine months of 2015. Although total average interest-bearing liabilities increased \$522.7 million, or 4.7%, compared to the first nine months of 2015, the funding mix became more concentrated in lower-cost deposits and short-term borrowings. This shift and the impact of FHLB Advance refinancing activity and the impact of the redemption of TruPs funded with lower-cost subordinated debt resulted in a decrease in interest expense.

Average deposits, by type, are summarized in the following table:

|                            | Nine months ended September 30 |        |              |        | Increase<br>(Decrease) in<br>Balance |        |
|----------------------------|--------------------------------|--------|--------------|--------|--------------------------------------|--------|
|                            | 2016                           |        | 2015         |        | \$                                   | %      |
|                            | Balance                        | Rate   | Balance      | Rate   |                                      |        |
|                            | (dollars in thousands)         |        |              |        |                                      |        |
| Noninterest-bearing demand | \$4,091,555                    | — %    | \$3,767,919  | — %    | \$323,636                            | 8.6 %  |
| Interest-bearing demand    | 3,498,659                      | 0.18   | 3,202,380    | 0.13   | 296,279                              | 9.3    |
| Savings                    | 4,000,871                      | 0.19   | 3,600,695    | 0.14   | 400,176                              | 11.1   |
| Total demand and savings   | 11,591,085                     | 0.12   | 10,570,994   | 0.09   | 1,020,091                            | 9.6    |
| Time deposits              | 2,842,011                      | 1.06   | 3,017,271    | 1.03   | (175,260 )                           | (5.8 ) |
| Total deposits             | \$14,433,096                   | 0.30 % | \$13,588,265 | 0.30 % | \$844,831                            | 6.2 %  |

The \$1.0 billion, or 9.6%, increase in total demand and savings account balances was primarily due to a \$495.1 million, or 10.1%, increase in personal account balances, a \$361.7 million, or 9.4%, increase in business account balances and a \$166.1 million, or 9.3%, increase in municipal account balances. While the cost of both demand and savings deposits and time deposits increased, the shift to a higher concentration of lower-cost demand and savings deposits resulted in a total cost of interest-bearing deposits of 0.30% for both the first nine months of 2016 and 2015. The following table summarizes changes in average short-term borrowings and long-term debt, by type:

|                                         | Nine months ended September 30 |        |             |        | Increase<br>(Decrease)<br>in Balance |         |
|-----------------------------------------|--------------------------------|--------|-------------|--------|--------------------------------------|---------|
|                                         | 2016                           |        | 2015        |        | \$                                   | %       |
|                                         | Balance                        | Rate   | Balance     | Rate   |                                      |         |
|                                         | (dollars in thousands)         |        |             |        |                                      |         |
| Short-term borrowings:                  |                                |        |             |        |                                      |         |
| Customer repurchase agreements          | \$179,892                      | 0.11 % | \$167,526   | 0.10 % | \$12,366                             | 7.4 %   |
| Customer short-term promissory notes    | 73,859                         | 0.04   | 81,854      | 0.02   | (7,995 )                             | (9.8 )  |
| Total short-term customer funding       | 253,751                        | 0.09   | 249,380     | 0.07   | 4,371                                | 1.8     |
| Federal funds purchased                 | 156,812                        | 0.44   | 72,961      | 0.17   | 83,851                               | 114.9   |
| Short-term FHLB advances <sup>(1)</sup> | 14,588                         | 0.43   | 15,678      | 0.31   | (1,090 )                             | (7.0 )  |
| Total short-term borrowings             | 425,151                        | 0.23   | 338,019     | 0.11   | 87,132                               | 25.8    |
| Long-term debt:                         |                                |        |             |        |                                      |         |
| FHLB advances                           | 601,120                        | 3.18   | 634,403     | 3.50   | (33,283 )                            | (5.2 )  |
| Other long-term debt                    | 361,877                        | 5.00   | 414,231     | 5.50   | (52,354 )                            | (12.6 ) |
| Total long-term debt                    | 962,997                        | 3.86   | 1,048,634   | 4.29   | (85,637 )                            | (8.2 )  |
| Total borrowings                        | \$1,388,148                    | 2.75 % | \$1,386,653 | 3.27 % | \$1,495                              | 0.1 %   |

(1) Represents FHLB advances with an original maturity term of less than one year.

Average total borrowings increased \$1.5 million during the first nine months of 2016 in comparison to the same period of 2015. The cost of borrowings, however, decreased 52 basis points, or 15.9%, as a result of lower-cost, short-term borrowings comprising a larger percentage of total borrowings.

Total long-term debt decreased \$85.6 million, or 8.2%, as the result of maturing FHLB advances and the maturity of \$100.0 million of subordinated debt in April 2015. In addition, in June 2015, the Corporation issued \$150 million of subordinated debt at an

52

---

effective rate of 4.69%. The proceeds of this issuance were used to redeem \$150 million of trust preferred securities, with an effective rate of 6.52%, in July 2015.

In the third quarter of 2015, the Corporation executed two transactions to restructure its long-term FHLB advances. First, \$200 million of FHLB advances, with a weighted average rate of 4.45% and a maturity date in the first quarter of 2017, were refinanced with new advances maturing from September 2019 to December 2020, at a weighted average rate of 2.95%. This transaction reduced interest expense on a quarterly basis by approximately \$750,000, beginning in the fourth quarter of 2015. Second, forward agreements were executed to refinance an additional \$200 million of FHLB advances when the advances mature in December 2016. These forward agreements have maturity dates from March 2021 to December 2021 and the refinancing will reduce the weighted average rate on these advances from 4.03% to 2.40% and decrease interest expense on a quarterly basis by approximately \$800,000, beginning in the first quarter of 2017.

#### Provision for Credit Losses

The provision for credit losses was \$8.2 million for the first nine months of 2016, an increase of \$8.7 million in comparison to the first nine months of 2015. In the first nine months of 2015, a negative provision of \$500,000 was recorded, primarily due to an improvement in net charge-off levels, particularly among pooled impaired loans. For details related to the Corporation's allowance and provision for credit losses, see the "Financial Condition" section of Management's Discussion under the heading "Provision for Credit Losses and Allowance for Credit Losses."

#### Non-Interest Income

The following table presents the components of non-interest income:

|                                                   | Nine months ended      |              | Increase   |         |
|---------------------------------------------------|------------------------|--------------|------------|---------|
|                                                   | September 30           | September 30 | (Decrease) |         |
|                                                   | 2016                   | 2015         | \$         | %       |
|                                                   | (dollars in thousands) |              |            |         |
| Service charges on deposit accounts:              |                        |              |            |         |
| Overdraft fees                                    | \$16,426               | \$15,806     | \$620      | 3.9 %   |
| Cash management fees                              | 10,651                 | 10,004       | 647        | 6.5     |
| Other                                             | 11,455                 | 11,378       | 77         | 0.7     |
| Total service charges on deposit accounts         | 38,532                 | 37,188       | 1,344      | 3.6     |
| Investment management and trust services          | 33,660                 | 33,137       | 523        | 1.6     |
| Other service charges and fees:                   |                        |              |            |         |
| Merchant fees                                     | 12,155                 | 11,265       | 890        | 7.9     |
| Debit card income                                 | 7,948                  | 7,587        | 361        | 4.8     |
| Commercial swap fees                              | 8,552                  | 3,088        | 5,464      | 176.9   |
| Letter of credit fees                             | 3,385                  | 3,474        | (89 )      | (2.6 )  |
| Other                                             | 6,100                  | 5,902        | 198        | 3.4     |
| Total other service charges and fees              | 38,140                 | 31,316       | 6,824      | 21.8    |
| Mortgage banking income:                          |                        |              |            |         |
| Gains on sales of mortgage loans                  | 11,967                 | 10,588       | 1,379      | 13.0    |
| MSR impairment charge                             | (3,001 )               | —            | (3,001 )   | N/M     |
| Mortgage servicing income                         | 3,490                  | 3,303        | 187        | 5.7     |
| Total mortgage banking income                     | 12,456                 | 13,891       | (1,435 )   | (10.3 ) |
| Credit card income                                | 7,688                  | 7,257        | 431        | 5.9     |
| Other income                                      | 5,922                  | 4,921        | 1,001      | 20.3    |
| Total, excluding investment securities gains, net | 136,398                | 127,710      | 8,688      | 6.8     |

Edgar Filing: FULTON FINANCIAL CORP - Form 10-Q

|                                  |           |           |          |         |
|----------------------------------|-----------|-----------|----------|---------|
| Investment securities gains, net | 1,025     | 8,290     | (7,265 ) | (87.6 ) |
| Total                            | \$137,423 | \$136,000 | \$1,423  | 1.0 %   |

The \$620,000, or 3.9%, increase in overdraft fee income during the nine months ended September 30, 2016 in comparison to the same period in 2015 consisted of a \$385,000 increase in fees assessed on personal accounts and a \$235,000 increase in fees assessed

on commercial accounts, due to higher volumes. Cash management fees increased \$647,000, or 6.5%, compared to 2015 due to higher transaction volumes and fee increases in 2016.

The \$890,000, or 7.9%, increase in merchant fee income and the \$361,000, or 4.8%, increase in debit card income were due to an increase in the volumes of transactions in comparison to 2015. The \$5.5 million increase in commercial loan interest rate swap fees was due to growth in commercial loans and the attractiveness of interest rate swaps in the current rate environment.

Gains on sales of mortgage loans increased \$1.4 million, or 13.0%, due to a 23.3% increase in pricing spreads compared to the prior year, partially offset by a \$68.1 million, or 8.3%, decrease in new loan volumes. Mortgage servicing income increased \$187,000, or 5.7%. A \$3.0 million impairment charges on MSRs was recognized in the first nine months of 2016. See Note 6, "Mortgage Servicing Rights," in the Notes to Consolidated Financial Statements for additional details regarding the impairment charge.

Gains on sales of investment securities decreased \$7.3 million compared to the first nine months of 2015. See Note 4, "Investment Securities," in the Notes to Consolidated Financial Statements for additional details.

#### Non-Interest Expense

The following table presents the components of non-interest expense:

|                                                  | Nine months ended      |           | Increase (Decrease) |         |   |
|--------------------------------------------------|------------------------|-----------|---------------------|---------|---|
|                                                  | September 30           |           |                     |         |   |
|                                                  | 2016                   | 2015      | \$                  | %       |   |
|                                                  | (dollars in thousands) |           |                     |         |   |
| Salaries and employee benefits                   | \$210,097              | \$195,365 | \$14,732            | 7.5     | % |
| Net occupancy expense                            | 35,813                 | 36,211    | (398)               | (1.1)   | ) |
| Other outside services                           | 17,347                 | 21,248    | (3,901)             | (18.4)  | ) |
| Data processing                                  | 15,486                 | 14,767    | 719                 | 4.9     |   |
| Software                                         | 11,991                 | 10,678    | 1,313               | 12.3    |   |
| Equipment expense                                | 9,380                  | 10,888    | (1,508)             | (13.9)  | ) |
| Professional fees                                | 8,221                  | 8,430     | (209)               | (2.5)   | ) |
| Supplies and postage                             | 7,844                  | 7,803     | 41                  | 0.5     |   |
| FDIC insurance expense                           | 7,700                  | 8,574     | (874)               | (10.2)  | ) |
| Marketing                                        | 5,314                  | 5,570     | (256)               | (4.6)   | ) |
| Telecommunications                               | 4,358                  | 4,920     | (562)               | (11.4)  | ) |
| Operating risk loss                              | 2,082                  | 2,637     | (555)               | (21.0)  | ) |
| Other real estate owned and repossession expense | 1,745                  | 2,507     | (762)               | (30.4)  | ) |
| Loss on redemption of trust preferred securities | —                      | 5,626     | (5,626)             | (100.0) | ) |
| Intangible amortization                          | —                      | 241       | (241)               | (100.0) | ) |
| Other                                            | 24,520                 | 26,256    | (1,736)             | (6.6)   | ) |
| Total                                            | \$361,898              | \$361,721 | \$177               | —       | % |

The \$14.7 million, or 7.5%, increase in salaries and employee benefits during the nine months ended September 30, 2016 in comparison to the same period in 2015 was primarily driven by a \$12.1 million, or 7.3%, increase in salaries, resulting from higher average salaries per full-time equivalent employee, normal merit increases and an increase in incentive compensation. The average number of full-time equivalent employees increased to 3,490 for the nine months ended September 30, 2016, compared to 3,470 for the nine months ended September 30, 2015. Benefits expenses increased \$2.6 million, or 8.3%, due to an increase in health care expense, 401(k) matching expense, defined benefit plan expense, employee education and other employee benefits.

The \$3.9 million, or 18.4%, decrease in other outside services in comparison to the first nine months of 2015 was due to lower expenses associated with the Corporation's BSA/AML compliance program remediation efforts, and lower costs for information technology and human resources initiatives.



The \$2.0 million, or 8.0%, combined increase in data processing and software resulted from higher transaction volumes and contractual increases related to core processing systems, and amortization of capitalized software investments.

Equipment expense decreased \$1.5 million, or 13.9%, primarily due to lower depreciation expense, as certain assets became fully depreciated. FDIC insurance expense decreased \$874,000, or 10.2%, due to a reduction in the assessment rate beginning in the the third quarter of 2016. Other real estate owned and repossession expense decreased \$762,000, or 30.4%, when compared to the first nine months of 2015 due to decreases in repossession expense, maintenance expense and insurance expense on other real estate properties. This expense category can experience volatility from period to period based on the timing of foreclosures and sales of properties and payments of expenses, such as real estate taxes.

In July 2015, the Corporation redeemed \$150.0 million of TruPS. In connection with this redemption, a loss of \$5.6 million was recognized as a component of non-interest expense.

Other expense decreased \$1.7 million, or 6.6%, due to lower state taxes and the timing of certain expense items, which can fluctuate from period to period.

#### Income Taxes

Income tax expense for the first nine months of 2016 was \$36.4 million, a \$396,000, or 1.1%, increase from \$36.0 million in 2015.

The Corporation's effective tax rate was 23.4% in the first nine months of 2016, as compared to 24.5% in the first nine months of 2015. The effective tax rate is generally lower than the federal statutory rate of 35% due to tax-exempt interest income earned on loans, investments in tax-free municipal securities and credits earned from Tax Credit Investments. The decrease in the effective rate from 2015 was driven by higher net credits from these investments.

#### FINANCIAL CONDITION

The table below presents condensed consolidated ending balance sheets.

|                                             | September<br>30, 2016 | December<br>31, 2015 | Increase (Decrease) |              |
|---------------------------------------------|-----------------------|----------------------|---------------------|--------------|
|                                             |                       |                      | \$                  | %            |
| (dollars in thousands)                      |                       |                      |                     |              |
| <b>Assets</b>                               |                       |                      |                     |              |
| Cash and due from banks                     | \$86,497              | \$101,120            | \$(14,623)          | (14.5)%      |
| Other interest-earning assets               | 428,966               | 292,516              | 136,450             | 46.6         |
| Loans held for sale                         | 27,836                | 16,886               | 10,950              | 64.8         |
| Investment securities                       | 2,508,068             | 2,484,773            | 23,295              | 0.9          |
| Loans, net of allowance                     | 14,228,712            | 13,669,548           | 559,164             | 4.1          |
| Premises and equipment                      | 228,009               | 225,535              | 2,474               | 1.1          |
| Goodwill and intangible assets              | 531,556               | 531,556              | —                   | —            |
| Other assets                                | 661,418               | 592,784              | 68,634              | 11.6         |
| <b>Total Assets</b>                         | <b>\$18,701,062</b>   | <b>\$17,914,718</b>  | <b>\$786,344</b>    | <b>4.4 %</b> |
| <b>Liabilities and Shareholders' Equity</b> |                       |                      |                     |              |
| Deposits                                    | \$14,952,479          | \$14,132,317         | \$820,162           | 5.8 %        |
| Short-term borrowings                       | 264,042               | 497,663              | (233,621)           | (46.9)       |
| Long-term debt                              | 965,286               | 949,542              | 15,744              | 1.7          |
| Other liabilities                           | 389,819               | 293,302              | 96,517              | 32.9         |
| <b>Total Liabilities</b>                    | <b>16,571,626</b>     | <b>15,872,824</b>    | <b>698,802</b>      | <b>4.4</b>   |
| <b>Total Shareholders' Equity</b>           | <b>2,129,436</b>      | <b>2,041,894</b>     | <b>87,542</b>       | <b>4.3</b>   |

Total Liabilities and Shareholders' Equity \$18,701,062 \$17,914,718 \$786,344 4.4 %

Other Interest-earning Assets

The \$136.5 million, or 46.6%, increase in other interest-earning assets during the first nine months of 2016 resulted from higher balances on deposit with the Federal Reserve Bank as funding provided by deposit outpaced the growth in loans and investments.

## Investment Securities

The following table presents the carrying amount of investment securities:

|                                             | September<br>30, 2016  | December<br>31, 2015 | Increase (Decrease) |         |
|---------------------------------------------|------------------------|----------------------|---------------------|---------|
|                                             |                        |                      | \$                  | %       |
|                                             | (dollars in thousands) |                      |                     |         |
| U.S. Government sponsored agency securities | \$ 140                 | \$ 25,136            | \$(24,996)          | (99.4)% |
| State and municipal securities              | 401,572                | 262,765              | 138,807             | 52.8    |
| Corporate debt securities                   | 107,241                | 96,955               | 10,286              | 10.6    |
| Collateralized mortgage obligations         | 652,359                | 821,509              | (169,150)           | (20.6)  |
| Mortgage-backed securities                  | 1,226,547              | 1,158,835            | 67,712              | 5.8     |
| Auction rate securities                     | 97,726                 | 98,059               | (333)               | (0.3)   |
| Total debt securities                       | 2,485,585              | 2,463,259            | 22,326              | 0.9     |
| Equity securities                           | 22,483                 | 21,514               | 969                 | 4.5     |
| Total                                       | \$ 2,508,068           | \$ 2,484,773         | \$ 23,295           | 0.9 %   |

U.S. Government sponsored agency securities decreased \$25.0 million, or 99.4%, as the result of maturities. The proceeds were generally reinvested in municipal securities, which increased \$138.8 million, or 52.8%. These investments have a more attractive yield in the current low interest rate environment.

Collateralized mortgage obligations decreased \$169.2 million, or 20.6%, as the Corporation reduced its holdings in lower coupon investments due to volatility in market pricing. In addition to state and municipal securities, the proceeds were also reinvested in mortgage-backed securities, which increased \$67.7 million, or 5.8%.

## Loans, net of Unearned Income

The following table presents ending balances of loans outstanding, net of unearned income:

|                                                     | September<br>30, 2016  | December 31,<br>2015 | Increase<br>(Decrease) |       |
|-----------------------------------------------------|------------------------|----------------------|------------------------|-------|
|                                                     |                        |                      | \$                     | %     |
|                                                     | (dollars in thousands) |                      |                        |       |
| Real estate – commercial mortgage                   | \$ 5,818,915           | \$ 5,462,330         | \$ 356,585             | 6.5 % |
| Commercial – industrial, financial and agricultural | 4,024,119              | 4,088,962            | (64,843)               | (1.6) |
| Real estate – home equity                           | 1,640,421              | 1,684,439            | (44,018)               | (2.6) |
| Real estate – residential mortgage                  | 1,542,696              | 1,376,160            | 166,536                | 12.1  |
| Real estate – construction                          | 861,634                | 799,988              | 61,646                 | 7.7   |
| Consumer                                            | 283,673                | 268,588              | 15,085                 | 5.6   |
| Leasing, other and overdrafts                       | 219,780                | 158,135              | 61,645                 | 39.0  |
| Loans, net of unearned income                       | \$ 14,391,238          | \$ 13,838,602        | \$ 552,636             | 4.0 % |

Loans, net of unearned income, increased \$552.6 million, or 4.0%, in comparison to December 31, 2015, with the increases realized across all of the Corporation's geographic markets. Commercial mortgage loans increased \$356.6 million, or 6.5%, in comparison to December 31, 2015, with the growth occurring primarily in the Pennsylvania (\$197.3 million, or 7.1%), Maryland (\$56.5 million, or 9.9%) and New Jersey (\$45.4 million, or 3.2%) markets. Residential mortgage loans increased \$166.5 million, or 12.1%, compared to December 31, 2015, with the growth occurring primarily in the Maryland (\$85.3 million, or 46.9%) and Virginia (\$70.2 million, or 31.3%) markets as the result of new portfolio product offerings that were introduced in 2015. Construction loans increased \$61.6 million, or

7.7%, in comparison to December 31, 2015, with the growth occurring primarily in the Maryland (\$24.2 million, or 38.7%), Pennsylvania (\$17.5 million, or 3.7%) and New Jersey (\$16.8 million, or 10.8%) markets. Leasing, other and overdrafts increased compared to December 31, 2015 as a result of a \$61.6 million increase in the leasing portfolio.

Construction loans include loans to commercial borrowers secured by commercial real estate, loans to commercial borrowers secured by residential real estate, and other construction loans, which represent loans to individuals secured by residential real estate. The following table presents outstanding construction loans and their delinquency rates by these class segments:

|                                  | September 30, 2016     |                      |            | December 31, 2015 |                      |            |
|----------------------------------|------------------------|----------------------|------------|-------------------|----------------------|------------|
|                                  | Balance                | Delinquency Rate (1) | % of Total | Balance           | Delinquency Rate (1) | % of Total |
|                                  | (dollars in thousands) |                      |            |                   |                      |            |
| Commercial                       | \$636,892              | 0.2 %                | 73.9 %     | \$559,991         | 0.2 %                | 70.0 %     |
| Commercial - residential         | 161,908                | 7.2                  | 18.8       | 179,303           | 7.3                  | 22.4       |
| Other                            | 62,834                 | 1.7                  | 7.3        | 60,694            | 1.1                  | 7.6        |
| Total Real estate - construction | \$861,634              | 1.6 %                | 100.0 %    | \$799,988         | 1.8 %                | 100.0 %    |

(1) Represents all accruing loans 30 days or more past due and non-accrual loans as a percentage of total loans in each class segment.

The Corporation does not have a significant concentration of credit risk with any single borrower, industry or geographical location. Approximately \$6.7 billion, or 46.4%, of the loan portfolio was in commercial mortgage and construction loans as of September 30, 2016. The Corporation's maximum total lending commitment to an individual borrowing relationship was \$50.0 million as of September 30, 2016. In addition to its policy of limiting the maximum total lending commitment to any individual borrowing relationship to \$50.0 million, the Corporation has established lower total lending limits for certain types of lending commitments, and lower total lending limits based on the Corporation's internal risk rating of an individual borrowing relationship at the time the lending commitment is approved. As of September 30, 2016, the Corporation had 115 individual borrowing relationships with total borrowing commitments between \$20.0 million and \$50.0 million.

The following table summarizes the industry concentrations within the commercial loan portfolio:

|                             | September 30, 2016 |   | December 31, 2015 |   |
|-----------------------------|--------------------|---|-------------------|---|
|                             | Balance            | % | Balance           | % |
| Services                    | 21.0               | % | 22.6              | % |
| Retail                      | 15.0               |   | 8.3               |   |
| Health care                 | 10.6               |   | 10.6              |   |
| Construction <sup>(1)</sup> | 9.5                |   | 9.7               |   |
| Manufacturing               | 9.3                |   | 11.3              |   |
| Wholesale                   | 7.3                |   | 8.0               |   |
| Real estate <sup>(2)</sup>  | 6.9                |   | 7.3               |   |
| Agriculture                 | 4.7                |   | 5.1               |   |
| Arts and entertainment      | 2.7                |   | 2.8               |   |
| Transportation              | 2.4                |   | 2.7               |   |
| Financial services          | 2.1                |   | 1.7               |   |
| Other                       | 8.5                |   | 9.9               |   |
| Total                       | 100.0              | % | 100.0             | % |

(1) Includes commercial loans to borrowers engaged in the construction industry.

(2) Includes commercial loans to borrowers engaged in the business of: renting, leasing or managing real estate for others; selling and/or buying real estate for others; and appraising real estate.



Commercial loans and commercial mortgage loans also include shared national credits, which are participations in loans or loan commitments of at least \$20.0 million that are shared by three or more banks. Below is a summary of the Corporation's outstanding purchased shared national credits:

|                                                     | September 30, 2016 | December 31, 2015 |
|-----------------------------------------------------|--------------------|-------------------|
|                                                     | (in thousands)     |                   |
| Commercial - industrial, financial and agricultural | \$163,452          | \$152,830         |
| Real estate - commercial mortgage                   | 77,977             | 96,219            |
| Total                                               | \$241,429          | \$249,049         |

Total shared national credits decreased \$7.6 million, or 3.1%, in comparison to December 31, 2015. The Corporation's shared national credits are to borrowers located in its geographical markets, and are subject to normal lending activities consistent with the Corporation's underwriting policies. As of September 30, 2016, none of the shared national credits were past due compared to one credit totaling \$1.1 million, or 0.4%, of the total balance that was past due as of December 31, 2015.

#### Provision for Credit Losses and Allowance for Credit Losses

The following table presents the activity in the allowance for credit losses:

|                                                               | Three months ended<br>September 30 |              | Nine months ended September 30 |              |   |
|---------------------------------------------------------------|------------------------------------|--------------|--------------------------------|--------------|---|
|                                                               | 2016                               | 2015         | 2016                           | 2015         |   |
|                                                               | (dollars in thousands)             |              |                                |              |   |
| Average balance of loans, net of unearned income              | \$14,212,250                       | \$13,369,874 | \$14,011,301                   | \$13,220,339 |   |
| Balance of allowance for credit losses at beginning of period | \$165,108                          | \$169,453    | \$171,412                      | \$185,931    |   |
| Loans charged off:                                            |                                    |              |                                |              |   |
| Commercial – industrial, financial and agricultural           | 3,144                              | 1,640        | 13,957                         | 14,669       |   |
| Real estate – residential mortgage                            | 802                                | 1,035        | 2,210                          | 3,099        |   |
| Real estate – home equity                                     | 709                                | 940          | 3,295                          | 2,578        |   |
| Real estate – commercial mortgage                             | 1,350                              | 660          | 3,406                          | 3,011        |   |
| Consumer                                                      | 685                                | 650          | 2,261                          | 1,787        |   |
| Real estate – construction                                    | 150                                | 114          | 1,218                          | 201          |   |
| Leasing, other and overdrafts                                 | 832                                | 522          | 3,226                          | 1,352        |   |
| Total loans charged off                                       | 7,672                              | 5,561        | 29,573                         | 26,697       |   |
| Recoveries of loans previously charged off:                   |                                    |              |                                |              |   |
| Commercial – industrial, financial and agricultural           | 1,539                              | 1,598        | 6,789                          | 3,855        |   |
| Real estate – residential mortgage                            | 228                                | 201          | 784                            | 547          |   |
| Real estate – home equity                                     | 241                                | 304          | 929                            | 744          |   |
| Real estate – commercial mortgage                             | 296                                | 842          | 2,488                          | 1,729        |   |
| Consumer                                                      | 222                                | 314          | 957                            | 923          |   |
| Real estate – construction                                    | 898                                | 898          | 2,844                          | 2,276        |   |
| Leasing, other and overdrafts                                 | 168                                | 346          | 357                            | 587          |   |
| Total recoveries                                              | 3,592                              | 4,503        | 15,148                         | 10,661       |   |
| Net loans charged off                                         | 4,080                              | 1,058        | 14,425                         | 16,036       |   |
| Provision for credit losses                                   | 4,141                              | 1,000        | 8,182                          | (500)        |   |
| Balance of allowance for credit losses at end of period       | \$165,169                          | \$169,395    | \$165,169                      | \$169,395    |   |
| Net charge-offs to average loans (annualized)                 | 0.11                               | % 0.03       | % 0.14                         | % 0.16       | % |





The following table presents the components of the allowance for credit losses:

|                                          | September 30,<br>2016  | December 31,<br>2015 |
|------------------------------------------|------------------------|----------------------|
|                                          | (dollars in thousands) |                      |
| Allowance for loan losses                | \$162,526              | \$169,054            |
| Reserve for unfunded lending commitments | 2,643                  | 2,358                |
| Allowance for credit losses              | \$165,169              | \$171,412            |

|                                                  |      |   |      |   |
|--------------------------------------------------|------|---|------|---|
| Allowance for credit losses to loans outstanding | 1.15 | % | 1.24 | % |
|--------------------------------------------------|------|---|------|---|

The provision for credit losses for the three months ended September 30, 2016 was \$4.1 million, an increase of \$3.1 million in comparison to the same period in 2015. For the nine months ended September 30, 2016, the provision for credit losses was \$8.2 million, an increase of \$8.7 million in comparison to the first nine months of 2015. The increase in the provision for credit losses was attributable to continued loan growth as overall credit metrics were stable to improving.

Net charge-offs increased \$3.0 million, to \$4.1 million for the third quarter of 2016, compared to \$1.1 million for the third quarter of 2015. Gross charge-offs increased by \$2.1 million and recoveries decreased by \$911,000. Of the \$4.1 million of net charge-offs recorded in the third quarter of 2016, the majority were for loans originated in Pennsylvania (\$1.9 million), Maryland (\$1.6 million) and New Jersey (\$737,000) partially offset by net recoveries in Virginia and Delaware.

During the first nine months of 2016, net charge-offs decreased \$1.6 million, or 10.0%, to \$14.4 million compared to \$16.0 million for the same period of 2015. The decrease in net charge-offs was primarily due to an increase in recoveries during the first nine months of 2016 compared to the same period in the prior year. Of the \$14.4 million of net charge-offs recorded in the first nine months of 2016, the majority were for loans originated in Pennsylvania (\$9.8 million), New Jersey (\$4.4 million) and Maryland (\$601,000) partially offset by net recoveries in Virginia and Delaware.

The following table summarizes non-performing assets as of the indicated dates:

|                                                     | September 30,<br>2016  | September 30,<br>2015 | December 31,<br>2015 |   |
|-----------------------------------------------------|------------------------|-----------------------|----------------------|---|
|                                                     | (dollars in thousands) |                       |                      |   |
| Non-accrual loans                                   | \$124,017              | \$132,154             | \$129,523            |   |
| Loans 90 days or more past due and still accruing   | 14,095                 | 12,867                | 15,291               |   |
| Total non-performing loans                          | 138,112                | 145,021               | 144,814              |   |
| Other real estate owned (OREO)                      | 11,981                 | 10,561                | 11,099               |   |
| Total non-performing assets                         | \$150,093              | \$155,582             | \$155,913            |   |
| Non-accrual loans to total loans                    | 0.86                   | % 0.98                | % 0.94               | % |
| Non-performing assets to total assets               | 0.80                   | % 0.87                | % 0.87               | % |
| Allowance for credit losses to non-performing loans | 119.59                 | % 116.81              | % 118.37             | % |



The following table presents accruing loans whose terms have been modified under troubled debt restructurings ("TDRs"), by type, as of the indicated dates:

|                                                     | September 30, 2016 | September 30, 2015 | December 31, 2015 |
|-----------------------------------------------------|--------------------|--------------------|-------------------|
|                                                     | (in thousands)     |                    |                   |
| Real estate – residential mortgage                  | \$26,854           | \$ 29,330          | \$ 28,511         |
| Real estate – commercial mortgage                   | 16,085             | 17,282             | 17,563            |
| Real estate – construction                          | 843                | 4,363              | 3,942             |
| Commercial – industrial, financial and agricultural | 7,488              | 7,399              | 5,953             |
| Real estate – home equity                           | 7,668              | 3,954              | 4,556             |
| Consumer                                            | 39                 | 29                 | 33                |
| Total accruing TDRs                                 | 58,977             | 62,357             | 60,558            |
| Non-accrual TDRs <sup>(1)</sup>                     | 27,904             | 27,618             | 31,035            |
| Total TDRs                                          | \$86,881           | \$ 89,975          | \$ 91,593         |

(1) Included with non-accrual loans in the preceding table.

TDRs modified during the first nine months of 2016 and still outstanding as of September 30, 2016 totaled \$10.3 million. During the first nine months of 2016, \$6.0 million of TDRs that were modified in the previous 12 months had a payment default, which the Corporation defines as a single missed scheduled payment, subsequent to modification. The following table presents the changes in non-accrual loans for the three and nine months ended September 30, 2016:

|                                                      | Commercial and Agricultural | Real Estate Commercial Mortgage | Real Estate Construction | Real Estate - Residential Mortgage | Real Estate - Home Equity | Consumer | Increasing | Total      |
|------------------------------------------------------|-----------------------------|---------------------------------|--------------------------|------------------------------------|---------------------------|----------|------------|------------|
|                                                      | (in thousands)              |                                 |                          |                                    |                           |          |            |            |
| Three months ended September 30, 2016                |                             |                                 |                          |                                    |                           |          |            |            |
| Balance of non-accrual loans at June 30, 2016        | \$35,538                    | \$ 35,512                       | \$ 9,420                 | \$ 20,569                          | \$ 10,703                 | \$ —     | \$—        | \$ 111,742 |
| Additions                                            | 17,267                      | 9,573                           | 2,653                    | 1,371                              | 1,907                     | 685      | 381        | 33,837     |
| Payments                                             | (2,913 )                    | (1,844 )                        | (801 )                   | (476 )                             | (527 )                    | —        | —          | (6,561 )   |
| Charge-offs                                          | (3,144 )                    | (1,350 )                        | (150 )                   | (802 )                             | (709 )                    | (685)    | (381 )     | (7,221 )   |
| Transfers to accrual status                          | (2,525 )                    | (2,543 )                        | —                        | —                                  | (23 )                     | —        | —          | (5,091 )   |
| Transfers to OREO                                    | (53 )                       | (381 )                          | (646 )                   | (1,281 )                           | (328 )                    | —        | —          | (2,689 )   |
| Balance of non-accrual loans at September 30, 2016   | \$44,170                    | \$ 38,967                       | \$ 10,476                | \$ 19,381                          | \$ 11,023                 | \$ —     | \$—        | \$ 124,017 |
| Nine months ended September 30, 2016                 |                             |                                 |                          |                                    |                           |          |            |            |
| Balance of non-accrual loans as of December 31, 2015 | \$42,199                    | \$ 40,731                       | \$ 12,044                | \$ 21,914                          | \$ 11,210                 | \$ —     | \$ 1,425   | \$ 129,523 |
| Additions                                            | 30,043                      | 20,367                          | 6,503                    | 4,868                              | 6,962                     | 2,264    | 673        | 71,680     |
| Payments                                             | (11,132 )                   | (10,537 )                       | (5,169 )                 | (2,222 )                           | (1,979 )                  | (1 )     | (24 )      | (31,064 )  |
| Charge-offs                                          | (13,957 )                   | (3,406 )                        | (1,218 )                 | (2,210 )                           | (3,295 )                  | (2,261)  | (2,074 )   | (28,421 )  |
| Transfers to accrual status                          | (2,525 )                    | (5,692 )                        | —                        | (310 )                             | (904 )                    | (2 )     | —          | (9,433 )   |
| Transfers to OREO                                    | (458 )                      | (2,496 )                        | (1,684 )                 | (2,659 )                           | (971 )                    | —        | —          | (8,268 )   |
| Balance of non-accrual loans at September 30, 2016   | \$44,170                    | \$ 38,967                       | \$ 10,476                | \$ 19,381                          | \$ 11,023                 | \$ —     | \$—        | \$ 124,017 |

Non-accrual loans decreased \$8.1 million, or 6.2%, and \$5.5 million, or 4.3%, in comparison to September 30, 2015 and December 31, 2015, respectively.

The following table summarizes non-performing loans, by type, as of the indicated dates:

|                                                     | September 30,<br>2016 | September 30,<br>2015 | December 31,<br>2015 |
|-----------------------------------------------------|-----------------------|-----------------------|----------------------|
|                                                     | (in thousands)        |                       |                      |
| Real estate – commercial mortgage                   | \$39,631              | \$ 49,021             | \$ 41,170            |
| Commercial – industrial, financial and agricultural | 47,330                | 38,032                | 44,071               |
| Real estate – residential mortgage                  | 23,451                | 27,707                | 28,484               |
| Real estate – home equity                           | 14,260                | 13,107                | 14,683               |
| Real estate – construction                          | 11,223                | 14,989                | 12,460               |
| Consumer                                            | 2,166                 | 2,079                 | 2,440                |
| Leasing                                             | 51                    | 86                    | 1,506                |
| Total non-performing loans                          | \$138,112             | \$ 145,021            | \$ 144,814           |

Non-performing loans decreased \$6.9 million, or 4.8%, and \$6.7 million, or 4.6%, in comparison to September 30, 2015 and December 31, 2015, respectively. The decrease in non-performing loans was realized across all loan categories except commercial, which increased \$9.3 million, or 24.4%, and \$3.3 million, or 7.4%, in comparison to September 30, 2015 and December 31, 2015, respectively, and home equity which increased \$1.2 million, or 8.8%, in comparison to September 30, 2015.

The following table summarizes the Corporation's OREO, by property type, as of the indicated dates:

|                        | September 30,<br>2016 | September 30,<br>2015 | December 31,<br>2015 |
|------------------------|-----------------------|-----------------------|----------------------|
|                        | (in thousands)        |                       |                      |
| Residential properties | \$6,279               | \$ 6,934              | \$ 7,303             |
| Commercial properties  | 3,050                 | 1,584                 | 2,167                |
| Undeveloped land       | 2,652                 | 2,043                 | 1,629                |
| Total OREO             | \$11,981              | \$ 10,561             | \$ 11,099            |

The ability to identify potential problem loans in a timely manner is important to maintaining an adequate allowance for credit losses. For commercial loans, commercial mortgages and construction loans to commercial borrowers, an internal risk rating process is used to monitor credit quality. The evaluation of credit risk for residential mortgages, home equity loans, construction loans to individuals, consumer loans and lease receivables is based on payment history, through the monitoring of delinquency levels and trends. For a description of the Corporation's risk ratings, see Note 5, "Loans and Allowance for Credit Losses," in the Notes to Consolidated Financial Statements.



Edgar Filing: FULTON FINANCIAL CORP - Form 10-Q

Total internally risk rated loans were \$10.6 billion and \$10.3 billion as of September 30, 2016 and December 31, 2015, respectively. The following table presents internal risk ratings for commercial loans, commercial mortgages and construction loans to commercial borrowers with internal risk ratings of Special Mention (considered criticized loans) or Substandard or lower (considered classified loans), by class segment:

|                                                                   | Special Mention        |                   | Increase (decrease) |        | Substandard or lower |                   | Increase (decrease) |         | Total Criticized and Classified Loans |                   |
|-------------------------------------------------------------------|------------------------|-------------------|---------------------|--------|----------------------|-------------------|---------------------|---------|---------------------------------------|-------------------|
|                                                                   | September 30, 2016     | December 31, 2015 | \$                  | %      | September 30, 2016   | December 31, 2015 | \$                  | %       | September 30, 2016                    | December 31, 2015 |
|                                                                   | (dollars in thousands) |                   |                     |        |                      |                   |                     |         |                                       |                   |
| Real estate - commercial mortgage                                 | \$131,941              | \$102,625         | \$29,316            | 28.6 % | \$131,214            | \$155,442         | \$(24,228)          | (15.6)% | \$263,155                             | \$258,060         |
| Commercial - secured                                              | 106,701                | 92,711            | 13,990              | 15.1   | 121,611              | 136,710           | (15,099)            | (11.0)  | 228,312                               | 229,421           |
| Commercial - unsecured                                            | 5,009                  | 2,761             | 2,248               | 81.4   | 2,904                | 3,346             | (442)               | (13.2)  | 7,913                                 | 6,107             |
| Total Commercial - industrial, financial and agricultural         | 111,710                | 95,472            | 16,238              | 17.0   | 124,515              | 140,056           | (15,541)            | (11.1)  | 236,225                               | 235,528           |
| Construction - commercial residential                             | 15,853                 | 17,154            | (1,301)             | (7.6)  | 14,180               | 21,812            | (7,632)             | (35.0)  | 30,033                                | 38,966            |
| Construction - commercial                                         | 2,530                  | 3,684             | (1,154)             | (31.3) | 5,048                | 3,597             | 1,451               | 40.3    | 7,578                                 | 7,281             |
| Total real estate - construction (excluding construction - other) | 18,383                 | 20,838            | (2,455)             | (11.8) | 19,228               | 25,409            | (6,181)             | (24.3)  | 37,611                                | 46,247            |
| Total                                                             | \$262,034              | \$218,935         | \$43,099            | 19.7 % | \$274,957            | \$320,907         | \$(45,950)          | (14.3)% | \$536,991                             | \$539,840         |
| % of total risk rated loans                                       | 2.4                    | % 2.1             | %                   |        | 2.6                  | % 3.1             | %                   |         | 5.0                                   | % 5.2             |

The following table summarizes loan delinquency rates, by type, as of the dates indicated:

|                                   | September 30, 2016 |               |        | September 30, 2015 |               |        | December 31, 2015 |               |        |   |
|-----------------------------------|--------------------|---------------|--------|--------------------|---------------|--------|-------------------|---------------|--------|---|
|                                   | 30-89 Days         | ≥ 90 Days (1) | Total  | 30-89 Days         | ≥ 90 Days (1) | Total  | 30-89 Days        | ≥ 90 Days (1) | Total  |   |
| Real estate - commercial mortgage | 0.18               | % 0.69        | % 0.87 | % 0.16             | % 0.92        | % 1.08 | % 0.14            | % 0.77        | % 0.91 | % |
| Commercial industrial,            | 0.31               | % 1.17        | % 1.48 | % 0.35             | % 0.97        | % 1.32 | % 0.21            | % 1.06        | % 1.27 | % |



|                                    |          |           |           |          |           |           |          |           |           |   |
|------------------------------------|----------|-----------|-----------|----------|-----------|-----------|----------|-----------|-----------|---|
| financial and agricultural         |          |           |           |          |           |           |          |           |           |   |
| Real estate – construction         | 0.31     | % 1.30    | % 1.61    | % 0.30   | % 1.95    | % 2.25    | % 0.28   | % 1.59    | % 1.87    | % |
| Real estate – residential mortgage | 1.15     | % 1.52    | % 2.67    | % 1.27   | % 2.00    | % 3.27    | % 1.33   | % 2.07    | % 3.40    | % |
| Real estate – home equity          | 0.64     | % 0.87    | % 1.51    | % 0.54   | % 0.77    | % 1.31    | % 0.53   | % 0.87    | % 1.40    | % |
| Consumer, leasing and other        | 1.18     | % 0.44    | % 1.62    | % 1.30   | % 0.51    | % 1.81    | % 1.36   | % 0.92    | % 2.28    | % |
| Total                              | 0.42     | % 0.96    | % 1.38    | % 0.42   | % 1.07    | % 1.49    | % 0.37   | % 1.04    | % 1.41    | % |
| Total dollars (in thousands)       | \$59,822 | \$138,112 | \$197,934 | \$56,694 | \$145,021 | \$201,715 | \$51,927 | \$144,814 | \$196,741 |   |

(1) Includes non-accrual loans.

Management believes that the allowance for credit losses of \$165.2 million as of September 30, 2016 is sufficient to cover incurred losses in the loan portfolio and unfunded lending commitments as of that date and is appropriate based on applicable accounting standards.

#### Other Assets and Other Liabilities

The \$68.6 million, or 11.6%, increase in other assets and the \$96.5 million, or 32.9%, increase in other liabilities were primarily driven by higher fair values for derivative financial instruments, mainly commercial loan interest rate swaps. See Note 9, "Derivative Financial Instruments," in the Notes to Consolidated Financial Statements for additional details.

## Deposits and Borrowings

The following table presents ending deposits, by type:

|                            | September 30,<br>2016  | December 31,<br>2015 | Increase<br>(Decrease) |       |
|----------------------------|------------------------|----------------------|------------------------|-------|
|                            |                        |                      | \$                     | %     |
|                            | (dollars in thousands) |                      |                        |       |
| Noninterest-bearing demand | \$4,210,099            | \$3,948,114          | \$261,985              | 6.6 % |
| Interest-bearing demand    | 3,703,048              | 3,451,207            | 251,841                | 7.3   |
| Savings                    | 4,235,015              | 3,868,046            | 366,969                | 9.5   |
| Total demand and savings   | 12,148,162             | 11,267,367           | 880,795                | 7.8   |
| Time deposits              | 2,804,317              | 2,864,950            | (60,633 )              | (2.1) |
| Total deposits             | \$14,952,479           | \$14,132,317         | \$820,162              | 5.8 % |

Noninterest-bearing demand deposits increased \$262.0 million, or 6.6%, primarily as a result of increases in business account balances of \$234.9 million, or 7.9%, and municipal account balances of \$27.0 million, or 29.4%, due to seasonality.

The \$367.0 million, or 9.5%, increase in savings account balances was due to a \$298.9 million, or 12.0%, increase in personal account balances, a \$37.9 million, or 6.6%, increase in municipal account balances due to seasonality, and a \$30.2 million, or 6.6%, increase in business account balances. Interest-bearing demand accounts increased \$251.8 million, or 7.3%, primarily due to a \$294.4 million, or 23.2%, seasonal increase in municipal account balances.

The following table summarizes the changes in ending borrowings, by type:

|                                         | September 30,<br>2016  | December 31,<br>2015 | Increase (Decrease) |          |
|-----------------------------------------|------------------------|----------------------|---------------------|----------|
|                                         |                        |                      | \$                  | %        |
|                                         | (dollars in thousands) |                      |                     |          |
| Short-term borrowings:                  |                        |                      |                     |          |
| Customer repurchase agreements          | \$189,727              | \$111,496            | \$78,231            | 70.2 %   |
| Customer short-term promissory notes    | 65,871                 | 78,932               | (13,061 )           | (16.5 )  |
| Total short-term customer funding       | 255,598                | 190,428              | 65,170              | 34.2     |
| Federal funds purchased                 | 8,444                  | 197,235              | (188,791 )          | (95.7 )  |
| Short-term FHLB advances <sup>(1)</sup> | —                      | 110,000              | (110,000 )          | (100.0)  |
| Total short-term borrowings             | 264,042                | 497,663              | (233,621 )          | (46.9 )  |
| Long-term debt:                         |                        |                      |                     |          |
| FHLB advances                           | 603,271                | 587,756              | 15,515              | 2.6      |
| Other long-term debt                    | 362,015                | 361,786              | 229                 | 0.1      |
| Total long-term debt                    | 965,286                | 949,542              | 15,744              | 1.7      |
| Total borrowings                        | \$1,229,328            | \$1,447,205          | \$(217,877)         | (15.1 )% |

(1) Represents FHLB advances with an original maturity term of less than one year.

The \$233.6 million, or 46.9%, decrease in total short-term borrowings resulted from deposit growth exceeding loan growth during the first nine months of 2016.

## Shareholders' Equity

Total shareholders' equity increased \$87.5 million, or 4.3%, during the first nine months of 2016. The increase was due primarily to \$119.5 million of net income and a \$26.5 million increase in other comprehensive income, partially offset by \$50.2 million of common stock dividends and \$18.5 million in treasury stock purchases.

## Regulatory Capital

The Corporation and its subsidiary banks are subject to regulatory capital requirements administered by various banking regulators. Failure to meet minimum capital requirements could result in certain actions by regulators that could have a material effect on the Corporation's financial statements. In July 2013, the Federal Reserve Board approved final rules (the "U.S. Basel III Capital Rules") establishing a new comprehensive capital framework for U.S. banking organizations and implementing the Basel Committee on Banking Supervision's December 2010 framework for strengthening international capital standards. The U.S. Basel III Capital Rules substantially revise the risk-based capital requirements applicable to bank holding companies and depository institutions.

The new minimum regulatory capital requirements established by the U.S. Basel III Capital Rules became effective for the Corporation on January 1, 2015, and will be fully phased in on January 1, 2019.

The U.S. Basel III Capital Rules require the Corporation and its bank subsidiaries to:

- Meet a new minimum Common Equity Tier 1 capital ratio of 4.50% of risk-weighted assets and a Tier 1 capital ratio of 6.00% of risk-weighted assets;

- Continue to require the current minimum Total capital ratio of 8.00% of risk-weighted assets and the minimum Tier 1 leverage capital ratio of 4.00% of average assets; and

- Comply with a revised definition of capital to improve the ability of regulatory capital instruments to absorb losses.

- Certain non-qualifying capital instruments, including cumulative preferred stock and TruPS, are being phased out as a component of Tier 1 capital for institutions of the Corporation's size.

When fully phased in on January 1, 2019, the Corporation and its bank subsidiaries will also be required to maintain a "capital conservation buffer" of 2.50% above the minimum risk-based capital requirements, which must be maintained to avoid restrictions on capital distributions and certain discretionary bonus payments.

The U.S. Basel III Capital Rules use a standardized approach for risk weightings that expands the risk-weightings for assets and off-balance sheet exposures from the previous 0%, 20%, 50% and 100% categories to a much larger and more risk-sensitive number of categories, depending on the nature of the assets and off-balance sheet exposures and resulting in higher risk weights for a variety of asset categories.

As of September 30, 2016, the Corporation and each of its bank subsidiaries met the minimum requirements of the U.S. Basel III Capital Rules, and each of the Corporation's bank subsidiaries' capital ratios exceeded the amounts required to be considered "well capitalized" as defined in the regulations. As of September 30, 2016, the Corporation's capital levels also met the fully-phased in minimum capital requirements, including the capital conservation buffers, as prescribed in the U.S. Basel III Capital Rules.

The following table summarizes the Corporation's capital ratios in comparison to regulatory requirements:

|                                                | September 30, 2016 |   | December 31, 2015 |   | Regulatory Minimum for Capital Adequacy |   | Fully Phased-in, with Capital Conservation Buffers |   |
|------------------------------------------------|--------------------|---|-------------------|---|-----------------------------------------|---|----------------------------------------------------|---|
| Total Capital (to Risk-Weighted Assets)        | 13.2               | % | 13.2              | % | 8.0                                     | % | 10.5                                               | % |
| Tier I Capital (to Risk-Weighted Assets)       | 10.4               | % | 10.2              | % | 6.0                                     | % | 8.5                                                | % |
| Common Equity Tier I (to Risk-Weighted Assets) | 10.4               | % | 10.2              | % | 4.5                                     | % | 7.0                                                | % |
| Tier I Capital (to Average Assets)             | 9.1                | % | 9.0               | % | 4.0                                     | % | 4.0                                                | % |



### Item 3. Quantitative and Qualitative Disclosures About Market Risk

Market risk is the exposure to economic loss that arises from changes in the values of certain financial instruments. The types of market risk exposures generally faced by financial institutions include interest rate risk, equity market price risk, debt security market price risk, foreign currency price risk and commodity price risk. Due to the nature of its operations, foreign currency price risk and commodity price risk are not significant to the Corporation.

#### Interest Rate Risk, Asset/Liability Management and Liquidity

Interest rate risk creates exposure in two primary areas. First, changes in rates have an impact on the Corporation's liquidity position and could affect its ability to meet obligations and continue to grow. Second, movements in interest rates can create fluctuations in the Corporation's net interest income and changes in the economic value of its equity.

The Corporation employs various management techniques to minimize its exposure to interest rate risk. An Asset/Liability Management Committee (ALCO) is responsible for reviewing the interest rate sensitivity and liquidity positions of the Corporation, approving asset and liability management policies, and overseeing the formulation and implementation of strategies regarding balance sheet positions.

The Corporation uses two complementary methods to measure and manage interest rate risk. They are simulation of net interest income and estimates of economic value of equity. Using these measurements in tandem provides a reasonably comprehensive summary of the magnitude of the Corporation's interest rate risk, level of risk as time evolves, and exposure to changes in interest rates.

Simulation of net interest income is performed for the next 12-month period. A variety of interest rate scenarios are used to measure the effects of sudden and gradual movements upward and downward in the yield curve. These results are compared to the results obtained in a flat or unchanged interest rate scenario. Simulation of net interest income is used primarily to measure the Corporation's short-term earnings exposure to rate movements. The Corporation's policy limits the potential exposure of net interest income, in a non-parallel instantaneous shock, to 10% of the base case net interest income for a 100 basis point shock in interest rates, 15% for a 200 basis point shock and 20% for a 300 basis point shock. A "shock" is an immediate upward or downward movement of interest rates. The shocks do not take into account changes in customer behavior that could result in changes to mix and/or volumes in the balance sheet, nor do they take into account the potential effects of competition on the pricing of deposits and loans over the forward 12-month period.

Contractual maturities and repricing opportunities of loans are incorporated in the simulation model as are prepayment assumptions, maturity data and call options in the investment portfolio. Assumptions based on past experience are incorporated into the model for non-maturity deposit accounts. The assumptions used are inherently uncertain and, as a result, the model cannot precisely measure future net interest income or precisely predict the impact of fluctuations in market interest rates on net interest income. Actual results will differ from the model's simulated results due to timing, amount and frequency of interest rate changes as well as changes in market conditions and the application and timing of various management strategies.

The following table summarizes the expected impact of abrupt interest rate changes on net interest income as of September 30, 2016 (due to the current level of interest rates, the 200 and 300 basis point downward shock scenarios are not shown):

| Rate Shock (1) | Annual change<br>in net interest income | % Change in net interest income |
|----------------|-----------------------------------------|---------------------------------|
| +300 bp        | + \$84.5 million                        | 15.4%                           |
| +200 bp        | + \$56.8 million                        | 10.3%                           |

|         |                  |        |
|---------|------------------|--------|
| +100 bp | + \$26.3 million | 4.8%   |
| -100 bp | - \$18.5 million | - 3.4% |

(1) These results include the effect of implicit and explicit interest rate floors that limit further reduction in interest rates.

Economic value of equity estimates the discounted present value of asset and liability cash flows. Discount rates are based upon market prices for like assets and liabilities. Abrupt changes or "shocks" in interest rates, both upward and downward, are used to determine the comparative effect of such interest rate movements relative to the unchanged environment. This measurement tool is used primarily to evaluate the longer-term repricing risks and options in the Corporation's balance sheet. The Corporation's policy limits the economic value of equity that may be at risk, in a non-parallel instantaneous shock, to 10% of the base case economic value of equity for a 100 basis point shock in interest rates, 20% for a 200 basis point shock and 30% for a 300 basis

point shock. As of September 30, 2016, the Corporation was within economic value of equity policy limits for every 100 basis point shock.

### Interest Rate Swaps

The Corporation enters into interest rate swaps with certain qualifying commercial loan customers to meet their interest rate risk management needs. The Corporation simultaneously enters into interest rate swaps with dealer counterparties, with identical notional amounts and terms. The net result of these interest rate swaps is that the customer pays a fixed rate of interest and the Corporation receives a floating rate. These interest rate swaps are derivative financial instruments that are recorded at their fair value in other assets and liabilities on the consolidated balance sheets. Changes in fair value during the period are recorded in other non-interest expense on the consolidated statements of income.

### Liquidity

The Corporation must maintain a sufficient level of liquid assets to meet the cash needs of its customers, who, as depositors, may want to withdraw funds or who, as borrowers, need credit availability. Liquidity is provided on a continuous basis through scheduled and unscheduled principal and interest payments on investments and outstanding loans and through the availability of deposits and borrowings. The Corporation also maintains secondary sources that provide liquidity on a secured and unsecured basis to meet short-term and long-term needs. In addition, the Corporation has filed a shelf registration statement with the Securities and Exchange Commission (SEC) under which the Corporation may, from time to time, offer various types of debt and equity securities.

The Corporation maintains liquidity sources in the form of demand and savings deposits, time deposits, repurchase agreements and short-term promissory notes. The Corporation can access additional liquidity from these sources, if necessary, by increasing the rates of interest paid on those accounts and borrowings. The positive impact to liquidity resulting from paying higher interest rates could have a detrimental impact on the net interest margin and net income if rates on interest-earning assets do not experience a proportionate increase. Borrowing availability with the Federal Home Loan Bank and the Federal Reserve Bank, along with federal funds lines at various correspondent banks, provides the Corporation with additional liquidity.

Each of the Corporation's subsidiary banks is a member of the FHLB and has access to FHLB overnight and term credit facilities. As of September 30, 2016, the Corporation had \$603.3 million of advances outstanding from the FHLB with an additional borrowing capacity of approximately \$2.6 billion under these facilities. Advances from the FHLB are secured by qualifying commercial real estate and residential mortgage loans, investments and other assets.

As of September 30, 2016, the Corporation had aggregate availability under federal funds lines of \$1.1 billion with \$8.4 million borrowed against that amount. A combination of commercial real estate loans, commercial loans and securities are pledged to the Federal Reserve Bank of Philadelphia to provide access to Federal Reserve Bank Discount Window borrowings. As of September 30, 2016, the Corporation had \$1.3 billion of collateralized borrowing availability at the Discount Window, and no outstanding borrowings.

Liquidity must also be managed at the Fulton Financial Corporation parent company level. For safety and soundness reasons, banking regulations limit the amount of cash that can be transferred from subsidiary banks to the parent company in the form of loans and dividends. Generally, these limitations are based on the subsidiary banks' regulatory capital levels and their net income. Management continues to monitor the liquidity and capital needs of the parent company and will implement appropriate strategies, as necessary, to remain adequately capitalized and to meet its cash needs.



The Corporation's sources and uses of funds were discussed in general terms in the net interest income section of Management's Discussion and Analysis. The consolidated statements of cash flows provide additional information. The Corporation's operating activities during the first nine months of 2016 generated \$143.8 million of cash, mainly due to net income. Cash used in investing activities was \$698.8 million, mainly due to net increases in loans and short-term investments. Net cash provided by financing activities was \$540.3 million due mainly to increases in deposits, partially offset by a decrease in short-term borrowings and cash dividends.

#### Equity Market Price Risk

Equity market price risk is the risk that changes in the values of equity investments could have a material impact on the financial position or results of operations of the Corporation. As of September 30, 2016, equity investments consisted of \$21.6 million of common stocks of publicly traded financial institutions and \$901,000 of other equity investments.

The equity investments most susceptible to equity market price risk are the financial institutions stocks, which had a cost basis of approximately \$13.4 million and a fair value of \$21.6 million at September 30, 2016, including an investment in a single financial institution with a cost basis of \$7.4 million and a fair value of \$11.4 million. The fair value of this investment accounted for 52.7% of the fair value of the common stocks of publicly traded financial institutions. No other investment in a single financial institution in the financial institutions stock portfolio exceeded 10% of the portfolio's fair value. In total, net unrealized gains in this portfolio were approximately \$8.3 million as of September 30, 2016.

Management continuously monitors the fair value of its equity investments and evaluates current market conditions and operating results of the issuers. Periodic sale and purchase decisions are made based on this monitoring process. None of the Corporation's equity securities are classified as trading.

In addition to its equity portfolio, investment management and trust services income may be impacted by fluctuations in the equity markets. A portion of this revenue is based on the value of the underlying investment portfolios, many of which include equity investments. If the values of those investment portfolios decrease, whether due to factors influencing U.S. or international securities markets in general or otherwise, the Corporation's revenue would be negatively impacted. In addition, the Corporation's ability to sell its brokerage services in the future will be dependent, in part, upon consumers' level of confidence in financial markets.

#### Debt Security Market Price Risk

Debt security market price risk is the risk that changes in the values of debt securities, unrelated to interest rate changes, could have a material impact on the financial position or results of operations of the Corporation. The Corporation's debt security investments consist primarily of U.S. government sponsored agency issued mortgage-backed securities and collateralized mortgage obligations, state and municipal securities, U.S. government debt securities, auction rate securities and corporate debt securities. All of the Corporation's investments in mortgage-backed securities and collateralized mortgage obligations have principal payments that are guaranteed by U.S. government sponsored agencies.

#### State and Municipal Securities

As of September 30, 2016, the Corporation owned \$401.6 million of municipal securities issued by various municipalities. Downward pressure on local tax revenues of issuers due to adverse economic conditions could have an adverse impact on the underlying credit quality of issuers. The Corporation evaluates existing and potential holdings primarily based on the creditworthiness of the issuing municipality and then, to a lesser extent, on any underlying credit enhancement. Municipal securities can be supported by the general obligation of the issuing municipality, allowing the securities to be repaid by any means available to the issuing municipality. As of September 30, 2016, approximately 98% of municipal securities were supported by the general obligation of corresponding municipalities. Approximately 62% of these securities were school district issuances, which are also supported by the states of the issuing municipalities.

#### Auction Rate Securities

As of September 30, 2016, the Corporation's investments in student loan auction rate certificates (ARC), a type of auction rate securities, had a cost basis of \$107.1 million and a fair value of \$97.7 million.

ARCs are long-term securities that were structured to allow their sale in periodic auctions, resulting in both the treatment of ARCs as short-term instruments in normal market conditions and fair values that could be derived based on periodic auction prices. However, beginning in 2008, market auctions for these securities began to fail due to an

insufficient number of buyers, resulting in an illiquid market. Therefore, as of September 30, 2016, the fair values of the ARCs currently in the portfolio were derived using significant unobservable inputs based on an expected cash flows model which produced fair values that were materially different from those that would be expected from settlement of these investments in the current market. The expected cash flows model produced fair values which assumed a return to market liquidity sometime in the next five years. The Corporation believes that the trusts underlying the ARCs will self-liquidate as student loans are repaid.

The credit quality of the underlying debt associated with the ARCs is also a factor in the determination of their estimated fair value. As of September 30, 2016, all of the ARCs were rated above investment grade. All of the loans underlying the ARCs have principal payments that are guaranteed by the federal government. At September 30, 2016, all ARCs were current and making scheduled interest payments.

### Corporate Debt Securities

The Corporation holds corporate debt securities in the form of pooled trust preferred securities, single-issuer trust preferred securities, subordinated debt issued by financial institutions and senior debt. As of September 30, 2016, these securities had an amortized cost of \$109.5 million and an estimated fair value of \$107.2 million.

See "Note 4 - Investment Securities," in the Notes to Consolidated Financial Statements for further discussion related to the Corporation's other-than-temporary impairment evaluations for debt securities, and see "Note 11 - Fair Value Measurements," in the Notes to Consolidated Financial Statements for further discussion related to the fair values of debt securities.

Item 4. Controls and Procedures

The Corporation carried out an evaluation, under the supervision and with the participation of the Corporation's management, including the Corporation's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Corporation's disclosure controls and procedures pursuant to Rule 13a-15, promulgated under the Securities Exchange Act of 1934 (the "Exchange Act"). Based upon that evaluation, the Corporation's Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this quarterly report, the Corporation's disclosure controls and procedures are effective. Disclosure controls and procedures are controls and procedures that are designed to ensure that information required to be disclosed in Corporation reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

There have been no changes in the Corporation's internal control over financial reporting during the fiscal quarter covered by this quarterly report that have materially affected, or are reasonably likely to materially affect, the Corporation's internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings

The information presented in the "Legal Proceedings" section of Note 10 "Commitment and Contingencies" of the Notes to Consolidated Financial Statements is incorporated herein by reference.

Item 1A. Risk Factors

There have been no material changes to the risk factors previously disclosed in Part I, Item 1A of the Corporation's Annual Report on Form 10-K for the year ended December 31, 2015 and in Part II, Item 1A of the Corporation's Quarterly Report on Form 10-Q for the quarter ended June 30, 2016.

## Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table presents the Corporation's monthly repurchases of its common stock during the third quarter of 2016:

| Period                                  | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Approximate Dollar Value that May Yet Be Purchased Under the Plans or Programs |
|-----------------------------------------|----------------------------------|------------------------------|----------------------------------------------------------------------------------|----------------------------------------------------------------------------------------|
| July 1, 2016 to July 31, 2016           | 176,161                          | \$ 13.00                     | 176,161                                                                          | \$ 31,455,430                                                                          |
| August 1, 2016 to August 31, 2016       | —                                | —                            | —                                                                                | 31,455,430                                                                             |
| September 1, 2016 to September 30, 2016 | —                                | —                            | —                                                                                | 31,455,430                                                                             |

In October, 2015, the Corporation announced that its board of directors had approved a share repurchase program pursuant to which the Corporation is authorized to repurchase up to \$50.0 million of its outstanding shares of common stock, or approximately 2.3% of its outstanding shares, through December 31, 2016. Repurchased shares may be added to treasury stock, at cost. As permitted by securities laws and other legal requirements and subject to market conditions and other factors, purchases may be made from time to time in open market or privately negotiated transactions, including without limitation, through accelerated share repurchase transactions. The share repurchase program may be discontinued at any time. During 2016, 1.5 million shares have been repurchased under this program for a total cost of \$18.5 million, or \$12.48 per share.

No stock repurchases were made outside the program and all repurchases were made in accordance with the guidelines of Rule 10b-18 and in compliance with Regulation M.

## Item 3. Defaults Upon Senior Securities

Not applicable.

## Item 4. Mine Safety Disclosures

Not applicable.

## Item 5. Other Information

Not applicable.

## Item 6. Exhibits

See Exhibit Index for a list of the exhibits required by Item 601 of Regulation S-K and filed as part of this report.

FULTON FINANCIAL CORPORATION AND SUBSIDIARIES  
SIGNATURES

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

FULTON FINANCIAL  
CORPORATION

Date: November 4, 2016 /s/ E. Philip Wenger  
E. Philip Wenger  
Chairman, Chief Executive Officer and President

Date: November 4, 2016 /s/ Patrick S. Barrett  
Patrick S. Barrett  
Senior Executive Vice President and  
Chief Financial Officer



EXHIBIT INDEX  
Exhibits Required Pursuant  
to Item 601 of Regulation S-K

3.1 Articles of  
Incorporation,  
as amended and  
restated, of  
Fulton Financial  
Corporation—  
Incorporated by  
reference to  
Exhibit 3.1 of  
the Fulton  
Financial  
Corporation  
Current Report  
on Form 8-K  
dated June 24,  
2011.

3.2 Bylaws of  
Fulton Financial  
Corporation as  
amended –  
Incorporated by  
reference to  
Exhibit 3.1 of  
the Fulton  
Financial  
Corporation  
Current Report  
on an Amended  
Form 8-K dated  
September 23,  
2014.

10.1 Agreement  
between Fulton  
Financial  
Corporation and  
Fiserv  
Solutions, Inc.  
dated July 11,  
2016. Portions  
of this exhibit  
have been  
redacted and are

subject to a confidential treatment request filed with the Securities and Exchange Commission pursuant to Rule 24b-2 under the Securities Exchange Act of 1934, as amended. The redacted material was filed separately with the Securities and Exchange Commission.

31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification of Chief Financial Officer pursuant to Section 906 of the

Sarbanes-Oxley  
Act of 2002.

Financial  
statements from  
the Quarterly  
Report on Form  
10-Q of Fulton  
Financial  
Corporation for  
the period ended  
September 30,  
2016, filed on  
November 4,  
2016, formatted  
in XBRL: (i) the  
Consolidated  
Balance Sheets,  
(ii) the  
Consolidated  
101 Statements of  
Income, (iii) the  
Consolidated  
Statements of  
Comprehensive  
Income (iv) the  
Consolidated  
Statements of  
Shareholders'  
Equity, (v) the  
Consolidated  
Statements of  
Cash Flows and  
(vi) the Notes to  
Consolidated  
Financial  
Statements -  
filed herewith.