

FIRST INTERSTATE BANCSYSTEM INC
Form 10-Q
August 05, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

Quarterly report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended June 30, 2016
OR

Transition report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from _____ to _____
COMMISSION FILE NUMBER 001-34653

First Interstate BancSystem, Inc.
(Exact name of registrant as specified in its charter)

Montana	81-0331430
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

401 North 31st Street, Billings, MT	59116-0918
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: 406/255-5390

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

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files.)

Yes No

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

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

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

Yes No

Indicate the number of shares outstanding of each of the Registrant's classes of common stock:

June 30, 2016 – Class A common stock 21,131,759

June 30, 2016 – Class B common stock 23,614,455

FIRST INTERSTATE BANCSYSTEM, INC. AND SUBSIDIARIES

Quarterly Report on Form 10-Q

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CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)

(Unaudited)

	June 30, 2016	December 31, 2015
Assets		
Cash and due from banks	\$ 125,995	\$ 132,595
Interest bearing deposits in banks	349,910	647,299
Federal funds sold	146	563
Total cash and cash equivalents	476,051	780,457
Investment securities:		
Available-for-sale	1,505,581	1,456,840
Held-to-maturity (estimated fair values of \$574,482 and \$607,550 at June 30, 2016 and December 31, 2015, respectively)	556,247	600,665
Total investment securities	2,061,828	2,057,505
Loans held for investment	5,340,189	5,193,321
Mortgage loans held for sale	73,053	52,875
Total loans	5,413,242	5,246,196
Less allowance for loan losses	80,340	76,817
Net loans	5,332,902	5,169,379
Goodwill	204,481	204,523
Company-owned life insurance	189,524	187,253
Premises and equipment, net of accumulated depreciation	187,538	190,812
Accrued interest receivable	27,448	27,729
Mortgage servicing rights, net of accumulated amortization and impairment reserve	16,038	15,621
Core deposit intangibles, net of accumulated amortization	8,935	10,589
Other real estate owned ("OREO")	7,908	6,254
Other assets	92,723	78,074
Total assets	\$8,605,376	\$ 8,728,196
Liabilities and Stockholders' Equity		
Deposits:		
Non-interest bearing	\$ 1,783,609	\$ 1,823,716
Interest bearing	5,197,839	5,265,221
Total deposits	6,981,448	7,088,937
Securities sold under repurchase agreements	466,399	510,635
Accounts payable and accrued expenses	59,664	53,042
Accrued interest payable	5,647	4,960
Deferred tax liability	16,673	9,765
Long-term debt	27,928	27,885
Other borrowed funds	15	2
Subordinated debentures held by subsidiary trusts	82,477	82,477
Total liabilities	7,640,251	7,777,703
Stockholders' equity:		
Nonvoting noncumulative preferred stock without par value; authorized 100,000 shares; no shares issued and outstanding as of June 30, 2016 or December 31, 2015	—	—
Common stock	290,366	311,720

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Retained earnings	664,337	638,367
Accumulated other comprehensive income, net	10,422	406
Total stockholders' equity	965,125	950,493
Total liabilities and stockholders' equity	\$8,605,376	\$ 8,728,196

See accompanying notes to unaudited consolidated financial statements.

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Table of ContentsFIRST INTERSTATE BANCSYSTEM, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share data)

(Unaudited)

	Three Months		Six Months Ended	
	Ended June 30,		June 30,	
	2016	2015	2016	2015
Interest income:				
Interest and fees on loans	\$62,634	\$60,402	\$125,450	\$119,773
Interest and dividends on investment securities:				
Taxable	7,982	8,000	16,020	15,971
Exempt from federal taxes	858	1,040	1,737	2,099
Interest on deposits in banks	482	271	1,127	660
Interest on federal funds sold	3	5	5	7
Total interest income	71,959	69,718	144,339	138,510
Interest expense:				
Interest on deposits	3,108	3,239	6,336	6,548
Interest on securities sold under repurchase agreements	92	53	182	107
Interest on long-term debt	451	538	900	1,052
Interest on subordinated debentures held by subsidiary trusts	675	600	1,338	1,190
Total interest expense	4,326	4,430	8,756	8,897
Net interest income	67,633	65,288	135,583	129,613
Provision for loan losses	2,550	1,340	6,550	2,435
Net interest income after provision for loan losses	65,083	63,948	129,033	127,178
Non-interest income:				
Payment services revenues	8,648	8,437	16,639	15,809
Mortgage banking revenues	9,409	8,802	15,550	14,708
Wealth management revenues	5,166	4,897	9,741	9,834
Service charges on deposit accounts	4,626	4,053	9,089	7,997
Other service charges, commissions and fees	2,845	2,736	5,453	5,231
Investment securities gains, net	108	46	87	52
Other income	2,457	2,792	4,750	6,050
Non-recurring litigation recovery	3,750	—	3,750	—
Total non-interest income	37,009	31,763	65,059	59,681
Non-interest expense:				
Salaries and wages	26,707	26,093	51,389	51,442
Employee benefits	8,066	8,063	17,675	15,979
Outsourced technology services	4,800	2,593	9,632	5,056
Occupancy, net	4,284	4,529	8,948	9,021
Furniture and equipment	2,460	3,703	4,716	7,496
OREO expense, net of income	140	(823)	101	(884)
Professional fees	1,136	1,514	2,444	2,815
FDIC insurance premiums	1,198	1,304	2,456	2,446
Mortgage servicing rights amortization	722	627	1,356	1,246
Mortgage servicing rights impairment recovery	(20)	(56)	(5)	(71)
Core deposit intangibles amortization	827	854	1,654	1,709
Other expenses	12,575	13,577	24,198	25,381
Acquisition expenses	—	(7)	—	63

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Total non-interest expense	62,895	61,971	124,564	121,699
Income before income tax expense	39,197	33,740	69,528	65,160
Income tax expense	13,643	11,518	23,850	21,958
Net income	\$25,554	\$22,222	\$45,678	\$43,202

Basic earnings per common share	\$0.58	\$0.49	\$1.03	\$0.95
Diluted earnings per common share	\$0.57	\$0.49	\$1.02	\$0.94

See accompanying notes to unaudited consolidated financial statements.

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CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Net income	\$25,554	\$22,222	\$45,678	\$43,202
Other comprehensive income, before tax:				
Investment securities available-for sale:				
Change in net unrealized gains (losses) during period	10,043	(9,196)	18,671	1,412
Reclassification adjustment for net gains included in income	(108)	(46)	(87)	(52)
Change in unamortized loss on available-for-sale securities transferred into held-to-maturity	452	451	904	902
Unrealized loss on derivatives	(804)	—	(3,002)	—
Defined benefit post-retirement benefits plans:				
Change in net actuarial loss	13	13	28	28
Other comprehensive income (loss), before tax	9,596	(8,778)	16,514	2,290
Deferred tax benefit (expense) related to other comprehensive income	(3,775)	3,454	(6,498)	(901)
Other comprehensive income (loss), net of tax	5,821	(5,324)	10,016	1,389
Comprehensive income, net of tax	\$31,375	\$16,898	\$55,694	\$44,591
See accompanying notes to unaudited consolidated financial statements.				

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CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

(In thousands, except share and per share data)

(Unaudited)

	Common stock	Retained earnings	Accumulated other comprehensive income (loss)	Total stockholders' equity
Balance at December 31, 2015	\$311,720	\$638,367	\$ 406	\$ 950,493
Net income	—	45,678	—	45,678
Other comprehensive income, net of tax expense	—	—	10,016	10,016
Common stock transactions:				
995,600 common shares purchased and retired	(26,042)	—	—	(26,042)
16,085 common shares issued	—	—	—	—
189,624 non-vested common shares issued	—	—	—	—
21,397 non-vested common shares forfeited	—	—	—	—
186,430 stock options exercised, net of 57,153 shares tendered in payment of option price and income tax withholding amounts	1,684	—	—	1,684
Tax benefit of stock-based compensation	619	—	—	619
Stock-based compensation expense	2,385	—	—	2,385
Common cash dividend declared (\$0.44 per share)	—	(19,708)	—	(19,708)
Balance at June 30, 2016	\$290,366	\$664,337	\$ 10,422	\$ 965,125
Balance at December 31, 2014	\$323,596	\$587,862	\$ (2,534)	\$ 908,924
Net income	—	43,202	—	43,202
Other comprehensive income, net of tax expense	—	—	1,389	1,389
Common stock transactions:				
588,409 common shares purchased and retired	(15,264)	—	—	(15,264)
21,414 common shares issued	—	—	—	—
156,956 non-vested common shares issued	—	—	—	—
1,678 non-vested common shares forfeited	—	—	—	—
129,885 stock options exercised, net of 37,357 shares tendered in payment of option price and income tax withholding amounts	1,670	—	—	1,670
Tax benefit of stock-based compensation	804	—	—	804
Stock-based compensation expense	2,319	—	—	2,319
Common cash dividend declared (\$0.40 per share)	—	(18,189)	—	(18,189)
Balance at June 30, 2015	\$313,125	\$612,875	\$ (1,145)	\$ 924,855

See accompanying notes to unaudited consolidated financial statements.

Table of ContentsFIRST INTERSTATE BANCSYSTEM, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Six Months Ended	
	June 30,	
	2016	2015
Cash flows from operating activities:		
Net income	\$45,678	\$43,202
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	6,550	2,435
Net (gain) loss on disposal of premises and equipment	188	(856)
Depreciation and amortization	9,491	9,090
Net premium amortization on investment securities	6,347	7,021
Net gain on investment securities transactions	(87)	(52)
Realized and unrealized net gains on mortgage banking activities	(10,544)	(10,759)
Net gain on sale of OREO	(636)	(1,736)
Write-downs of OREO and other assets pending disposal	621	106
Mortgage servicing rights impairment recovery	(5)	(71)
Deferred income tax expense	321	9,108
Net increase in cash surrender value of company-owned life insurance	(2,271)	(1,304)
Stock-based compensation expense	2,385	2,319
Tax benefits from stock-based compensation expense	619	804
Excess tax benefits from stock-based compensation expense	(495)	(530)
Originations of mortgage loans held for sale	(468,560)	(561,779)
Proceeds from sales of mortgage loans held for sale	457,132	546,871
Changes in operating assets and liabilities:		
Decrease (increase) in interest receivable	281	(1,945)
Increase in other assets	(14,551)	(1,034)
Increase (decrease) in accrued interest payable	687	(467)
Increase (decrease) in accounts payable and accrued expenses	3,701	(12,268)
Net cash provided by operating activities	36,852	28,155
Cash flows from investing activities:		
Purchases of investment securities:		
Held-to-maturity	(9,883)	(27,640)
Available-for-sale	(459,569)	(223,483)
Proceeds from maturities and pay-downs of investment securities:		
Held-to-maturity	53,977	55,654
Available-for-sale	424,458	337,538
Purchases of company-owned life insurance	—	(22,500)
Extensions of credit to customers, net of repayments	(159,410)	(190,392)
Recoveries of loans charged-off	4,717	3,285
Proceeds from sale of OREO	2,398	7,807
Proceeds from sale of loan production office	932	—
Capital expenditures, net of sales	(3,638)	514
Net cash used in investing activities	\$(146,018)	\$(59,217)

Table of ContentsFIRST INTERSTATE BANCSYSTEM, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)

(In thousands)

(Unaudited)

	Six Months Ended June 30, 2016		2015	
Cash flows from financing activities:				
Net decrease in deposits	\$ (107,489)		\$ (201,811)	
Net decrease in securities sold under repurchase agreements	(44,236)		(33,105)	
Net increase (decrease) in other borrowed funds	13		(6)	
Repayments of long-term debt	(32)		(30)	
Advances on long-term debt	75		5,031	
Proceeds from issuance of common stock	1,684		1,670	
Excess tax benefits from stock-based compensation expense	495		530	
Purchase and retirement of common stock	(26,042)		(15,264)	
Dividends paid to common stockholders	(19,708)		(18,189)	
Net cash used in financing activities	(195,240)		(261,174)	
Net decrease in cash and cash equivalents	(304,406)		(292,236)	
Cash and cash equivalents at beginning of period	780,457		798,670	
Cash and cash equivalents at end of period	\$ 476,051		\$ 506,434	

Supplemental disclosures of cash flow information:

Cash paid during the period for income taxes	\$ 27,566	\$ 18,450
Cash paid during the period for interest expense	8,069	9,364
Supplemental disclosures of noncash investing and financing activities:		
Transfer of loans to loans held for sale	26	10,619
Transfer of loans to other real estate owned	4,019	4,396
Capitalization of internally originated mortgage servicing rights	1,768	1,792

See accompanying notes to unaudited consolidated financial statements.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands, except share and per share data)

(1)Basis of Presentation

In the opinion of management, the accompanying unaudited consolidated financial statements of First Interstate BancSystem, Inc. and subsidiaries (the "Company") contain all adjustments (all of which are of a normal recurring nature) necessary to present fairly the financial position of the Company at June 30, 2016 and December 31, 2015, the results of operations for each of the three and six month periods ended June 30, 2016 and 2015, and cash flows each of the six month periods ended June 30, 2016 and 2015, in conformity with U.S. generally accepted accounting principles. The balance sheet information at December 31, 2015 is derived from audited consolidated financial statements. Certain reclassifications, none of which were material, have been made to conform prior year financial statements to the June 30, 2016 presentation. These reclassifications did not change previously reported net income or stockholders' equity.

These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2015. Operating results for the three and six months ended June 30, 2016 are not necessarily indicative of the results that may be expected for the year ending December 31, 2016.

(2)Acquisitions

Flathead Bank. On April 6, 2016, the Company's bank subsidiary, First Interstate Bank, entered into a stock purchase agreement to acquire all of the outstanding stock of Flathead Bank of Bigfork ("Flathead Bank"), a Montana-based bank wholly owned by Flathead Holding Company. With total assets of \$231,574 as of December 31, 2015, Flathead Bank operates seven branches in western and northwestern Montana. Upon closing of the transaction, which is expected to occur during the third quarter of 2016, all Flathead Bank branches will become branches of First Interstate Bank. Pursuant to the Purchase Agreement, First Interstate Bank will pay cash consideration of approximately \$34,237 for the stock, subject to certain financial performance and other adjustments, the amount of which will be determined prior to the closing date of the transaction.

Absarokee Bancorporation, Inc. On July 24, 2015, the Company acquired all of the outstanding stock of Absarokee Bancorporation, Inc. ("Absarokee"), a Montana-based bank holding company that operated one subsidiary bank, United Bank. The Company merged United Bank with and into First Interstate Bank immediately subsequent to the acquisition. During March 2016, the Company completed its review of Absarokee's tax items and finalized the fair value of the acquired deferred tax asset. Finalization of provisional estimates resulted in a \$42 decrease in goodwill.

(3)Investment Securities

The amortized cost and approximate fair values of investment securities are summarized as follows:

June 30, 2016	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-Sale:				
U.S. Treasury notes	\$3,909	\$ 44	\$ —	\$3,953
Obligations of U.S. government agencies	450,544	2,882	(21) 453,405
	1,022,462	22,252	(117) 1,044,597

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U.S. agency residential mortgage-backed securities & collateralized
mortgage obligations

Private mortgage-backed securities

Other investments

Total

136	1	(2)	135
3,450	41	—		3,491
\$1,480,501	\$ 25,220	\$ (140)	\$1,505,581

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FIRST INTERSTATE BANCSYSTEM, INC. AND SUBSIDIARIES
 NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
 (Dollars in thousands, except share and per share data)

June 30, 2016	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Held-to-Maturity:				
State, county and municipal securities	\$ 164,334	\$ 7,024	\$ (1)	\$ 171,357
Corporate securities	51,262	580	—	51,842
Obligations of U.S. government agencies	19,737	483	—	20,220
U.S. agency residential mortgage-backed securities & collateralized mortgage obligations	320,620	15,925	(5,777)	330,768
Other investments	294	1	—	295
Total	\$ 556,247	\$ 24,013	\$ (5,778)	\$ 574,482
December 31, 2015	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-Sale:				
U.S. Treasury notes		\$ 3,912	\$ 3	\$ (4) \$ 3,911
Obligations of U.S. government agencies		521,079	712	(1,610) 520,181
U.S. agency residential mortgage-backed securities & collateralized mortgage obligations		921,699	9,448	(2,101) 929,046
Private mortgage-backed securities		156	1	(1) 156
Other investments		3,550	5	(9) 3,546
Total		\$ 1,450,396	\$ 10,169	\$ (3,725) \$ 1,456,840
December 31, 2015	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Held-to-Maturity:				
State, county and municipal securities		\$ 173,785	\$ 5,103	\$ (227) \$ 178,661
Corporate securities		50,046	64	(220) 49,890
Obligations of U.S. government agencies		19,738	—	(102) 19,636
U.S. agency residential mortgage-backed securities & collateralized mortgage obligations		356,742	7,686	(5,420) 359,008
Other investments		354	1	— 355
Total		\$ 600,665	\$ 12,854	\$ (5,969) \$ 607,550

Gross realized gains and losses from the disposition of investment securities are summarized in the following table:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Gross realized gains	\$ 108	\$ 46	\$ 165	\$ 52
Gross realized losses	—	—	(78)	—

On October 30, 2015, the Company transferred available-for-sale U.S. agency residential mortgage-backed securities and collateralized mortgage obligations with amortized costs and fair values of \$100,343 and \$100,140, respectively, into the held-to-maturity category. Unrealized net losses of \$203 included in accumulated other comprehensive income at the time of the transfer are being amortized to yield over the remaining expected lives of the transferred securities of 4 years.

On June 27, 2014, the Company transferred available-for-sale U.S. agency residential mortgage-backed securities and collateralized mortgage obligations with amortized costs and fair values of \$396,640 and \$388,808, respectively, into the held-to-maturity category. Unrealized net losses of \$7,832 at the time of the transfer are being amortized to yield over the remaining expected lives of the transferred securities of 4.3 years.

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FIRST INTERSTATE BANCSYSTEM, INC. AND SUBSIDIARIES
 NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
 (Dollars in thousands, except share and per share data)

The following tables show the gross unrealized losses and fair values of investment securities, aggregated by investment category, and the length of time individual investment securities have been in a continuous unrealized loss position, as of June 30, 2016 and December 31, 2015:

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
June 30, 2016						
Available-for-Sale:						
Obligations of U.S. government agencies	\$—	\$ —	\$10,477	\$(21)	\$10,477	\$(21)
U.S. agency residential mortgage-backed securities & collateralized mortgage obligations	11,097	(41)	18,609	(76)	29,706	(117)
Private mortgage-backed securities	—	—	54	(2)	54	(2)
Total	\$11,097	\$(41)	\$29,140	\$(99)	\$40,237	\$(140)
June 30, 2016						
Held-to-Maturity:						
State, county and municipal securities	\$625	\$ —	\$2,233	\$(1)	\$2,858	\$(1)
U.S. agency residential mortgage-backed securities & collateralized mortgage obligations	5,030	(2,631)	20,683	(3,146)	25,713	(5,777)
Total	\$5,655	\$(2,631)	\$22,916	\$(3,147)	\$28,571	\$(5,778)
December 31, 2015						
Available-for-Sale:						
U.S. Treasury notes	\$2,092	\$(4)	\$—	\$—	\$2,092	\$(4)
Obligations of U.S. government agencies	209,631	(1,077)	54,619	(533)	264,250	(1,610)
U.S. agency residential mortgage-backed securities & collateralized mortgage obligations	343,875	(1,577)	28,010	(524)	371,885	(2,101)
Private mortgage-backed securities	—	—	61	(1)	61	(1)
Other investments	1,225	(9)	—	—	1,225	(9)
Total	\$556,823	\$(2,667)	\$82,690	\$(1,058)	\$639,513	\$(3,725)
December 31, 2015						
Held-to-Maturity:						
State, county and municipal securities	\$10,182	\$(39)	\$9,476	\$(188)	\$19,658	\$(227)

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Obligations of U.S. government agencies	19,738	(102)	—	—	19,738	(102)
U.S. agency residential mortgage-backed securities & collateralized mortgage obligations	67,295	(4,288)	69,539	(1,132)	136,834	(5,420)
Corporate securities	31,135					