COLUMBIA BANKING SYSTEM INC
Form 10-K
February 28, 2019
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K
x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2018 or
TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission File Number 0-20288
COLUMBIA BANKING SYSTEM, INC.
(Exact name of registrant as specified in its charter)

Washington	91-1422237
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

1301 A Street
Tacoma, Washington 98402
(Address of principal executive offices) (Zip code)
Registrant’s Telephone Number, Including Area Code: (253) 305-1900

Securities Registered Pursuant to Section 12(b) of the Act:
Common Stock, No Par Value
(Title of class)
Securities Registered Pursuant to Section 12(g) of the Act: None
Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No x
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 x No
Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes x No
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (17 C.F.R. 229.405) is not contained herein, and will not be contained, to the best of registrant’s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or emerging growth company. See definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.
x Large Accelerated Filer Accelerated Filer Non-accelerated Filer Smaller Reporting Company Emerging Growth Company
If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No x

The aggregate market value of Common Stock held by non-affiliates of the registrant at June 30, 2018 was $2,967,255,859 based on the closing sale price of the Common Stock on that date.

The number of shares of registrant's Common Stock outstanding at January 31, 2019 was 73,267,025.

DOCUMENTS INCORPORATED BY REFERENCE:

Portions of the Registrant's definitive 2019 Annual Meeting Proxy Statement.	Part III

COLUMBIA BANKING SYSTEM, INC.
FORM 10-K ANNUAL REPORT
DECEMBER 31, 2018

TABLE OF CONTENTS

PART I

Item 1.	Business	2
Item 1A.	Risk Factors	15
Item 1B.	Unresolved Staff Comments	23
Item 2.	Properties	24
Item 3.	Legal Proceedings	24
Item 4.	Mine Safety Disclosures	24

PART II

Item 5.	Market for the Registrant's Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities	25
Item 6.	Selected Financial Data	27
Item 7.	Management's Discussion and Analysis of Financial Condition and Results of Operations	29
Item 7A.	Quantitative and Qualitative Disclosures About Market Risk	54
Item 8.	Financial Statements and Supplementary Data	56
Item 9.	Changes in and Disagreements With Accountants on Accounting and Financial Disclosure	112
Item 9A.	Controls and Procedures	112
Item 9B.	Other Information	114

PART III

Item 10.	Directors, Executive Officers and Corporate Governance	115
Item 11.	Executive Compensation	115
Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	115
Item 13.	Certain Relationships and Related Transactions, and Director Independence	115
Item 14.	Principal Accounting Fees and Services	115

PART IV

Item 15.	Exhibits, Financial Statement Schedules	116
Item 16.	Form 10-K Summary	116

Signatures	117
Index to Exhibits	118

Table of Contents

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This annual report on Form 10-K may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements include, but are not limited to, statements about our plans, objectives, expectations and intentions that are not historical facts, and statements identified by words such as "expects," "anticipates," "intends," "plans," "believes," "should," "projects," "seeks," "estimates" or the negative version of words or other comparable words or phrases of a future or forward-looking nature. Forward-looking statements are based on current beliefs and expectations of management and are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control. In addition, forward-looking statements are subject to assumptions with respect to future business strategies and decisions that are subject to change. In addition to the factors set forth in the sections titled "Risk Factors," "Business" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" in this Form 10-K, the following factors, among others, could cause actual results to differ materially from the anticipated results expressed or implied by forward-looking statements:

- national and global economic conditions could be less favorable than expected or could have a more direct and pronounced effect on us than expected and adversely affect our ability to continue internal growth and maintain the quality of our earning assets;
- the markets where we operate and make loans could face challenges;
- the risks presented by the economy, which could adversely affect credit quality, collateral values, including real estate collateral, investment values, liquidity and loan originations and loan portfolio delinquency rates;
- the efficiencies and enhanced financial and operating performance we expect to realize from investments in personnel, acquisitions and infrastructure may not be realized;
- interest rate changes could significantly reduce net interest income and negatively affect funding sources;
- the effect of changes to LIBOR ("London Interbank Offering Rate");
- projected business increases following strategic expansion could be lower than expected;
- changes in the scope and cost of Federal Deposit Insurance Corporation ("FDIC") insurance and other coverages;
- the impact of acquired loans on our earnings;
- changes in accounting principles, policies and guidelines applicable to bank holding companies and banking;
- changes in laws and regulations affecting our businesses, including changes in the enforcement and interpretation of such laws and regulations by applicable governmental and regulatory agencies;
- competition among financial institutions and nontraditional providers of financial services could increase significantly;
- continued consolidation in the Northwest financial services industry resulting in the creation of larger financial institutions that may have greater resources could change the competitive landscape;
- the goodwill we have recorded in connection with acquisitions could become impaired, which may have an adverse impact on our earnings and capital;
- our ability to identify and address cyber-security risks, including security breaches, "denial of service attacks," "hacking" and identity theft;
- any material failure or interruption of our information and communications systems or inability to keep pace with technological changes;
- our ability to effectively manage credit risk, interest rate risk, market risk, operational risk, legal risk, liquidity risk and regulatory and compliance risk;
- failure to maintain effective internal controls over financial reporting or disclosure controls and procedures;
- the effect of geopolitical instability, including wars, conflicts and terrorist attacks;
- our profitability measures could be adversely affected if we are unable to effectively manage our capital;
- natural disasters, including earthquakes, tsunamis, flooding, fires and other unexpected events; and
- the effects of any damage to our reputation resulting from developments related to any of the items identified above.

You should take into account that forward-looking statements speak only as of the date of this report. Given the described uncertainties and risks, we cannot guarantee our future performance or results of operations and you should not place undue reliance on forward-looking statements. We undertake no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required under federal securities laws.

Table of Contents

PART I

ITEM 1. BUSINESS

General

Columbia Banking System, Inc. (referred to in this report as "we," "our," "the Company" and "Columbia") is a registered bank holding company whose wholly owned banking subsidiary is Columbia State Bank ("Columbia Bank" or "the Bank"). Established in 1993 in Tacoma, Washington, we provide a full range of banking services to small and medium-sized businesses, professionals and individuals throughout Washington, Oregon and Idaho. The Company's subsidiary Columbia Trust Company ("Columbia Trust") is an Oregon trust company that provides agency, fiduciary and other related trust services with offices in Washington, Oregon and Idaho.

Columbia Bank has locations throughout Washington, Oregon and Idaho. The vast majority of Columbia Bank's loans and deposits are within its service areas. Columbia Bank is a Washington state-chartered commercial bank, the deposits of which are insured in whole or in part by the FDIC. Columbia Bank is subject to regulation by the FDIC, the Washington State Department of Financial Institutions Division of Banks, the Oregon Department of Consumer and Business Services Division of Finance and Corporate Securities, and the Idaho Department of Finance. Although Columbia Bank is not a member of the Federal Reserve System, the Board of Governors of the Federal Reserve System ("Federal Reserve") has certain supervisory authority over the Company, which can also affect Columbia Bank.

Business Overview

Having celebrated our 25th anniversary in 2018, our goal is to continue to be a leading Northwest regional community banking company while consistently increasing shareholder value. We continue to build on our reputation for exceptional customer satisfaction in order to be recognized as the bank of choice for individual and business customers in all markets we serve.

We have established a network of 150 branches in Washington, Oregon and Idaho as of December 31, 2018, from which we intend to grow market share. We operate 74 branches in 21 counties in the state of Washington, 62 branches in 16 counties in Oregon and 14 branches in 10 counties in Idaho.

Our branch system funds our lending activities and allows us to better serve both retail and business depositors. We believe this approach enables us to expand lending activities while attracting a stable core deposit base and enhancing utilization of our full range of products and services. To support our strategy of market penetration and increased profitability, while continuing our personalized banking approach, we have invested in experienced banking and administrative personnel and have incurred related costs in the creation of our branch network. Our branch system and other delivery channels are continually evaluated as an important component of ongoing efforts to improve efficiencies without compromising customer service. We are taking major steps towards enhancing our digitally enabled bank that puts the client first and ensures they can bank when, how and where they choose.

Business Strategy

Our business strategy is to provide our customers with the financial sophistication and product depth of a regional banking company while retaining the appeal and service level of a community bank. We continually evaluate our existing business processes while focusing on maintaining asset quality and a diversified loan and deposit portfolio. We continue to build our strong core deposit base, expanding total revenue and controlling expenses in an effort to gain operational efficiencies and increase our return on average equity. As a result of our strong commitment to highly personalized, relationship-oriented customer service, our diverse products, our strategic branch locations and the long-standing community presence of our managers and staff, we believe we are well positioned to attract and retain new customers and to increase our market share of loans, deposits, investments and other financial services. We are dedicated to increasing market share in the communities we serve by continuing to leverage our existing branch network and considering business combinations that are consistent with our expansion strategy throughout the Northwest. We have grown our franchise over the past decade through a combination of acquisitions and organic growth.

Table of Contents

Products & Services

We place the highest priority on customer service and assist our clients in making informed decisions when selecting from the products and services we offer. We continually review our product and service offerings to ensure that we provide our customers with the tools to meet their financial needs. A more complete listing of all the services and products available to our customers can be found on our website: www.columbiabank.com. Some of the core products and services we offer include:

Personal Banking
- Checking and Savings Accounts
- Debit and Credit Cards
- Digital Banking
- Personal Loans
- Home Loans
- Foreign Currency

Business Banking
- Checking and Savings Accounts
- Debit and Credit Cards
- Business Loans
- Professional Banking
- Treasury Management
- Merchant Card Services
- International Banking

Wealth Management
- Financial Services
- Private Banking
- Trust and Investment Services

Personal Banking: We offer our personal banking customers an assortment of account products including noninterest and interest-bearing checking, savings, money market and certificate of deposit accounts. Overdraft protection is also available with direct links to the customer’s checking account. Personal banking customers may also choose from a variety of loan products including home mortgages for purchases and refinances, home equity loans and lines of credit, and other personal loans. Eligible personal banking customers with checking accounts are provided a Visa® Debit Card. Further, a variety of Visa® Credit Cards are available to eligible personal banking customers.

In addition, Columbia Connect, our personal digital banking platform, allows our personal banking customers to safely and securely conduct their banking business 24 hours a day, 7 days a week across all of their devices. Columbia Connect has simple navigation and provides access to frequently used features such as depositing checks, paying bills, transferring funds, or locating the nearest Columbia Bank branch or ATM.

Business Banking: A variety of checking, savings, interest bearing money market and certificate of deposit accounts are offered to business banking customers to satisfy all their banking needs. In addition to these core banking products, we provide a breadth of services to support the complete financial needs of small and middle market businesses including Business Debit and Credit Cards, Business Loans, Professional Banking, Treasury Management, Merchant Card Services, and International Banking.

Business Debit and Credit Cards

Our business banking customers are offered a selection of Visa® Cards including the Business Debit Card that works like a check wherever Visa® is accepted. We also partner with Elan Financial Services to offer a variety of Visa® Credit Cards that come with important business features including expense management tools, free employee cards and added security benefits. A specialty community card for nonprofit organizations and municipalities is also available.

Business Loans

We offer a variety of loan products tailored to meet the diverse needs of business banking customers. Business loan products include agricultural loans, asset-based loans, builder and other commercial real estate loans, and loans guaranteed by the Small Business Administration. In addition, we offer a suite of Business Edge loans designed for small businesses looking to expand, purchase equipment, or in need of working capital.

Professional Banking

Columbia Professional Bankers are uniquely qualified to help dentists, physicians and veterinarians acquire, build and grow their practice. We offer tailored banking solutions delivered by experienced bankers with the industry knowledge necessary to meet their business’s unique needs.

Table of Contents

Treasury Management

Columbia Bank's diversified Treasury Management Programs are tailored to meet specific banking needs of each individual business. We combine technology with integrated operations and local expertise for safe, powerful, flexible solutions. Columbia's clients, of all sizes, choose from a full range of transaction and Treasury Management tools to gain more control over their money. Treasury Management solutions include Business Online and Mobile Banking, Business Bill Pay, Automated Clearing House (ACH) collections and payments, Remote Deposit Capture, and a variety tools to protect against fraud and manage excess funds.

Merchant Card Services

Since 2017, we have partnered with Vantiv to provide businesses with a broad range of payment acceptance solutions to meet their customer's needs. Our Merchant Card Services powered by Vantiv provide businesses with sophisticated technology, competitive pricing and best-in-class service for their merchant needs.

International Banking

Columbia International Banking offers a range of financial services to help our business customers explore global markets and conduct international trade smoothly and expediently. We are proud to provide small and mid-size businesses with the same caliber of expertise and personalized service that national banks usually limit to large businesses. Our experience with foreign currency exchange, letters of credit, foreign collections and trade finance services can help companies open the door to new markets and suppliers overseas.

Wealth Management: We offer tailored solutions to individuals, families and professional businesses in the areas of financial services and private banking, as well as trust and investment services.

CB Financial Services

CB Financial Services[1] offers a comprehensive array of financial solutions that focuses on wealth management by delivering personalized service and experience through dedicated financial advisors serving various geographical areas.

Financial Services solutions include:

Financial Planning: Asset Allocation, Net Worth Analysis, Estate Planning & Preservation[2], Education Funding, Wealth Transfer.

Wealth Management: Professional Asset Management, Tailored Investment Strategies, and Professional Money Managers.

Insurance Solutions: Long-Term Care, Life, and Disability Insurance.

Individual Retirement Solutions: Retirement Planning, Retirement Income Strategies, and Traditional and Roth IRAs.

Business Solutions: Business Retirement Plans, Key Person Insurance, Business Succession Planning, and Deferred Compensation Plans.

Private Banking

Columbia Private Banking offers affluent clientele and their businesses complex financial solutions, such as deposit and treasury management services, credit services, and wealth management strategies. Each private banker coordinates a relationship team of experienced financial professionals to meet the unique needs of each discerning customer.

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(1) Securities and insurance products are offered through Cetera Investment Services LLC (doing insurance business in California as CFGIS Insurance Agency), member FINRA/SIPC. Advisory services are offered through Cetera Investment Advisers LLC. Neither firm is affiliated with the financial institution where investment services are offered.

* Investment products are not FDIC insured * No bank guarantee * Not a deposit * Not insured by any federal government agency * May lose value.

(2) For a comprehensive review of your personal situation, always consult a tax or legal advisor. Neither Cetera, nor any of its representatives may give legal or tax advice.

Table of Contents

Trust and Investment Services: Through our Columbia Trust Company subsidiary, we offer a wide range of high quality fiduciary, investment and administrative trust services, coupled with local, personalized attention to the unique requirements of each trust. Services include Personal Trusts, Special Needs (Supplemental) Trusts, Estate Settlement Services, Investment Agency and Charitable Management Services. A more complete listing of all the services and products available to our customers can be found on Columbia Trust's website: www.columbiatrustcompany.com. Information contained on Columbia Trust's website is not incorporated by reference into this report.

Competition

Our industry is highly competitive. Several other financial institutions with greater resources compete for banking business in our market areas. These competitors have the ability to make larger loans, finance extensive advertising and promotional campaigns, access international financial markets and allocate their investment assets to regions of highest yield and demand. In addition to competition from other banking institutions, we continue to compete with non-banking companies such as credit unions, brokerage houses, financial technology companies and other financial services companies. We compete for deposits, loans, and other financial services by offering our customers similar breadth of products as our larger competitors while delivering a more personalized service level.

Employees

As of December 31, 2018, the Company employed 2,137 full-time equivalent employees. We value our employees and pride ourselves on providing a professional work environment accompanied by comprehensive pay and benefit programs. We are committed to providing flexible and value-added benefits to our employees through a "Total Compensation Philosophy" which incorporates all compensation and benefits. Our continued commitment to employees was demonstrated by Columbia Bank being honored as one of the Puget Sound Business Journal's "Washington's Best Workplaces" for the 12th consecutive year.

Available Information

We file annual reports on Form 10-K, quarterly reports on Form 10-Q, periodic reports on Form 8-K, proxy statements and other information with the United States Securities and Exchange Commission (the "SEC"). The public may obtain copies of these reports and any amendments at the SEC's Internet site, www.sec.gov.
Additionally, reports filed with the SEC can be obtained free of charge through our website at www.columbiabank.com. These reports are made available through our website as soon as reasonably practicable after they are filed electronically with the SEC. Information contained on our website is not incorporated by reference into this report.

Supervision and Regulation

The following discussion provides an overview of certain elements of the extensive regulatory framework applicable to the Company and Columbia State Bank, which operates under the name Columbia Bank in Washington, Oregon and Idaho. This regulatory framework is primarily designed for the protection of depositors, customers, federal deposit insurance funds and the banking system as a whole, rather than specifically for the protection of shareholders or non-depository creditors. Due to the breadth and growth of this regulatory framework, our costs of compliance continue to increase in order to monitor and satisfy these requirements.

To the extent that this section describes statutory and regulatory provisions, it is qualified by reference to those provisions. These statutes and regulations, as well as related policies, are subject to change by Congress, state legislatures and federal and state regulators. Changes in statutes, regulations or regulatory policies applicable to us, including the interpretation or implementation thereof, cannot be predicted, but may have a material effect on our business, financial condition, or results of operations. In light of the 2008 financial crisis, numerous changes to the statutes, regulations or regulatory policies applicable to us have been made or proposed. The full extent to which these changes will impact our business is not yet known. In addition, recent political developments, including the change in the presidential administration in the United States, have added additional uncertainty to the implementation, scope and timing of regulatory reforms. However, our continued efforts to monitor and comply with new regulatory requirements add to the complexity and cost of our business.

Table of Contents

Federal and State Bank Holding Company Regulation

General. The Company is a bank holding company as defined in the Bank Holding Company Act of 1956, as amended (the "BHCA"), and is therefore subject to regulation, supervision and examination by the Federal Reserve. In general, the BHCA limits the business of bank holding companies to owning or controlling banks and engaging in other activities closely related to banking. The Company must file reports with and provide the Federal Reserve such additional information as it may require. Under the Financial Services Modernization Act of 1999, a bank holding company may apply to the Federal Reserve to become a financial holding company, and thereby engage (directly or through a subsidiary) in certain expanded activities deemed financial in nature, such as securities and insurance underwriting. As of the date of this report, we have not elected to be treated as a financial holding company.

Holding Company Bank Ownership. The BHCA requires every bank holding company to obtain the prior approval of the Federal Reserve before (i) acquiring, directly or indirectly, ownership or control of any voting shares of another bank or bank holding company if, after such acquisition, it would own or control more than 5% of such shares; (ii) acquiring all or substantially all of the assets of another bank or bank holding company; or (iii) merging or consolidating with another bank holding company. In addition, under the Bank Merger Act of 1960, as amended, the prior approval of the FDIC is required for the Bank to merge with another bank or purchase all or substantially all of the assets or assume any of the deposits of another FDIC-insured depository institution. In reviewing applications seeking approval of merger and acquisition transactions, bank regulators consider, among other things, the competitive effect and public benefits of the transactions, the capital position and managerial resources of the combined organization, the risks to the stability of the U.S. banking or financial system, the applicant's performance record under the Community Reinvestment Act of 1977 (the "CRA"), the applicant's compliance with fair housing and other consumer protection laws and the effectiveness of all organizations involved in combating money laundering activities. In addition, failure to implement or maintain adequate compliance programs could cause bank regulators not to approve an acquisition where regulatory approval is required or to prohibit an acquisition even if approval is not required.

Holding Company Control of Nonbanks. With some exceptions, the BHCA also prohibits a bank holding company from acquiring or retaining direct or indirect ownership or control of more than 5% of the voting shares of any company which is not a bank or bank holding company, or from engaging directly or indirectly in activities other than those of banking, managing or controlling banks, or providing services for its subsidiaries. The principal exceptions to these prohibitions involve certain non-bank activities that, by statute or by Federal Reserve regulation or order, have been identified as activities so closely related to the business of banking as to be a proper incident thereto, such as Columbia Trust.

Tying Arrangements. We are prohibited from engaging in certain tie-in arrangements in connection with any extension of credit, sale or lease of property or furnishing of services. For example, with certain exceptions, neither the Company nor its subsidiaries may condition an extension of credit to a customer on either (i) a requirement that the customer obtain additional services provided by us; or (ii) an agreement by the customer to refrain from obtaining other services from a competitor.

Support of Subsidiary Banks. Under Federal Reserve policy, as codified by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), the Company is required to act as a source of financial and managerial strength to Columbia Bank, including at times when we may not be in a financial position to provide such resources, and it may not be in our, or our shareholders', best interests to do so. This means that the Company is required to commit resources, as necessary, to support Columbia Bank. Any capital loans a bank holding company makes to its subsidiary banks are subordinate to deposits and to certain other indebtedness of those subsidiary banks.

State Law Restrictions. As a Washington corporation, the Company is subject to certain limitations and restrictions under applicable Washington corporate law. For example, state law restrictions in Washington include limitations and restrictions relating to indemnification of directors, distributions to shareholders, transactions involving directors, officers or interested shareholders, maintenance of books, records, and minutes, and observance of certain corporate formalities.

Federal and State Regulation of Columbia Bank

General. The deposits of Columbia Bank, a Washington chartered commercial bank with branches in Washington, Oregon and Idaho, are insured by the FDIC. As a result, Columbia Bank is subject to supervision and regulation by the Washington Department of Financial Institutions' Division of Banks and the FDIC. These agencies have the authority to prohibit banks from engaging in what they believe constitute unsafe or unsound banking practices. Furthermore, under the Federal Deposit Insurance Act ("FDIA"), insurance of deposits may be terminated by the FDIC if the FDIC finds that the insured depository institution has engaged in unsafe and unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC. With respect to branches of Columbia Bank in Oregon and Idaho, the Bank is also subject to certain laws and regulations governing its activities in those states.

Consumer Protection. The Bank is subject to a variety of federal and state consumer protection laws and regulations that govern its relationship with consumers, including laws and regulations that impose certain disclosure requirements and regulate the manner in which we take deposits, make and collect loans, and provide other services. Failure to comply with these laws and regulations may subject the Bank to various penalties, including but not limited to, enforcement actions, injunctions, fines, civil monetary penalties, criminal penalties, punitive damages, and the loss of certain contractual rights. Columbia Bank has established a compliance management system designed to ensure consumer protection.

Community Reinvestment. The CRA requires that, in connection with examinations of financial institutions within their jurisdiction, the Federal Reserve or the FDIC evaluate the record of the financial institution in meeting the credit needs of its local communities, including low and moderate-income neighborhoods, consistent with the safe and sound operation of the institution. A bank's community reinvestment record is also considered by the applicable banking agencies in evaluating mergers, acquisitions and applications to open a branch or facility. The Bank's failure to comply with the CRA could, among other things, result in the denial or delay in connection with such transactions. The Bank received a rating of "satisfactory" in its most recently completed CRA examination.

Anti-Money Laundering and Anti-Terrorism. The Bank Secrecy Act (the "BSA") requires all financial institutions, including banks to, among other things, establish a risk-based system of internal controls reasonably designed to prevent money laundering and the financing of terrorism. It includes a variety of recordkeeping and reporting requirements (such as cash and suspicious activity reporting) as well as due diligence/know-your-customer documentation requirements.

The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, intended to combat terrorism, was renewed with certain amendments in 2006 (the "Patriot Act"). The Patriot Act further augments and strengthens the requirements set forth in the BSA. The Patriot Act, in relevant part, (i) prohibits banks from providing correspondent accounts directly to foreign shell banks; (ii) imposes due diligence requirements on banks opening or holding accounts for foreign financial institutions or wealthy foreign individuals; (iii) requires financial institutions to establish an anti-money-laundering compliance program; and (iv) eliminates civil liability for persons who file suspicious activity reports. The Patriot Act also includes provisions providing the government with power to investigate terrorism, including expanded government access to bank account records. An institution that fails to meet these standards may be subject to regulatory sanctions, including limitations on growth. Columbia Bank has established compliance programs designed to comply with the BSA and the Patriot Act.

Transactions with Affiliates; Insider Credit Transactions. Transactions between the Bank and its subsidiaries, on the one hand, and the Company or any other subsidiary, on the other hand, are regulated under federal banking law. The Federal Reserve Act imposes quantitative and qualitative requirements and collateral requirements on covered transactions by the Bank with, or for the benefit of, its affiliates. In addition, subsidiary banks of a bank holding company are subject to restrictions on extensions of credit to the holding company or its subsidiaries, on investments in securities of the holding company or its subsidiaries and on the use of their securities as collateral for loans to any borrower. These regulations and restrictions may limit the Company's ability to obtain funds from Columbia Bank for its cash needs, including funds for payment of dividends, interest and operational expenses.

Banks are also subject to certain restrictions imposed by the Federal Reserve Act on extensions of credit to executive officers, directors, principal shareholders or any related interests of such persons. Extensions of credit (i) must be made on substantially the same terms, including interest rates and collateral, and follow credit underwriting procedures that are at least as stringent as those prevailing at the time for comparable transactions with persons not related to the lending bank; and (ii) must not involve more than the normal risk of repayment or present other unfavorable features. Banks are also subject to certain lending limits and restrictions on overdrafts to insiders. A violation of these restrictions may result in the assessment of substantial civil monetary penalties, regulatory enforcement actions, and other regulatory sanctions. The Columbia Bank board has established controls to ensure compliance with regulatory expectations around affiliated transactions.

Regulation of Management. Federal law (i) sets forth circumstances under which officers or directors of a bank may be removed by the institution's federal supervisory agency; (ii) places restraints on lending by a bank to its executive

officers, directors, principal shareholders, and their related interests; and (iii) generally prohibits management personnel of a bank from serving as directors or in other management positions of another financial institution whose assets exceed a specified amount or which has an office within a specified geographic area.

Table of Contents

Safety and Soundness Standards. Certain non-capital safety and soundness standards are also imposed upon banks. These standards cover internal controls, information systems and internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation, fees and benefits, such other operational and managerial standards as the agency determines to be appropriate, and standards for asset quality, earnings and stock valuation. An institution that fails to meet these standards may be subject to regulatory sanctions, including limitations on growth. Columbia Bank has established policies and risk management activities designed to ensure the safety and soundness of the Bank.

Interstate Banking and Branching

The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (the "Interstate Act") together with the Dodd-Frank Act relaxed prior interstate branching restrictions under federal law by permitting, subject to regulatory approval, state and federally chartered commercial banks to establish branches in states where the laws permit banks chartered in such states to establish branches. The Interstate Act requires regulators to consult with community organizations before permitting an interstate institution to close a branch in a low-income area. Federal banking agency regulations prohibit banks from using their interstate branches primarily for deposit production and the federal banking agencies have implemented a loan-to-deposit ratio screen to ensure compliance with this prohibition.

Dividends and Stress Testing

Columbia is a legal entity separate and distinct from the Bank and its other subsidiaries. As a bank holding company, Columbia is subject to certain restrictions on its ability to pay dividends under applicable banking laws and regulations. Federal bank regulators are authorized to determine under certain circumstances relating to the financial condition of a bank holding company or a bank that the payment of dividends would be an unsafe or unsound practice and to prohibit payment thereof. In particular, federal bank regulators have stated that paying dividends that deplete a banking organization's capital base to an inadequate level would be an unsafe and unsound banking practice and that banking organizations should generally pay dividends only out of current operating earnings. In addition, in the current financial and economic environment, the Federal Reserve has indicated that bank holding companies should carefully review their dividend policy and has discouraged payment ratios that are at maximum allowable levels unless both asset quality and capital are very strong. A significant portion of our income comes from dividends from the Bank, which is also the primary source of our liquidity. In addition to the restrictions discussed above, the Bank is subject to limitations under Washington law regarding the level of dividends that it may pay to us. Washington law limits a bank's ability to pay dividends that are greater than the bank's retained earnings without approval of the applicable banking agency.

In October 2012, as required by the Dodd-Frank Act, the Federal Reserve and the FDIC published final rules regarding company-run stress testing. These rules require bank holding companies and banks with average total consolidated assets greater than $10 billion over a specified period of time to conduct an annual company-run stress test of capital, consolidated earnings and losses under one base and at least two stress scenarios provided by the federal bank regulators. In May 2018, the Economic Growth, Regulatory Relief, and Consumer Protection Act ("EGRRCPA") was enacted. On January 8, 2019, the Federal Reserve issued proposed rules to amend its stress testing requirements. This followed a similar proposal issued by the FDIC on December 18, 2018. Under the proposed rules, consistent with the requirements imposed by the EGRRCPA, the minimum threshold requiring bank holding companies and state-chartered banks to conduct company-run stress tests would be increased from $10 billion to $250 billion, and would generally require firms above the threshold to conduct company-run stress tests once every other year. We are unable to predict at this time what impact the amendment will have on the Company or the Bank, and any such impact will depend on the final form of the proposed rules. Although the proposed rules would increase the asset size requirement to above our current asset size, we do intend to continue to perform stress testing.

Regulatory Capital Requirements

The Federal Reserve monitors the capital adequacy of the Company on a consolidated basis, and the FDIC and the Washington Department of Financial Institutions' Division of Banks monitor the capital adequacy of the Bank. The risk-based capital standards currently applicable to the Company and the Bank, parts of which are subject to phase-in, are based on the December 2010 final capital framework for strengthening international capital standards, known as Basel III, of the Basel Committee on Banking Supervision (the "Basel Committee"). We believe that, as of December

31, 2018, we and the Bank would meet all capital adequacy requirements under the Capital Rules, as described below, on a fully phased-in basis as if such requirements were then in effect.

Prior to January 1, 2015, the risk-based capital standards applicable to the Company and the Bank were based on the 1988 Capital Accord, known as Basel I, of the Basel Committee. In July 2013, the federal bank regulators approved final rules implementing Basel III and various provisions of the Dodd-Frank Act (the "Capital Rules"). The Capital Rules substantially revised the risk-based capital requirements applicable to bank holding companies and banks, including us and the Bank, compared to the risk-based capital rules in effect at December 31, 2014. The Capital Rules revised the components of capital and addressed other issues affecting the numerator in regulatory capital ratio calculations. The Capital Rules also addressed risk weights and other issues affecting the denominator in regulatory capital ratio calculations, including by replacing the prior risk-weighting approach derived from Basel I with a more risk-sensitive approach based, in part, on the standardized approach adopted by the Basel Committee in its 2004 capital accords, known as Basel II. The Capital Rules also implemented the requirements of Section 939A of the Dodd-Frank Act to remove references to credit ratings from the federal bank regulators' rules. Subject to a phase-in period for various provisions, the Capital Rules, became effective for us and for the Bank on January 1, 2015.

The Capital Rules, among other things (i) include a capital measure called Common Equity Tier 1 ("CET1"), (ii) specify that Tier 1 capital consists of CET1 and "Additional Tier 1 capital" instruments meeting specified requirements, (iii) define CET1 narrowly by requiring that most deductions/adjustments to regulatory capital measures be made to CET1 and not to the other components of capital and (iv) expand the scope of the deductions/adjustments to capital as compared to existing regulations.

Under the Capital Rules, the minimum capital ratios as of January 1, 2015 are (i) 4.5% CET1 to risk-weighted assets, (ii) 6% Tier 1 capital (that is, CET1 plus Additional Tier 1 capital) to risk-weighted assets and (iii) 8% total capital (that is, Tier 1 capital plus Tier 2 capital) to risk-weighted assets.

Subject to a transition schedule that was fully phased in on January 1, 2019, the Capital Rules also require an institution to establish a capital conservation buffer of CET1 in an amount above the minimum risk-based capital requirements for "adequately capitalized" institutions equal to 2.5% of total risk-weighted assets. Banking institutions with a ratio of CET1 to risk-weighted assets above the minimum but below the capital conservation buffer will face constraints on dividends, equity repurchases and compensation based on the amount of the shortfall and the institution's "eligible retained income" (that is, four quarter trailing net income, net of distributions and tax effects not reflected in net income).

The Capital Rules provide for a number of deductions from and adjustments to CET1. These include, for example, the requirement that mortgage servicing rights, certain deferred tax assets and significant investments in non-consolidated financial entities be deducted from CET1 to the extent that any one such category exceeds 10% of CET1 or all such categories in the aggregate exceed 15% of CET1. Implementation of the deductions and other adjustments to CET1 began on January 1, 2015 and was fully phased in as of January 1, 2019. The Capital Rules also generally preclude certain hybrid securities, such as trust preferred securities, from being counted as Tier 1 capital for most bank holding companies. However, bank holding companies such as us who had less than $15 billion in assets as of December 31, 2009 (and who continue to have less than $15 billion in assets) are permitted to include trust preferred securities issued prior to May 19, 2010 as Additional Tier 1 capital under the Capital Rules.

The Capital Rules also prescribe a new standardized approach for risk weightings that expands the risk-weighting categories from four Basel I-derived categories (0%, 20%, 50% and 100%) to a much larger and more risk-sensitive number of categories, depending on the nature of the assets, generally ranging from 0% for U.S. government and agency securities to 600% for certain equity exposures and resulting in higher risk weights for a variety of asset categories.

In December 2017, the Basel Committee published standards that it described as the finalization of the Basel III post-crisis regulatory reforms. The standards are commonly referred to as "Basel IV." Among other things, these standards revise the Basel Committee's standardized approach for credit risk (including by recalibrating risk weights and introducing new capital requirements for certain "unconditionally cancellable commitments," such as home equity lines of credit) and provides a new standardized approach for operational risk capital. Under the Basel framework, these standards will generally be effective on January 1, 2022, with an aggregate output floor phasing in through January 1, 2027. Under the current U.S. capital rules, operational risk capital requirements and a capital floor apply only to advanced approach institutions. The impact of Basel IV on the Company and the Bank will depend on the

manner in which it is implemented by the federal bank regulators.

With respect to the Bank, the Capital Rules also revise the prompt corrective action regulations pursuant to Section 38 of the FDIA. See "Prompt Corrective Action Framework."

Table of Contents

Prompt Corrective Action Framework

The FDIA requires the federal bank regulators to take prompt corrective action in respect of depository institutions that fail to meet specified capital requirements. The FDIA establishes five capital categories ("well-capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized" and "critically undercapitalized"), and the federa bank regulators are required to take certain mandatory supervisory actions, and are authorized to take other discretionary actions, with respect to institutions that are undercapitalized, significantly undercapitalized or critically undercapitalized. The severity of these mandatory and discretionary supervisory actions depends upon the capital category in which the institution is placed. Generally, subject to a narrow exception, the FDIA requires the regulator to appoint a receiver or conservator for an institution that is critically undercapitalized.

Under the rules currently in effect and as modified by the Capital Rules, an insured depository institution generally would be classified in the following categories based on the capital measures indicated:

"Well-capitalized"
Total capital ratio of at least 10%,
Tier 1 capital ratio of at least 8%,
CET1 ratio of at least 6.5%
Tier 1 leverage ratio of at least 5%, and
Not subject to any order or written directive requiring a specific capital level.

"Adequately capitalized"
Total capital ratio of at least 8%,
Tier 1 capital ratio of at least 6%
CET1 ratio of at least 4.5%, and
Tier 1 leverage ratio of at least 4%.

"Undercapitalized"
Total capital ratio of less than 8%,
Tier 1 capital ratio of less than 6%
CET1 ratio of less than 4.5%, or
Tier 1 leverage ratio of less than 4%.

"Significantly undercapitalized"
Total capital ratio of less than 6%,
Tier 1 capital ratio of less than 4%
CET1 ratio of less than 3%, or
Tier 1 leverage ratio of less than 3%.

"Critically undercapitalized"
Tangible equity to average quarterly tangible assets of 2% or less.

An institution may be downgraded to, or deemed to be in, a capital category that is lower than indicated by its capital ratios if it is determined to be in an unsafe or unsound condition or if it receives an unsatisfactory examination rating with respect to certain matters. A bank's capital category is determined solely for the purpose of applying prompt corrective action regulations, and the capital category may not constitute an accurate representation of the bank's overall financial condition or prospects for other purposes.

As of December 31, 2018, we and the Bank met the capital requirements to be well-capitalized with CET1 capital ratios of 12.7401% and 12.9576%, respectively, Tier 1 capital ratios of 12.7401% and 12.9576%, respectively, total capital ratios of 13.9920% and 13.8494%, respectively, and Tier 1 leverage ratios of 10.2444% and 10.4185%, respectively.

An institution that is categorized as undercapitalized, significantly undercapitalized or critically undercapitalized is required to submit an acceptable capital restoration plan to its appropriate federal bank regulator. Under the FDIA, in order for the capital restoration plan to be accepted by the appropriate federal banking agency, a bank holding company must guarantee that a subsidiary depository institution will comply with its capital restoration plan, subject to certain limitations. The bank holding company must also provide appropriate assurances of performance. The obligation of a controlling bank holding company under the FDIA to fund a capital restoration plan is limited to the lesser of 5% of an undercapitalized subsidiary's assets or the amount required to meet regulatory capital requirements. An undercapitalized institution is also generally prohibited from increasing its average total assets, making acquisitions and capital distributions, establishing any branches or engaging in any new line of business, except in accordance with an accepted capital restoration plan or with the approval of the FDIC. Institutions that are undercapitalized or significantly undercapitalized and either fail to submit an acceptable capital restoration plan or fail to implement an approved capital restoration plan may be subject to a number of requirements and restrictions, including orders to sell sufficient voting stock to become adequately capitalized, requirements to reduce total assets and cessation of receipt of deposits from correspondent banks. Critically undercapitalized depository institutions

failing to submit or implement an acceptable capital restoration plan are subject to appointment of a receiver or conservator.

Table of Contents

Brokered Deposits

The FDIA prohibits an insured depository institution from accepting brokered deposits or offering interest rates on any deposits significantly higher than the prevailing rate in the bank's normal market area or nationally (depending upon where the deposits are solicited), unless it is well-capitalized or is adequately capitalized and receives a waiver from the FDIC. A depository institution that is adequately capitalized and accepts brokered deposits under a waiver from the FDIC may not pay an interest rate on any deposit in excess of 75 basis points over certain prevailing market rates.

On December 18, 2018, the FDIC issued an advance notice of proposed rulemaking in connection with the FDIC's comprehensive review of its regulatory approach to brokered deposits to solicit comment on all aspects of the FDIC's brokered deposit regulations. The Company is not able to predict at this time whether any regulatory changes will be adopted as a result of the FDIC's notice, or what impact if any, such changes would have on the Bank.

Regulatory Oversight and Examination

The Federal Reserve conducts periodic inspections of bank holding companies. The supervisory objectives of the inspection program are to ascertain whether the financial strength of the bank holding company is being maintained on an ongoing basis and to determine the effects or consequences of transactions between a holding company or its non-banking subsidiaries and its subsidiary banks.

Banks are subject to periodic examinations by their primary regulators. Bank examinations have evolved from reliance on transaction testing in assessing a bank's condition to a risk-focused approach. These examinations are extensive and cover the entire breadth of operations of the bank. Generally, FDIC safety and soundness examinations for a bank of our size are completed on an annual basis through the execution of a quarterly focal review process. The FDIC and state bank regulatory agencies complete these examinations on a combined schedule.

The Consumer Financial Protection Bureau (the "CFPB") has primary examination and enforcement authority over institutions with assets of $10 billion or more, including the Bank, with respect to various federal consumer protection laws, and we are subject to continued examination by the FDIC on certain consumer regulations. State authorities are also responsible for monitoring our compliance with all state consumer laws.

The frequency of consumer compliance and CRA examinations is linked to the size of the institution and its compliance and CRA ratings at its most recent examinations. However, the examination authority of the Federal Reserve and the FDIC allows them to examine supervised banks as frequently as deemed necessary based on the condition of the bank or as a result of certain triggering events.

Corporate Governance and Accounting

The Sarbanes-Oxley Act of 2002 ("SOX") addresses, among other things, corporate governance, auditing and accounting, enhanced and timely disclosure of corporate information, and penalties for non-compliance. Generally, SOX (i) requires chief executive officers and chief financial officers to certify to the accuracy of periodic reports filed with the SEC; (ii) imposes specific and enhanced corporate disclosure requirements; (iii) accelerates the time frame for reporting of insider transactions and periodic disclosures by public companies; (iv) requires companies to adopt and disclose information about corporate governance practices, including whether or not they have adopted a code of ethics for senior financial officers and whether the audit committee includes at least one "audit committee financial expert;" and (v) requires the SEC, based on certain enumerated factors, to regularly and systematically review corporate filings.

Table of Contents

Deposit Insurance

The Bank's deposits are insured under the FDIA, up to the maximum applicable limits and are subject to deposit insurance assessments designed to tie what banks pay for deposit insurance to the risks they pose. The Dodd-Frank Act broadened the base for FDIC insurance assessments. Under the FDIC's assessment system for determining payments to the Deposit Insurance Fund (the "DIF"), insured depository institutions with more than $10 billion in assets ("large IDIs") are assessed under a complex "scorecard" methodology that seeks to capture both the probability that an individual large IDI will fail and the magnitude of the impact on the DIF if such a failure occurs. The assessment base of a large IDI is its total assets less tangible equity. In addition, the Dodd-Frank Act raised the minimum designated reserve ratio (the FDIC is required to set the reserve ratio each year) of the Deposit Insurance Fund (the "DIF") from 1.15% to 1.35%; required that the DIF meet that minimum ratio of insured deposits by 2020; and eliminated the requirement that the FDIC pay dividends to insured depository institutions when the reserve ratio exceeds certain thresholds. The rule imposed a surcharge on the assessments of depository institutions with $10 billion or more in assets beginning in the third quarter of 2016. The surcharge continued through September 30, 2018, when the reserve ratio reached 1.36% of insured deposits, exceeding the statutorily required minimum reserve ratio of 1.35%.

The Dodd-Frank Act

As a result of the financial crisis, on July 21, 2010, the Dodd-Frank Act was signed into law. The Dodd-Frank Act significantly changed the bank regulatory structure and is affecting the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies, including the Company and Columbia Bank. The full impact of the Dodd-Frank Act may not be known for years. Some of the provisions of the Dodd-Frank Act that may impact our business are summarized below.

Corporate Governance. The Dodd-Frank Act requires publicly traded companies to provide their shareholders with (i) a non-binding shareholder vote on executive compensation, (ii) a non-binding shareholder vote on the frequency of such vote, (iii) disclosure of "golden parachute" arrangements in connection with specified change in control transactions, and (iv) a non-binding shareholder vote on golden parachute arrangements in connection with these change in control transactions.

Risk Committee. The Dodd-Frank Act required bank holding companies with in excess of $10 billion in total consolidated assets to establish a dedicated risk committee of the board of directors responsible for overseeing enterprise wide risk management policies. The Company has established such a risk committee; however, the EGRRCPA amended the risk committee provision to require risk committees for bank holding companies with $50 billion or more in total consolidated assets.

Prohibition Against Charter Conversions of Troubled Institutions. The Dodd-Frank Act generally prohibits a depository institution from converting from a state to federal charter, or vice versa, while it is subject to an enforcement action unless the bank seeks prior approval from its regulator and complies with specified procedures to ensure compliance with the enforcement action.

Consumer Financial Protection Bureau. As described above, we are subject to oversight and examination by the CFPB because our total consolidated assets exceed $10 billion.

Repeal of Demand Deposit Interest Prohibition. The Dodd-Frank Act repealed the federal prohibitions on the payment of interest on demand deposits, thereby permitting depository institutions to pay interest on business transaction and other accounts.

The Volcker Rule. The Dodd-Frank Act prohibits banks and their affiliates from engaging in proprietary trading and investing in and sponsoring hedge funds and private equity funds. The statutory provision is commonly called the "Volcker Rule." The Volcker Rule does not significantly impact the operations of the Company and the Bank, as we do not have any significant engagement in the businesses prohibited by the Volcker Rule.

Interchange Fees. Under the Durbin Amendment to the Dodd-Frank Act, the Federal Reserve adopted rules establishing standards for assessing whether the interchange fees that may be charged with respect to certain electronic debit transactions are "reasonable and proportional" to the costs incurred by issuers for processing such transactions.

Table of Contents

Interchange fees, or “swipe” fees, are charges that merchants pay to us and other card-issuing banks for processing electronic payment transactions. Under the final rules, the maximum permissible interchange fee is equal to no more than 21 cents plus 5 basis points of the transaction value for many types of debit interchange transactions. The Federal Reserve also adopted a rule to allow a debit card issuer to recover one cent per transaction for fraud prevention purposes if the issuer complies with certain fraud-related requirements required by the Federal Reserve. The Federal Reserve also has rules governing routing and exclusivity that require issuers to offer two unaffiliated networks for routing transactions on each debit or prepaid product.

Incentive Compensation

The Dodd-Frank Act requires the federal bank regulators and the SEC to establish joint regulations or guidelines prohibiting incentive-based payment arrangements at specified regulated entities, including us and the Bank, having at least $1 billion in total assets that encourage inappropriate risks by providing an executive officer, employee, director or principal stockholder with excessive compensation, fees, or benefits or that could lead to material financial loss to the entity. In addition, these regulators must establish regulations or guidelines requiring enhanced disclosure to regulators of incentive-based compensation arrangements.

In June 2010, the Federal Reserve and FDIC issued comprehensive final guidance on incentive compensation policies intended to ensure that the incentive compensation policies of banking organizations do not undermine the safety and soundness of such organizations by encouraging excessive risk-taking. The guidance, which covers all employees that have the ability to materially affect the risk profile of an organization, either individually or as part of a group, is based upon the key principles that a banking organization’s incentive compensation arrangements should (i) provide incentives that appropriately balance risk and financial results in a manner that does not encourage employees to expose their organizations to imprudent risk, (ii) be compatible with effective internal controls and risk management and (iii) be supported by strong corporate governance, including active and effective oversight by the organization’s board of directors.

During the second quarter of 2016, the U.S. financial regulators, including the Federal Reserve and the SEC, proposed revised rules on incentive-based payment arrangements at specified regulated entities having at least $1 billion in total assets. The proposed revised rules would establish general qualitative requirements applicable to all covered entities, which would include (i) prohibiting incentive arrangements that encourage inappropriate risks by providing excessive compensation; (ii) prohibiting incentive arrangements that encourage inappropriate risks that could lead to a material financial loss; (iii) establishing requirements for performance measures to appropriately balance risk and reward; (iv) requiring board of director oversight of incentive arrangements; and (v) mandating appropriate record-keeping. Under the proposed rule, larger financial institutions with total consolidated assets of at least $50 billion would also be subject to additional requirements applicable to such institutions’ “senior executive officers” and “significant risk-takers.” If the rules are adopted in the form proposed, they may restrict our flexibility with respect to the manner in which we structure compensation and adversely affect our ability to compete for talent.

The Federal Reserve will review, as part of the regular, risk-focused examination process, the incentive compensation arrangements of banking organizations, such as us, that are not “large, complex banking organizations.” These reviews will be tailored to each organization based on the scope and complexity of the organization’s activities and the prevalence of incentive compensation arrangements. The findings of the supervisory initiatives will be included in reports of examination. Deficiencies will be incorporated into the organization’s supervisory ratings, which can affect the organization’s ability to make acquisitions and take other actions. Enforcement actions may be taken against a banking organization if its incentive compensation arrangements, or related risk management control or governance processes, pose a risk to the organization’s safety and soundness and the organization is not taking prompt and effective measures to correct the deficiencies.

Proposed Legislation

Proposed legislation relating to the banking industry is introduced in almost every legislative session. Certain of such legislation could dramatically affect the regulation of the banking industry. We cannot predict if any such legislation will be adopted or if it is adopted how it would affect the business of Columbia Bank or the Company. Recent history has demonstrated that new legislation or changes to existing laws or regulations usually results in a greater compliance burden and therefore generally increases the cost of doing business.

Table of Contents

Effects of Government Monetary Policy

Our earnings and growth are affected not only by general economic conditions, but also by the fiscal and monetary policies of the federal government, particularly the Federal Reserve. The Federal Reserve implements national monetary policy for such purposes as curbing inflation and combating recession, but its open market operations in U.S. government securities, control of the discount rate applicable to borrowings from the Federal Reserve, and establishment of reserve requirements against certain deposits, influence the growth of bank loans, investments and deposits, and also affect interest rates charged on loans or paid on deposits. The nature and impact of future changes in monetary policies and their impact on us cannot be predicted with certainty.

Table of Contents

ITEM 1A. RISK FACTORS

The following is a discussion of what we currently believe are the most significant risks and uncertainties that may affect our business, financial condition and future results.

National and global economic and other conditions could adversely affect our future results of operations or market price of our stock.

Our business is directly impacted by factors such as economic, political and market conditions, broad trends in industry and finance, changes in government monetary and fiscal policies and inflation, foreign policy, and financial market volatility, all of which are beyond our control. Global economies continue to face significant challenges to achieving normalized economic growth rates and there are continuing concerns related to the level of U.S. government debt and fiscal actions that may be taken to address that debt. There can be no assurance that economic conditions will continue to improve, and these conditions could worsen. Any deterioration in the economies of the nation as a whole or in our markets would have an adverse effect, which could be material, on our business, financial condition, results of operations and prospects, and could also cause the market price of our stock to decline. While it is impossible to predict how long challenging economic conditions may exist, a slow or fragile recovery could continue to present risks into the future for the industry and our company.

Economic conditions in the market areas we serve may adversely impact our earnings and could increase our credit risk associated with our loan portfolio, the value of our investment portfolio and the availability of deposits.

Substantially all of our loan and deposit customers are businesses and individuals in Washington, Oregon and Idaho, and soft economies in these market areas could have a material adverse effect on our business, financial condition, results of operations and prospects. A deterioration in the market areas we serve could result in the following consequences, any of which would have an adverse impact, which could be material, on our business, financial condition, results of operations and prospects:

- loan delinquencies may increase;
- problem assets and foreclosures may increase;
- collateral for loans made may decline in value, in turn reducing customers' borrowing power, reducing the value of assets and collateral associated with existing loans;
- certain securities within our investment portfolio could become other than temporarily impaired, requiring a write-down through earnings to fair value, thereby reducing equity;
- low cost or non-interest bearing deposits may decrease; and
- demand for our loan and other products and services may decrease.

Concentrations within our loan portfolio could result in increased credit risk in a challenging economy.

While our loan portfolio is diversified across business sectors, it is concentrated in commercial real estate and commercial business loans. These types of loans generally are viewed as having more risk of default than residential real estate loans or certain other types of loans or investments. In fact, the FDIC has issued pronouncements alerting banks of its concern about heavy loan concentrations. Because our loan portfolio contains commercial real estate and commercial business loans with relatively large balances, the deterioration of one or a few of these loans may cause a significant increase in our non-performing loans. An increase in non-performing loans could result in a loss of earnings from these loans, an increase in the provision for loan losses, or an increase in loan charge-offs, any of which would have an adverse impact, which could be material, on our business, financial condition, results of operations and prospects.

A large percentage of our loan portfolio is secured by real estate, in particular commercial real estate. Deterioration in the real estate market or other segments of our loan portfolio would lead to additional losses.

At December 31, 2018, 60% of our total gross loans, were secured by real estate. Any renewed downturn in the economies or real estate values in the markets we serve could have a material adverse effect on both borrowers' ability to repay their loans and the value of the real property securing such loans. Our ability to recover on defaulted loans would then be diminished, and we would be more likely to suffer losses on defaulted loans, any or all of which would have an adverse impact, which could be material, on our business, financial condition, results of operations and prospects.

15

Table of Contents

A failure in or breach of our operational or security systems, or those of our third party service providers, including as a result of cyber-attacks, could disrupt our business, result in unintentional disclosure or misuse of confidential or proprietary information, damage our reputation, increase our costs and cause losses.

As a financial institution, our operations rely heavily on the secure processing, storage and transmission of confidential and other information on our computer systems and networks. Any failure, interruption or breach in security or operational integrity of these systems could result in failures or disruptions in our online banking system, customer relationship management, general ledger, deposit and loan servicing and other systems. The security and integrity of our systems could be threatened by a variety of interruptions or information security breaches, including those caused by computer hacking, cyber attacks, electronic fraudulent activity or attempted theft of financial assets. We may not be able to anticipate, detect, or implement effective preventative measures against all potential threats, particularly because the techniques used by cyber criminals change frequently, often are not recognized until launched and can be initiated from a variety of sources. We cannot assure you that any such failures, interruption or security breaches will not occur, or if they do occur, that they will be adequately addressed. While we have certain protective policies and procedures in place, the nature and sophistication of the threats continue to evolve. We may be required to expend significant additional resources in the future to modify and enhance our protective measures.

Due to the complexity and interconnectedness of information technology systems, the process of enhancing our systems can itself create a risk of systems disruptions and security issues. Additionally, we face the risk of operational disruption, failure, termination or capacity constraints of any of the third parties that facilitate our business activities, including exchanges, clearing agents, clearing houses or other financial intermediaries. Such parties could also be the source of an attack on, or breach of, our operational systems. Any failures, interruptions or security breaches in our information systems could damage our reputation, result in a loss of customer business, result in a violation of privacy or other laws, or expose us to civil litigation, regulatory fines or losses not covered by insurance, all of which could have a material adverse impact on our business, financial condition, results of operations and prospects.

Our allowance for loan and lease losses (“ALLL”) may not be adequate to cover future loan losses, which could adversely affect earnings.

We maintain an ALLL in an amount that we believe is adequate to provide for losses inherent in our loan portfolio. While we strive to carefully monitor credit quality and to identify loans that may become non-performing, at any time there are loans in the portfolio that could result in losses, but that have not been identified as non-performing or potential problem loans. We cannot be sure that we will be able to identify deteriorating loans before they become non-performing assets, or that we will be able to limit losses on those loans that have been identified. Additionally, the process for determining the ALLL requires different, subjective and complex judgments about the future impact from current economic conditions that might impair the ability of borrowers to repay their loans. As a result, future significant increases to the ALLL may be necessary.

Future increases to the ALLL may be required based on changes in the composition of the loans comprising the portfolio, deteriorating values in underlying collateral (most of which consists of real estate) and changes in the financial condition of borrowers, such as may result from changes in economic conditions, or as a result of actual future events differing from assumptions used by management in determining the ALLL. Additionally, banking regulators, as an integral part of their supervisory function, periodically review our ALLL. These regulatory agencies may require us to increase the ALLL. Any increase in the ALLL would have an adverse effect, which could be material, on our financial condition and results of operations.

Nonperforming assets take significant time to resolve and could adversely affect our results of operations and financial condition.

Our nonperforming assets adversely affect our net income in various ways. We do not record interest income on nonaccrual loans, thereby adversely affecting our income and increasing loan administration costs. Assets acquired by foreclosure or similar proceedings are recorded at fair value less estimated costs to sell. The valuation of these foreclosed assets is periodically updated and resulting losses, if any, are charged to earnings in the period in which they are identified. An increase in the level of nonperforming assets also increases our risk profile and may impact the capital levels our regulators believe is appropriate in light of such risks. We utilize various techniques such as loan sales, workouts, and restructurings to manage our problem assets. Decreases in the value of these problem assets, the

underlying collateral, or in the borrowers' performance or financial condition would have an adverse impact, which could be material, on our business, financial condition, results of operations and prospects. In addition, the resolution of nonperforming assets requires significant commitments of time from management and staff, which can be detrimental to performance of their other responsibilities. We may experience increases in nonperforming loans in the future.

Table of Contents

Acquisitions and the integration of acquired businesses subject us to various risks and may not result in all of the benefits anticipated, future acquisitions may be dilutive to current shareholders and future acquisitions may be delayed, impeded or prohibited due to regulatory issues.

We have in the past and expect in the future seek to grow our business by acquiring other businesses. Our acquisitions may not have the anticipated positive results, including results relating to: correctly assessing the asset quality of the assets being acquired; the total cost of integration including management attention and resources; the time required to complete the integration successfully; the amount of longer-term cost savings; being able to profitably deploy funds acquired in an acquisition; or the overall performance of the combined entity.

In addition, unexpected contingent liabilities can arise from the businesses we acquire. Integration of an acquired business can be complex and costly, sometimes including combining relevant accounting and data processing systems, financial reporting and management and internal controls, as well as managing relevant relationships with employees, clients, suppliers and other business partners. Integration efforts could divert management attention and resources, which could adversely affect these systems, processes or controls and our operations or results.

Acquisitions may also result in business disruptions that cause us to lose customers or cause customers to remove their accounts from us and move their business to competing financial institutions. It is possible that the integration process related to acquisitions could result in the disruption of our ongoing businesses or inconsistencies in standards, controls, procedures and policies that could adversely affect our ability to maintain relationships with clients, customers, depositors and employees. The loss of key employees in connection with an acquisition could adversely affect our ability to successfully conduct our business.

We may engage in additional future acquisitions involving the issuance of additional common stock and/or cash. Any such acquisitions and related issuances of stock may have a dilutive effect on earnings per share, book value per share or the percentage ownership of current shareholders. The use of cash as consideration in any such acquisitions could impact our capital position and may require us to raise additional capital.

Furthermore, notwithstanding our recent acquisitions, we cannot provide any assurance as to the extent to which we can continue to grow through acquisitions as this will depend on the availability of prospective target opportunities at valuations we find attractive and other factors. Among other things, acquisitions by financial institutions are subject to approval by a variety of federal and state regulatory agencies. Regulatory approvals could be delayed, impeded, restrictively conditioned or denied due to existing or new regulatory issues we have, or may have, with regulatory agencies. In addition, the Northwest is experiencing intensified consolidation and we face significant competition from numerous other financial services institutions for attractive acquisition candidates, as many of these competitors will have greater financial resources than we do.

Our assumptions regarding the fair value of assets acquired could be inaccurate, which could materially and adversely affect our business, financial condition, results of operations, and future prospects.

Management makes various assumptions and judgments about the collectability of acquired loans, including the creditworthiness of borrowers and the value of the real estate and other assets serving as collateral for the repayment of secured loans. If our assumptions are incorrect, significant earnings volatility can occur and credit loss provisions may be needed to respond to different economic conditions or adverse developments in the acquired loan portfolio. Any increase in future loan losses could have a material adverse impact on our business, financial condition, results of operations and prospects.

Our management of capital could adversely affect profitability measures and the market price of our common stock and could dilute the holders of our outstanding common stock.

Our capital ratios are significantly higher than regulatory minimums. We may lower our capital ratios through either selective acquisitions that meet our disciplined criteria, organic loan growth, investment in securities, or a combination of all three. We continually evaluate opportunities to expand our business through strategic acquisitions. There can be no assurance that we will be able to negotiate future acquisitions on terms acceptable to us.

Conversely, there may be circumstances under which it would be prudent to consider alternatives for raising capital to take advantage of significant acquisition opportunities or in response to changing economic conditions. In addition, we may need to raise additional capital in the future to have sufficient capital resources and liquidity to meet our commitments and fund our business needs and future growth, particularly if the quality of our assets or earnings were

to deteriorate significantly. We may not be able to raise additional capital when needed on terms acceptable to us or at all. Our ability to raise additional capital, if needed, will depend on, among other things, conditions in the capital markets at the time, which are outside our control, and our financial performance. Further, if we need to raise capital in the future, we may have to do so when many other financial institutions are also seeking to raise capital and would then have to compete with those institutions for investors.

Table of Contents

An inability to raise additional capital on acceptable terms when needed could have a material adverse effect on our business, financial condition, results of operations and prospects. In addition, any capital raising alternatives could dilute the holders of our outstanding common stock and may adversely affect the market price of our common stock.
Conditions in the financial markets may limit access to additional funding to meet liquidity needs.
We may need or want to raise additional capital in the future to provide us with sufficient capital resources and liquidity to meet our commitments and business needs, particularly if our asset quality or earnings were to deteriorate significantly. Our ability to raise additional capital will depend on, among other things, conditions in the capital markets at that time, which are outside of our control, and our financial performance. Economic conditions and any loss of confidence in financial institutions generally may increase our cost of funding and limit access to certain customary sources of capital.
There can be no assurance that capital will be available on acceptable terms or at all. Any occurrence that may limit our access to the capital markets, such as a decline in the confidence of equity or debt purchasers, or counterparties participating in capital markets, may adversely affect our capital costs and our ability to raise capital and, potentially, our liquidity. Also, if we need to raise capital in the future, we may have to do so when many other financial institutions are also seeking to raise capital and would have to compete with those institutions for investors. An inability to raise additional capital on acceptable terms when needed could have a materially adverse effect on our business, financial condition and results of operations.
If the goodwill we have recorded in connection with acquisitions becomes impaired, it could have a material adverse impact on our earnings and shareholders' equity.
Accounting standards require that we account for acquisitions using the acquisition method of accounting. Under acquisition accounting, if the purchase price of an acquired company exceeds the fair value of its net assets, the excess is carried on the acquirer's balance sheet as goodwill. In accordance with generally accepted accounting principles, our goodwill is evaluated for impairment on an annual basis or more frequently if events or circumstances indicate that a potential impairment exists. Such evaluation may be based on a variety of factors, including the quoted price of our common stock, market prices of common stock of other banking organizations, common stock trading multiples, discounted cash flows, and data from comparable acquisitions. Future evaluations of goodwill may result in impairment and ensuing write-downs, which could have a material adverse impact on our earnings and shareholders' equity.
Fluctuating interest rates could adversely affect our business.
Significant increases in market interest rates on loans, or the perception that an increase may occur, could adversely affect both our ability to originate new loans and our ability to grow. Conversely, decreases in interest rates could result in an acceleration of loan prepayments. An increase in market interest rates could also adversely affect the ability of our floating-rate borrowers to meet their higher payment obligations. If this occurred, it could cause an increase in nonperforming assets and charge offs, which could adversely affect our business.
Further, our profitability is dependent to a large extent upon net interest income, which is the difference (or "spread") between the interest earned on loans, securities and other interest-earning assets and the interest paid on deposits, borrowings, and other interest-bearing liabilities. Because of the differences in maturities and repricing characteristics of our interest-earning assets and interest-bearing liabilities, changes in interest rates do not produce equivalent changes in interest income earned on interest-earning assets and interest paid on interest-bearing liabilities. Accordingly, fluctuations in interest rates could adversely affect our interest rate spread, and, in turn, our profitability.
Interest rates on our outstanding financial instruments might be subject to change based on regulatory developments, which could adversely affect our revenue, expenses, and the value of those financial instruments.
LIBOR and certain other "benchmarks" are the subject of recent national, international, and other regulatory guidance and proposals for reform. These reforms may cause such benchmarks to perform differently than in the past or have other consequences which cannot be predicted. On July 27, 2017, the United Kingdom's Financial Conduct Authority, which regulates LIBOR, publicly announced that it intends to stop persuading or compelling banks to submit LIBOR rates after 2021. It is unclear whether, at that time, LIBOR will cease to exist or if new methods of calculating LIBOR will be established. If LIBOR ceases to exist or if the methods of calculating LIBOR change from current methods for any reason, interest rates on our loans, deposits, derivatives, and other financial instruments tied to LIBOR rates, as

well as the revenue and expenses associated with those financial instruments, may be adversely affected. Further, any uncertainty regarding the continued use and reliability of LIBOR as a benchmark interest rate could adversely affect the value of our loans, deposits, derivatives, and other financial instruments tied to LIBOR rates.

Table of Contents

Our business depends on our ability to successfully manage credit risk.
The operation of our business requires us to manage credit risk. As a lender, we are exposed to the risk that our borrowers will be unable to repay their loans according to their terms, and that the collateral securing repayment of their loans, if any, may not be sufficient to ensure repayment. In addition, there are risks inherent in making any loan, including risks with respect to the period of time over which the loan may be repaid, risks relating to proper loan underwriting, risks resulting from changes in economic and industry conditions and risks inherent in dealing with individual borrowers. In order to successfully manage credit risk, we must, among other things, maintain disciplined and prudent underwriting standards and ensure that our bankers follow those standards. The weakening of these standards for any reason, such as an attempt to attract higher yielding loans, a lack of discipline or diligence by our employees in underwriting and monitoring loans, the inability of our employees to adequately adapt policies and procedures to changes in economic or any other conditions affecting borrowers and the quality of our loan portfolio, may result in loan defaults, foreclosures and additional charge-offs and may necessitate that we increase our ALLL, each of which could adversely affect our net income. As a result, our inability to successfully manage credit risk could have a material adverse effect on our business, financial condition, results of operations and prospects.
We operate in a highly regulated environment and changes to or increases in, or supervisory enforcement of, banking or other laws and regulations or governmental fiscal or monetary policies could adversely affect us.
We are subject to extensive regulation, supervision and examination by federal and state banking authorities. In addition, as a publicly-traded company, we are subject to regulation by the SEC. Any change in applicable regulations or federal, state or local legislation or in policies or interpretations or regulatory approaches to compliance and enforcement, income tax laws and accounting principles could have a substantial impact on us and our operations. Changes in laws and regulations may also increase our expenses by imposing additional fees or taxes or restrictions on our operations. Additional legislation and regulations that could significantly affect our powers, authority and operations may be enacted or adopted in the future, which could have a material adverse effect on our business, financial condition, results of operations and prospects. Failure to appropriately comply with any such laws, regulations or principles could result in sanctions by regulatory agencies or damage to our reputation, all of which could adversely affect our business, financial condition or results of operations. For example, the Dodd-Frank Act was enacted in July 2010. Among other provisions, the legislation (i) created the Consumer Financial Protection Bureau (the "CFPB") with broad powers to regulate consumer financial products such as credit cards and mortgages, (ii) created a Financial Stability Oversight Council comprised of the heads of other regulatory agencies, (iii) resulted in new capital requirements from federal banking agencies, (iv) placed new limits on electronic debit card interchange fees and (v) required the SEC and national stock exchanges to adopt significant new corporate governance and executive compensation reforms, some of which have yet to be promulgated. The Dodd-Frank Act and regulations that have been adopted thereunder have increased the overall costs of regulatory compliance, and further Dodd-Frank Act related regulations may lead to additional costs. In addition, the CFPB has broad rulemaking authority and is the principal federal regulatory agency responsible for the supervision and enforcement of a wide range of consumer protection laws for banks with greater than $10 billion in assets.
The Capital Rules implementing Basel III were fully phased in as of January 1, 2019. The Capital Rules could have an adverse impact on our financial position and future earnings due to, among other things, the increased capital requirements. In addition, if we fail to maintain appropriate levels of capital or liquidity, we could become subject to formal or informal enforcement actions that may impose restrictions on our business, including limiting our lending activities or our ability to expand, requiring us to raise additional capital (which may be dilutive to shareholders) or requiring regulatory approval to pay dividends or otherwise return capital to shareholders.
Further, regulators have significant discretion and authority to prevent or remedy unsafe or unsound practices or violations of laws or regulations by financial institutions and holding companies in the performance of their supervisory and enforcement duties. The exercise of regulatory authority may have an adverse impact, which could be material, on our business, financial condition, results of operations and prospects. Additionally, our business is affected significantly by the fiscal and monetary policies of the U.S. federal government and its agencies, including the Federal Reserve.

We cannot accurately predict the full effects of recent legislation or the various other governmental, regulatory, monetary and fiscal initiatives which have been and may be enacted on the financial markets, on the Company and on the Bank. The terms and costs of these activities, or any worsening of current financial market and economic conditions, could materially and adversely affect our business, financial condition and results of operations, as well as the trading price of our common stock.

Table of Contents

We may be required, in the future, to recognize impairment with respect to investment securities.
Our securities portfolio currently includes securities with unrecognized losses. At December 31, 2018, gross unrealized losses in our securities portfolio were $56.0 million. We may continue to observe declines in the fair market value of these securities. Securities issued by certain states and municipalities have recently come under scrutiny due to concerns about credit quality. Although management believes the credit quality of the Company’s state and municipal securities portfolio to be good, there can be no assurance that the credit quality of these securities will not decline in the future. We evaluate the securities portfolio for any other than temporary impairment each reporting period, as required by generally accepted accounting principles in the United States. There can be no assurance, however, that future evaluations of the securities portfolio will not require us to recognize impairment charges with respect to these and other holdings. For example, it is possible that government-sponsored programs to allow mortgages to be refinanced to lower rates could materially adversely impact the yield on our portfolio of mortgage-backed securities, since a significant portion of our investment portfolio is composed of such securities.
Substantial competition in our market areas could adversely affect us.
Commercial banking is a highly competitive business. We compete with other commercial banks, savings and loan associations, credit unions and finance, insurance and other non-depository companies operating in our market areas. We also experience competition, especially for deposits, from Internet-based banking institutions, which have grown rapidly in recent years. We are subject to substantial competition for loans and deposits from other financial institutions. Some of our competitors are not subject to the same degree of regulation and restriction as we are and/or have greater financial resources than we do. Some of our competitors may have liquidity issues, which could impact the pricing of deposits, loans and other financial products in our markets. Our inability to effectively compete in our market areas could have a material adverse impact on our business, financial condition, results of operations and prospects.
We may not be able to attract or retain key employees.
Our success depends in significant part on the skills of our management team and our ability to retain, recruit and motivate key officers and employees. We expect our future success to be driven in large part by the relationships maintained with our clients by our executives and other key employees. Leadership changes will occur from time to time, and we cannot predict whether significant resignations or other departures will occur or whether we will be able to recruit additional qualified personnel. Competition for senior executives and skilled personnel in the financial services and banking industry is intense, which means the cost of hiring, incentivizing and retaining skilled personnel may continue to increase. We need to continue to attract and retain key personnel and to recruit qualified individuals to succeed existing key personnel to ensure the continued growth and successful operation of our business. The unexpected loss of any such employees, or the inability to recruit and retain qualified personnel in the future, could have a material adverse impact on our business, financial condition, results of operations and prospects. In addition, the scope and content of U.S. banking regulators' regulations and policies on incentive compensation, as well as changes to these regulations and policies, could adversely affect our ability to hire, retain and motivate our key employees.
Changes in accounting standards could materially impact our financial statements.
From time to time, the Financial Accounting Standards Board (the “FASB”) and the SEC change the financial accounting and reporting standards that govern the preparation of our financial statements. These changes can materially impact how we record and report our financial condition and results of operations.
In June 2016, the FASB issued Accounting Standards Update (“ASU”) 2016-13, Measurement of Credit Losses on Financial Instruments. The amendments in this ASU introduce a new impairment model based on current expected credit losses (“CECL”) rather than incurred losses. The CECL model would apply to most debt instruments, including loan receivables and loan commitments.
Unlike the incurred loss models in existing GAAP, the CECL model does not specify a threshold for the recognition of an impairment allowance. Rather, the Company would recognize an impairment allowance equal to its current estimate of expected credit losses for financial instruments as of the end of the reporting period. Measuring expected credit losses will most likely be a significant challenge for all entities, including the Company. In addition, to estimate expected credit losses, the Company could incur one-time and recurring costs, some of which may be related to

system changes and data collection.

Table of Contents

Further, the impairment allowance measured under a CECL model could differ materially from the impairment allowance measured under the Company's incurred loss model. To initially apply the proposed amendments, for most debt instruments, the Company would record a cumulative-effect adjustment to its Consolidated Balance Sheets as of the beginning of the first reporting period in which the guidance is effective (a modified retrospective approach).The amendments in ASU 2016-13 are effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years, and are required to be adopted through a modified retrospective approach, with a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the ASU is effective.

There can be no assurance as to the level of dividends we may pay on our common stock.

Holders of our common stock are only entitled to receive such dividends as our board of directors may declare out of funds legally available for such payments. Although we have historically declared cash dividends on our common stock, we are not required to do so and there may be circumstances under which we would eliminate our common stock dividend in the future. This could adversely affect the market price of our common stock.

We rely on dividends and other payments from our bank for substantially all of our revenue.

We are a separate and distinct legal entity from the Bank, and we receive substantially all of our operating cash flows from dividends and other payments from the Bank. These dividends and payments are the principal source of funds to pay dividends on our capital stock and interest and principal on any debt we may have. Various federal and state laws and regulations limit the amount of dividends that the Bank may pay to us. Also, our right to participate in a distribution of assets upon a subsidiary's liquidation or reorganization is subject to the prior claims of the subsidiary's creditors. In the event the Bank is unable to pay dividends to us, we may not be able to service debt, pay obligations, or pay dividends on our common stock. The inability to receive dividends from the Bank could have a material adverse impact on our business, financial condition, results of operations and prospects.

Our ability to sustain or improve upon existing performance is dependent upon our ability to respond to technological change, and we may have fewer resources than some of our competitors to continue to invest in technological improvements.

The financial services industry is undergoing rapid technological changes with frequent introductions of new technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and to reduce costs. Many of our competitors have substantially greater resources to invest in technological improvements than we do. Our future success will depend, in part, upon our ability to address the needs of our clients by using technology to provide products and services that will satisfy client demands for convenience, as well as to create additional efficiencies in our operations. We may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to our customers. In addition, the implementation of technological changes and upgrades to maintain current systems and integrate new ones may also cause service interruptions, transaction processing errors and system conversion delays and may cause us to fail to comply with applicable laws. There can be no assurance that we will be able to successfully manage the risks associated with our increased dependency on technology.

We may be exposed to environmental liabilities in connection with real properties acquired.

During the ordinary course of business, we may foreclose on and take title to properties securing certain loans. In doing so, there is a risk that hazardous or toxic substances could be found on these properties. If previously unknown or undisclosed hazardous or toxic substances are discovered, we may be liable for remediation costs, as well as for personal injury and property damage. Environmental laws may require us to incur substantial expenses which may materially reduce the affected property's value or limit our ability to use or sell the affected property. In addition, future laws or more stringent interpretations or enforcement polices with respect to existing laws may increase our exposure to environmental liability. Although we have policies and procedures to perform an environmental review at the time of underwriting a loan secured by real property, and also before initiating any foreclosure action on real property, these reviews may not be sufficient to detect all potential environmental hazards. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on our financial condition and results of operations.

Table of Contents

Significant legal or regulatory actions could subject us to substantial uninsured liabilities and reputational harm and have a material adverse effect on our business and results of operations.

We are from time to time subject to claims and proceedings related to our operations. These claims and legal actions, which could include supervisory or enforcement actions by our regulators, or criminal proceedings by prosecutorial authorities, could involve large monetary claims, including civil money penalties or fines imposed by government authorities and significant defense costs. To mitigate the cost of some of these claims, we maintain insurance coverage in amounts and with deductibles that we believe are appropriate for our operations. However, our insurance coverage does not cover any civil money penalties or fines imposed by government authorities and may not cover all other claims that might be brought against us or continue to be available to us at a reasonable cost. As a result, we may be exposed to substantial uninsured liabilities, which could adversely affect our business, prospects, results of operations and financial condition. Substantial legal liability or significant regulatory action against us could cause significant reputational harm to us and/or could have a material adverse impact on our business, financial condition, results of operations and prospects. Because we primarily serve individuals and businesses located in the Northwest, any negative impact resulting from reputational harm, including any impact on our ability to attract and retain customers and employees, likely would be greater than if our business were more geographically diverse.

We are subject to a variety of operational risks, including reputational risk, legal risk and compliance risk, and the risk of fraud or theft by employees or outsiders, which may adversely affect our business and results of operations.

We are exposed to many types of operational risks, including reputational risk, legal and compliance risk, the risk of fraud or theft by employees or outsiders, and unauthorized transactions by employees or operational errors, including clerical or record-keeping errors or those resulting from faulty or disabled computer or telecommunications systems. If personal, non-public, confidential or proprietary information of customers in our possession were to be mishandled or misused, we could suffer significant regulatory consequences, reputational damage and financial loss. Such mishandling or misuse could include, for example, if such information were erroneously provided to parties who are not permitted to have the information, either by fault of our systems, employees, or counterparties, or where such information is intercepted or otherwise inappropriately taken by third parties.

Because the nature of the financial services business involves a high volume of transactions, certain errors may be repeated or compounded before they are discovered and successfully rectified. Our necessary dependence upon automated systems to record and process transactions and our large transaction volume may further increase the risk that technical flaws or employee tampering or manipulation of those systems will result in losses that are difficult to detect. We also may be subject to disruptions of our operating systems arising from events that are wholly or partially beyond our control (for example, computer viruses or electrical or telecommunications outages, natural disasters, disease pandemics or other damage to property or physical assets) which may give rise to disruption of service to customers and to financial loss or liability. We are further exposed to the risk that our external vendors may be unable to fulfill their contractual obligations (or will be subject to the same risk of fraud or operational errors by their respective employees as we are) and to the risk that we (or our vendors') business continuity and data security systems prove to be inadequate. The occurrence of any of these risks could result in a diminished ability of us to operate our business (for example, by requiring us to expend significant resources to correct the defect), as well as potential liability to clients, reputational damage and regulatory intervention, which could have a material adverse impact on our business, financial condition, results of operations and prospects.

Table of Contents

Failure to maintain effective internal control over financial reporting or disclosure controls and procedures may adversely affect our business and results of operations.

Management regularly reviews and updates our internal control over financial reporting, disclosure controls and procedures, and corporate governance policies and procedures. We maintain controls and procedures to mitigate risks such as processing system failures or errors and customer or employee fraud, and we maintain insurance coverage for certain of these risks. Any system of controls and procedures, however well designed and operated, is based in part on certain assumptions and provides only reasonable, not absolute, assurances that the objectives of the system are met. Events could occur which are not prevented or detected by our internal controls, are not insured against, or are in excess of our insurance limits. Any failure or circumvention of our controls and procedures, or failure to comply with regulations related to controls and procedures, could have an adverse effect on our business, financial condition, results of operations and prospects.

Our business is subject to the risks of earthquakes, tsunamis, floods, fires and other natural catastrophic events.

A major catastrophe, such as an earthquake, tsunami, flood, fire or other natural disaster could result in a prolonged interruption of our business. For example, our headquarters are located in Tacoma, Washington and we have operations throughout the Northwest, a geographical region that has been or may be affected by earthquake, tsunami and flooding activity. Because we primarily serve individuals and businesses in the Northwest, a natural disaster likely would have a greater impact on our business, operations and financial condition than if our business were more geographically diverse. The occurrence of any of these natural disasters could negatively impact our performance by disrupting our operations or the operations of our customers, which could have a material adverse effect on our financial condition, results of operations and cash flows.

We have various anti-takeover measures that could impede a takeover.

Our articles of incorporation include certain provisions that could make it more difficult to acquire us by means of a tender offer, a proxy contest, merger or otherwise. These provisions include certain non-monetary factors that our board of directors may consider when evaluating a takeover offer, and a requirement that any “Business Combination” be approved by the affirmative vote of no less than 66 2/3% of the total shares attributable to persons other than a “Control Person.” These provisions may have the effect of lengthening the time required for a person to acquire control of us through a tender offer, proxy contest or otherwise, and may deter any potentially hostile offers or other efforts to obtain control of us. This could deprive our shareholders of opportunities to realize a premium for their Columbia common stock, even in circumstances where such action is favored by a majority of our shareholders.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

Table of Contents

ITEM 2. PROPERTIES

The Company’s principal properties include our corporate headquarters which is located at 13th & A Street, Tacoma, Washington, two operations facilities in Pierce County, Washington, one operations facility in Vancouver, Washington, and one operations facility in Wilsonville, Oregon.

The Company’s branch network as of December 31, 2018 is made up of 150 branches located throughout several Washington, Oregon and Idaho counties compared to 155 branches at December 31, 2017. The number of branches per state, as well as whether they are owned or operated under a lease agreement is detailed in the following table:

	Number of Branches	Occupancy Type	
		Owned	Leased
Washington branches	74	56	18
Oregon branches	62	34	28
Idaho branches	14	10	4
Total Columbia Bank branches	150	100	50

For additional information concerning our premises and equipment and lease obligations, see Notes 8 and 17 respectively, to the Consolidated Financial Statements in “Item 8. Financial Statements and Supplementary Data” of this report.

ITEM 3. LEGAL PROCEEDINGS

The Company and its subsidiaries are party to routine litigation arising in the ordinary course of business. Management believes that, based on information currently known to it, any liabilities arising from such litigation will not have a material adverse impact on the Company’s financial conditions, results of operations or cash flows.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

Table of Contents

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Common Stock and Dividends

The Company's common stock is traded on the NASDAQ Global Select Market under the symbol "COLB." At January 31, 2019, the number of shareholders of record was 3,217. This figure does not represent the actual number of beneficial owners of common stock because shares are frequently held in "street name" by securities dealers and others for the benefit of individual owners who may vote the shares.

At December 31, 2018, a total of 5,514 stock options were outstanding. Additional information about stock options and other equity compensation plans is included in Note 22 to the Consolidated Financial Statements in "Item 8. Financial Statements and Supplementary Data" of this report.

Equity Compensation Plan Information

The following table provides information as of December 31, 2018, regarding securities issued and to be issued under our equity compensation plans that were in effect during 2018:

	Year Ended December 31, 2018		
	Number of Shares to be Issued Upon Exercise of Outstanding Options and Rights (1)	Weighted Average Exercise Price of Outstanding Options and Rights	Number of Shares Remaining Available for Future Issuance Under Equity Compensation Plans (2)
Equity compensation plans approved by security holders	5,514	$ 9.91	3,376,314
Equity compensation plans not approved by security holders	—	—	—

(1) Includes shares to be issued upon exercise of options under the West Coast Bancorp ('West Coast") plan, which was assumed as a result of the 2013 West Coast acquisition.

(2) Includes 3,015,957 shares available for future issuance under the current stock option and equity compensation plan and 360,357 shares available for purchase under the Employee Stock Purchase Plan as of December 31, 2018.

The following table provides information about repurchases of common stock by the Company during the quarter ended December 31, 2018:

Period	Total Number of Common Shares Purchased (1)	Average Price Paid per Common Share	Total Number of Shares Purchased as Part of Publicly Announced Plan (2) (3)	Maximum Number of Remaining Shares That May Be Purchased at Period End Under the Plan (2) (3)
10/1/2018 - 10/31/2018	115	$ 36.26	—	2,900,000
11/1/2018 - 11/30/2018	—	—	—	2,900,000
12/1/2018 - 12/31/2018	305	40.68	—	—
	420	$ 39.47	—	

(1) Common shares repurchased by the Company during the quarter relate to shares withheld to pay taxes due upon vesting of restricted stock.

(2) On September 27, 2017, the board of directors approved a stock repurchase program. The program, which expired on November 30, 2018, authorized the Company to repurchase up to 2.9 million shares of its outstanding common stock.

(3) On November 14, 2018, as modified on January 23, 2019, the board of directors approved a stock repurchase program to repurchase up to 2.9 million shares, up to a maximum aggregate purchase price of $100.0 million.

Table of Contents

Five-Year Stock Performance Graph

The following graph shows a five-year comparison of the total return to shareholders of Columbia's common stock, the NASDAQ Composite Index (which is a broad nationally recognized index of stock performance by companies listed on the Nasdaq Stock Market) and the KBW Regional Banking Index (comprised of 50 banks and bank holding companies headquartered throughout the country, including Columbia).

The definition of total return includes appreciation in market value of the stock as well as the actual cash and stock dividends paid to shareholders. The graph assumes that the value of the investment in Columbia's common stock, the NASDAQ Composite and the KBW Regional Banking Index was $100 on December 31, 2013, and that all dividends were reinvested.

Index	Period Ending					
	12/31/2013	12/31/2014	12/31/2015	12/31/2016	12/31/2017	12/31/2018
Columbia Banking System, Inc.	100.00	104.17	128.05	185.13	183.94	158.09
NASDAQ Composite	100.00	114.75	122.74	133.62	173.22	168.30
KBW Regional Banking Index	100.00	102.42	108.48	150.80	153.45	126.59

Source: Bloomberg LP, New York City, NY

ITEM 6. SELECTED FINANCIAL DATA

Five-Year Summary of Selected Consolidated Financial Data (1)

	2018	2017 (2)	2016	2015	2014 (3)
	(dollars in thousands except per share amounts)				
For the Year					
Interest income	$497,069	$374,746	$337,969	$328,891	$308,042
Interest expense	$18,230	$6,757	$4,350	$4,004	$3,994
Net interest income	$478,839	$367,989	$333,619	$324,887	$304,048
Provision for loan and lease losses	$14,769	$8,631	$10,778	$8,591	$6,727
Noninterest income	$88,256	$109,642	$88,082	$91,473	$59,750
Noninterest expense	$340,490	$291,017	$261,142	$266,149	$239,286
Net income	$172,882	$112,828	$104,866	$98,827	$81,574
Net income applicable to common shareholders	$172,882	$112,828	$104,709	$98,690	$81,478
Per Common Share					
Earnings (Basic)	$2.36	$1.86	$1.81	$1.71	$1.53
Earnings (Diluted)	$2.36	$1.86	$1.81	$1.71	$1.52
Book Value	$27.76	$26.70	$21.52	$21.48	$21.34
Averages					
Total assets	$12,725,086	$10,134,306	$9,311,621	$8,655,243	$7,468,091
Interest-earning assets	$11,241,321	$9,098,276	$8,363,309	$7,685,734	$6,561,047
Loans	$8,409,373	$6,682,259	$6,052,389	$5,609,261	$4,782,369
Securities, including Federal Home Loan Bank stock	$2,790,700	$2,350,844	$2,269,121	$2,031,859	$1,708,575
Deposits	$10,410,404	$8,482,350	$7,774,309	$7,146,828	$6,187,342
Shareholders' equity	$1,969,179	$1,410,056	$1,269,801	$1,246,952	$1,109,581
Financial Ratios					
Net interest margin (tax equivalent)	4.33 %	4.18 %	4.12 %	4.35 %	4.76 %
Return on average assets	1.36 %	1.11 %	1.13 %	1.14 %	1.09 %
Return on average common equity	8.78 %	8.00 %	8.26 %	7.93 %	7.36 %
Average equity to average assets	15.47 %	13.91 %	13.64 %	14.41 %	14.86 %
At Year End					
Total assets	$13,095,145	$12,716,886	$9,509,607	$8,951,697	$8,578,846
Loans	$8,391,511	$8,358,657	$6,213,423	$5,815,027	$5,445,378
Allowance for loan and lease losses	$83,369	$75,646	$70,043	$68,172	$69,569
Securities, including Federal Home Loan Bank stock	$3,193,408	$2,753,271	$2,288,817	$2,170,416	$2,131,622
Deposits	$10,458,126	$10,532,085	$8,059,415	$7,438,829	$6,924,722
Core deposits	$9,973,840	$10,039,557	$7,749,568	$7,238,713	$6,753,142
Shareholders' equity	$2,033,649	$1,949,922	$1,251,012	$1,242,128	$1,228,175
Nonperforming Assets					
Nonaccrual loans	$54,842	$66,189	$27,756	$21,464	$31,352
Other real estate owned and other personal property owned	6,049	13,298	5,998	13,738	22,225
Total nonperforming assets	$60,891	$79,487	$33,754	$35,202	$53,577
Nonperforming loans to year end loans	0.65 %	0.79 %	0.45 %	0.37 %	0.58 %
Nonperforming assets to year end assets	0.46 %	0.63 %	0.35 %	0.39 %	0.62 %
	0.99 %	0.91 %	1.13 %	1.17 %	1.28 %

Allowance for loan and lease losses to year end loans					
Net loan charge-offs	$7,046	$3,028	$8,907	$9,988	$9,612
Other nonfinancial data					
Full-time equivalent employees	2,137	2,120	1,819	1,868	1,934
Banking branches	150	155	143	149	154

(1) These unaudited schedules were derived from our audited financial statements and provide selected financial information concerning the Company that should be read in conjunction with "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" of this report.

(2) During 2017, Columbia acquired Pacific Continental Corporation. See Note 2 to the Consolidated Financial Statements in "Item 8. Financial Statements and Supplementary Data" of this report for further information regarding this acquisition.

(3) During 2014, Columbia acquired Intermountain Community Bancorp.

Table of Contents

Consolidated Five-Year Financial Data (1)

	Years ended December 31,				
	2018	2017 (2)	2016	2015	2014 (3)
	(in thousands, except per share amounts)				
Interest Income:					
Loans	$428,197	$324,229	$291,465	$286,166	$268,279
Taxable securities	55,969	38,659	35,167	30,774	28,754
Tax-exempt securities	12,201	11,045	11,121	11,842	10,830
Deposits in banks	702	813	216	109	179
Total interest income	497,069	374,746	337,969	328,891	308,042
Interest Expense:					
Deposits	12,105	4,800	3,134	2,977	3,005
Federal Home Loan Bank advances	3,750	1,078	671	474	396
Subordinated debentures	1,871	304	—	—	—
Other borrowings	504	575	545	553	593
Total interest expense	18,230	6,757	4,350	4,004	3,994
Net Interest Income	478,839	367,989	333,619	324,887	304,048
Provision for loan and lease losses	14,769	8,631	10,778	8,591	6,727
Net interest income after provision for loan and lease losses	464,070	359,358	322,841	316,296	297,321
Noninterest income	88,256	109,642	88,082	91,473	59,750
Noninterest expense	340,490	291,017	261,142	266,149	239,286
Income before income taxes	211,836	177,983	149,781	141,620	117,785
Provision for income taxes	38,954	65,155	44,915	42,793	36,211
Net Income	$172,882	$112,828	$104,866	$98,827	$81,574
Less: Dividends on preferred stock	—	—	157	137	96
Net Income Applicable to Common Shareholders	$172,882	$112,828	$104,709	$98,690	$81,478
Per Common Share					
Earnings basic	$2.36	$1.86	$1.81	$1.71	$1.53
Earnings diluted	$2.36	$1.86	$1.81	$1.71	$1.52
Average number of common shares outstanding (basic)	72,385	59,882	57,184	57,019	52,618
Average number of common shares outstanding (diluted)	72,390	59,888	57,193	57,032	53,183
Total assets at year end	$13,095,145	$12,716,886	$9,509,607	$8,951,697	$8,578,846
Long-term obligations	$35,462	$35,647	$—	$—	$—
Cash dividends declared per common share	$1.14	$0.88	$1.53	$1.34	$0.94

(1) These unaudited schedules were derived from our audited financial statements and provide selected financial information concerning the Company that should be read in conjunction with "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" of this report.

(2) During 2017, Columbia acquired Pacific Continental Corporation. See Note 2 to the Consolidated Financial Statements in "Item 8. Financial Statements and Supplementary Data" of this report for further information regarding this acquisition.

(3) During 2014, Columbia acquired Intermountain Community Bancorp.

Table of Contents

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This discussion should be read in conjunction with our Consolidated Financial Statements and related notes in "Item 8. Financial Statements and Supplementary Data" of this report. In the following discussion, unless otherwise noted, references to increases or decreases in average balances in items of income and expense for a particular period and balances at a particular date refer to the comparison with corresponding amounts for the period or date for the previous year.

Critical Accounting Policies

We have established certain accounting policies in preparing our Consolidated Financial Statements that are in accordance with accounting principles generally accepted in the United States. Our significant accounting policies are presented in Note 1 to the Consolidated Financial Statements in "Item 8. Financial Statements and Supplementary Data" of this report. Certain of these policies require the use of judgments, estimates and economic assumptions which may prove inaccurate or are subject to variation that may significantly affect our reported results of operations and financial position for the periods presented or in future periods. Management believes that the judgments, estimates and economic assumptions used in the preparation of the Consolidated Financial Statements are appropriate given the factual circumstances at the time. We consider the following policies to be most critical in understanding the judgments that are involved in preparing our Consolidated Financial Statements.

Allowance for Loan and Lease Losses

The allowance for loan and lease losses (the "allowance") is an accounting estimate of incurred credit losses in our loan portfolio at the balance sheet date. The primary components of the allowance are 1) loans collectively evaluated for impairment in accordance with the FASB Accounting Standards Codification ("ASC") Topic 450, Contingencies (ASC 450), 2) loans individually determined to be impaired in accordance with the FASB ASC Subtopic 310-10, Receivables: Overall (ASC 310-10) and 3) loans acquired with deteriorated credit quality in accordance with FASB ASC Subtopic 310-30, Receivables: Loans and Debt Securities Acquired with Deteriorated Credit Quality (ASC 310-30).

The measure of estimated credit losses for the ASC 450 component is based upon the loss experience over a historical base period adjusted for a loss emergence period. The loss emergence period is an estimate of the period that it takes, on average, for us to identify the amount of loss incurred for a loan that has suffered a loss-causing event. Management then considers the effects of the following qualitative factors to ensure our allowance reflects the inherent losses in the loan portfolio:

- Economic and business conditions;
- Concentration of credit;
- Lending management and staff;
- Lending policies and procedures;
- Loss and recovery trends;
- Nature and volume of the portfolio;
- Trends in problem loans, loan delinquencies and nonaccrual loans;
- Quality of internal loan review; and
- External factors.

These qualitative factors have a high degree of subjectivity and changes in any of the factors could have a significant impact on our calculation of the allowance. The qualitative adjustment by loan segment is based upon management's assessment of inherent losses within a range between the weighted historical loss factor by segment and the maximum consecutive quarterly losses in the relevant loss emergence period by segment over the historical base period.

The measure of estimated credit losses for the ASC 310-10 component begins if, based upon current information and events, we believe it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement or when a loan has been modified in a troubled debt restructuring. When a loan has been identified as impaired, the amount of impairment will be measured using discounted cash flows, except when it is determined that the remaining source of repayment for the loan is the operation or liquidation of the underlying collateral. In these cases, the current fair value of the collateral, reduced by costs to sell, will be used in place of discounted cash

flows. As a final alternative, the observable market price of the debt may be used to assess impairment. Predominantly, the Company uses the fair value of collateral approach based upon a reliable valuation.

Our allowance policy and the judgments, estimates and economic assumptions involved are described in greater detail in the “Allowance for Loan and Lease Losses and Unfunded Commitments and Letters of Credit” section of this discussion and in Note 1 to the Consolidated Financial Statements in “Item 8. Financial Statements and Supplementary Data” of this report.

Table of Contents

Business Combinations

The Company applies the acquisition method of accounting for business combinations. Under the acquisition method, the acquiring entity in a business combination recognizes the assets acquired and liabilities assumed at their acquisition date fair values. Management utilizes prevailing valuation techniques appropriate for the asset or liability being measured in determining these fair values. Any excess of the purchase price over amounts allocated to assets acquired, including identifiable intangible assets, and liabilities assumed is recorded as goodwill. Where amounts allocated to assets acquired and liabilities assumed is greater than the purchase price, a bargain purchase gain is recognized. Acquisition-related costs are expensed as incurred.

Valuation and Recoverability of Goodwill

Goodwill represented $765.8 million of our $13.10 billion in total assets as of December 31, 2018. The Company has a single reporting unit. We review goodwill for impairment annually, during the third quarter, and also test for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of our reporting unit below its carrying amount. Such events and circumstances may include among others: a significant adverse change in legal factors or in the general business climate; significant decline in our stock price and market capitalization; unanticipated competition; the testing for recoverability of a significant asset group within the reporting unit; and an adverse action or assessment by a regulator. Any adverse change in these factors could have a significant impact on the recoverability of goodwill and could have a material impact on our Consolidated Financial Statements.

Under the Intangibles – Goodwill and Other topic of the FASB ASC, the testing for impairment may begin with an assessment of qualitative factors to determine if it is more likely than not that the fair value of a reporting unit is less than its carrying amount. When required, the goodwill impairment test involves a two-step process. In step one, we would test goodwill for impairment by comparing the fair value of the reporting unit with its carrying amount. If the fair value of the reporting unit exceeds the carrying amount of the reporting unit, goodwill is not deemed to be impaired, and no further testing is necessary. If the carrying amount of the reporting unit were to exceed the fair value of the reporting unit, we would perform a second test to measure the amount of impairment loss, if any. To measure the amount of any impairment loss, we would determine the implied fair value of goodwill in the same manner as if the reporting unit were being acquired in a business combination. Specifically, we would allocate the fair value of the reporting unit to all of the assets and liabilities of the reporting unit in a hypothetical calculation that would determine the implied fair value of goodwill. If the implied fair value of goodwill is less than the recorded goodwill, we would record an impairment charge for the difference.

The accounting estimates related to our goodwill require us to make considerable assumptions about fair values. Our assumptions regarding fair values require significant judgment about economic and industry factors and the growth and earnings prospects of the Bank. Changes in these judgments, either individually or collectively, may have a significant effect on the estimated fair values.

Based on the results of the annual goodwill impairment test, we determined that no goodwill impairment charges were required as our single reporting unit's fair value exceeded its carrying amount. As of December 31, 2018, we determined there were no events or circumstances which would more likely than not reduce the fair value of our reporting unit below its carrying amount.

Please refer to Note 9 to the Consolidated Financial Statements in "Item 8. Financial Statements and Supplementary Data" of this report for further discussion.

Table of Contents

2018 Financial Summary

Income Statement

- Consolidated net income for 2018 was $172.9 million, or $2.36 per diluted common share, compared with net income of $112.8 million, or $1.86 per diluted common share, in 2017.

Net interest income for 2018 increased 30% to $478.8 million compared to $368.0 million for 2017. Interest income was $497.1 million in 2018, compared to $374.7 million in 2017. The increase was primarily due to income from higher average loan and securities balances acquired in the 2017 Pacific Continental acquisition. Interest expense increased $11.5 million compared to 2017, due to higher rates on interest-bearing liabilities and higher borrowing balances.

Provision for loan and lease losses was $14.8 million in 2018, compared to $8.6 million in 2017. Provision expense for the current year was driven by net charge-offs and growth in the loan portfolio.

Noninterest income was $88.3 million for 2018, a decrease from $109.6 million for 2017. Noninterest income was lower in 2018 than in 2017 primarily due to the $14.0 million one-time gain on the sale of our merchant card services portfolio in 2017. The decrease was also attributable to lower card revenue.

Noninterest expense increased $49.5 million, or 17% to $340.5 million for 2018 due primarily to higher compensation and employee benefits resulting from the Pacific Continental acquisition.

Balance Sheet

- Total assets at December 31, 2018 were $13.10 billion, up 3%, or $378.3 million from $12.72 billion at the end of 2017.
- The Company is well-capitalized with a total risk-based capital ratio of 13.9920% at December 31, 2018.

Investment securities at December 31, 2018 were $3.17 billion, up 15% from $2.74 billion at December 31, 2017.

Loans were $8.39 billion, an increase of $32.9 million from $8.36 billion at the end of 2017.

The allowance for loan and lease losses increased to $83.4 million at December 31, 2018 compared to $75.6 million at December 31, 2017 due to management’s on-going assessment of the credit quality of the loan portfolio. The Company’s allowance was 0.99% of total loans, compared with 0.91% at the end of 2017.

Nonperforming assets totaled $60.9 million at December 31, 2018, down from $79.5 million at December 31, 2017. The decrease in nonperforming assets was due to a decrease of $11.3 million in nonaccrual loans and a decrease in Other Real Estate Owned (“OREO”) compared to December 31, 2017. Nonperforming assets to year end assets decreased to 0.46% at December 31, 2018 compared to 0.63% at December 31, 2017.

Deposits totaled $10.46 billion at December 31, 2018 compared to $10.53 billion at December 31, 2017.

Core deposits totaled $9.97 billion at December 31, 2018, compared to $10.04 billion at December 31, 2017. Core deposits represented 95% of total deposits at December 31, 2018 and 2017.

Federal Home Loan Bank (“FHLB”) advances were $399.5 million at December 31, 2018, an increase of $387.9 million compared to December 31, 2017.

Table of Contents

Business Combinations

On November 1, 2017, the Company completed its acquisition of Pacific Continental. The Company acquired approximately $2.94 billion in assets, including $1.87 billion in loans measured at fair value and $2.12 billion in deposits. See Note 2 to the Consolidated Financial Statements in “Item 8. Financial Statements and Supplementary Data” of this report for further information regarding this acquisition.

On November 1, 2014, the Company completed its acquisition of Intermountain. The Company acquired approximately $964.4 million in assets, including $502.6 million in loans measured at fair value and $736.8 million in deposits.

RESULTS OF OPERATIONS

Summary

A summary of the Company’s results of operations for each of the last three years ended December 31 follows:

	Year ended 2018	Increase (Decrease) Amount	%	Year ended 2017	Increase (Decrease) Amount	%	Year ended 2016
	(dollars in thousands, except per share amounts)						
Interest income	$497,069	$122,323	33	$374,746	$36,777	11	$337,969
Interest expense	18,230	11,473	170	6,757	2,407	55	4,350
Net interest income	478,839	110,850	30	367,989	34,370	10	333,619
Provision for loan and lease losses	14,769	6,138	71	8,631	(2,147)	(20)	10,778
Noninterest income	88,256	(21,386)	(20)	109,642	21,560	24	88,082
Noninterest expense:							
Compensation and employee benefits	200,199	30,525	18	169,674	19,392	13	150,282
Other expense	140,291	18,948	16	121,343	10,483	9	110,860
Total	340,490	49,473	17	291,017	29,875	11	261,142
Income before income taxes	211,836	33,853	19	177,983	28,202	19	149,781
Provision for income taxes	38,954	(26,201)	(40)	65,155	20,240	45	44,915
Net income	$172,882	$60,054	53	$112,828	$7,962	8	$104,866
Less: earnings allocated to participating securities	1,892	388	26	1,504	(52)	(3)	1,556
Earnings allocated to common shareholders	$170,990	$59,666	54	$111,324	$8,014	8	$103,310
Earnings per common share, diluted	$2.36	$0.50	27	$1.86	$0.05	3	$1.81

Net Interest Income

Net interest income is the difference between interest income and interest expense. Net interest income on a fully taxable-equivalent basis expressed as a percentage of average total interest-earning assets is referred to as the net interest margin, which represents the average net effective yield on interest-earning assets.

Table of Contents

The following table sets forth the average balances of all major categories of interest-earning assets and interest-bearing liabilities, the total dollar amounts of interest income on interest-earning assets and interest expense on interest-bearing liabilities, the average yield earned on interest-earning assets and average cost of interest-bearing liabilities by category and in total, net interest income, net interest spread, net interest margin and the ratio of average interest-earning assets to interest-earning liabilities:

Net Interest Income Summary

	2018			2017			2016		
	Average Balances	Interest Earned/ Paid	Average Rate	Average Balances	Interest Earned/ Paid	Average Rate	Average Balances	Interest Earned/ Paid	Average Rate
	(dollars in thousands)								
ASSETS									
Loans, net (1)(2)(3)	$8,409,373	$432,781	5.15 %	$6,682,259	$330,400	4.94 %	$6,052,389	$296,283	4.90 %
Taxable securities (4)	2,275,892	55,969	2.46 %	1,886,128	38,659	2.05 %	1,804,004	35,167	1.95 %
Tax exempt securities (3)	514,808	15,445	3.00 %	464,716	16,992	3.66 %	465,117	17,109	3.68 %
Interest-earning deposits with banks	41,248	702	1.70 %	65,173	813	1.25 %	41,799	216	0.52 %
Total interest-earning assets	11,241,321	504,897	4.49 %	9,098,276	386,864	4.25 %	8,363,309	348,775	4.17 %
Other earning assets	224,595			181,792			156,871		
Noninterest-earning assets	1,259,170			854,238			791,441		
Total assets	$12,725,086			$10,134,306			$9,311,621		
LIABILITIES AND SHAREHOLDERS' EQUITY									
Certificates of deposit	$452,756	$2,206	0.49 %	$406,406	$656	0.16 %	$426,296	$522	0.12 %
Savings accounts	885,433	138	0.02 %	774,340	96	0.01 %	698,687	71	0.01 %
Interest-bearing demand	1,256,205	2,562	0.20 %	1,031,719	950	0.09 %	952,135	695	0.07 %
Money market accounts	2,773,208	7,199	0.26 %	2,158,656	3,098	0.14 %	1,993,283	1,846	0.09 %
Total interest-bearing deposits	5,367,602	12,105	0.23 %	4,371,121	4,800	0.11 %	4,070,401	3,134	0.08 %
Federal Home Loan Bank and Federal Reserve Bank advances	166,577	3,750	2.25 %	79,788	1,078	1.35 %	79,673	671	0.84 %
Subordinated debentures	35,553	1,871	5.26 %	5,905	304	5.15 %	—	—	— %
Other borrowings and interest-bearing liabilities	45,095	504	1.12 %	55,913	575	1.03 %	77,022	545	0.71 %
Total interest-bearing liabilities	5,614,827	18,230	0.32 %	4,512,727	6,757	0.15 %	4,227,096	4,350	0.10 %

Noninterest-bearing deposits	5,042,802	4,111,229	3,703,908
Other noninterest-bearing liabilities	98,278	100,294	110,816
Shareholders' equity	1,969,179	1,410,056	1,269,801
Total liabilities & shareholders' equity	$12,725,086	$10,134,306	$9,311,621
Net interest income (tax equivalent)	$486,667	$380,107	$344,425
Net interest spread (tax equivalent)	4.17 %	4.10 %	4.07 %
Net interest margin (tax equivalent)	4.33 %	4.18 %	4.12 %
Average interest-earning assets to average interest-bearing liabilities	200.21 %	201.61 %	197.85 %

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(1) Nonaccrual loans have been included in the table as loans carrying a zero yield. Amortized net deferred loan fees and unearned net discounts on acquired loans were included in the interest income calculations. The amortization of net deferred loan fees was $9.3 million in 2018, $7.1 million in 2017 and $5.3 million in 2016. The accretion of net unearned discounts on certain acquired loans was $10.9 million in 2018, $8.7 million in 2017, and $12.0 million in 2016.

(2) Incremental accretion on purchased credit impaired loans is also included in loan interest earned. The incremental accretion income on purchased credit impaired loans was $1.6 million in 2018, $4.1 million in 2017 and $6.0 million in 2016.

(3) Yields on fully taxable equivalent basis. The tax equivalent yield adjustment to interest earned on loans was $4.6 million, $6.2 million and $4.8 million for the years ended December 31, 2018, 2017, and 2016, respectively. The tax equivalent yield adjustment to interest earned on tax exempt securities was $3.2 million, $5.9 million and $6.0 million for the years ended December 31, 2018, 2017, and 2016, respectively.

(4) During the twelve months ended December 31, 2017, the Company recorded a $1.8 million adjustment to premium amortization, which decreased interest income on taxable securities.

Table of Contents

Net interest income is impacted by the volume (changes in volume multiplied by prior rate), interest rate (changes in rate multiplied by prior volume) and the mix of interest-earning assets and interest-bearing liabilities. The following table shows changes in net interest income on a fully taxable-equivalent basis between 2018 and 2017, as well as between 2017 and 2016 broken down between volume and rate. Changes attributable to the combined effect of volume and interest rates have been allocated proportionately to the changes due to volume and the changes due to interest rates:

Changes in Net Interest Income

	2018 Compared to 2017 Increase (Decrease) Due to			2017 Compared to 2016 Increase (Decrease) Due to		
	Volume	Rate	Total	Volume	Rate	Total
	(in thousands)					
Interest Income						
Loans, net (1)	$88,408	$13,973	$102,381	$31,116	$3,001	$34,117
Taxable securities	8,800	8,510	17,310	1,640	1,852	3,492
Tax-exempt securities (1)	1,709	(3,256)	(1,547)	(15)	(102)	(117)
Interest earning deposits with banks	(353)	242	(111)	169	428	597
Interest income	$98,564	$19,469	$118,033	$32,910	$5,179	$38,089
Interest Expense						
Deposits:						
Certificates of deposit	$83	$1,467	$1,550	$(25)	$159	$134
Savings accounts	15	27	42	8	17	25
Interest-bearing demand	245	1,367	1,612	62	193	255
Money market accounts	1,069	3,032	4,101	164	1,088	1,252
Total interest on deposits	1,412	5,893	7,305	209	1,457	1,666
Federal Home Loan Bank advances	1,657	1,015	2,672	1	406	407
Subordinated debentures	1,560	7	1,567	304	—	304
Other borrowings and interest-bearing liabilities	(130)	59	(71)	(45)	75	30
Interest expense	$4,499	$6,974	$11,473	$469	$1,938	$2,407
	$94,065	$12,495	$106,560	$32,441	$3,241	$35,682

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(1) For tax exempt loans and tax exempt securities, the amount of our tax equivalent adjustment for 2018 was impacted by the lower federal corporate tax rate. As a result, our tax equivalent adjustments for tax exempt loans and tax exempt securities were $4.7 million and $3.3 million lower, respectively, than they would have been utilizing the prior federal corporate tax rate. This change in federal corporate tax rate negatively impacted our current year net interest margin (tax equivalent) by 7 basis points.

Table of Contents

Incremental accretion income represents the amount of interest income recorded on acquired loans above the contractual rate stated in the individual loan notes. The additional interest income stems from the net discount established at the time these loan portfolios were acquired. The following table shows the impact to interest income of incremental accretion income as well as the net interest margin and operating net interest margin for the periods presented:

	Year Ended December 31, 2018	Year Ended December 31, 2017	Year Ended December 31, 2016
	(in thousands)		
Incremental accretion income due to:			
Federal Deposit Insurance Corporation purchased credit impaired loans	$1,635	$4,107	$5,972
Other acquired loans	10,921	8,689	11,983
Total incremental accretion income	$12,556	$12,796	$17,955
Net interest margin (tax equivalent)	4.33 %	4.18 %	4.12 %
Operating net interest margin (tax equivalent) (1)	4.30 %	4.15 %	4.01 %

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(1) Operating net interest margin (tax equivalent) is a Non-GAAP financial measure. See Non-GAAP financial measures section of "Item 7. Management's Discussion and Analysis of Financial Conditions and Results of Operations."

Comparison of 2018 with 2017

Taxable-equivalent net interest income totaled $486.7 million in 2018, compared with $380.1 million for 2017. The increase in net interest income during 2018 resulted from the increase in the size of the loan and securities portfolios, primarily due to the Pacific Continental acquisition. The increase in net interest income was partially offset by higher interest rates paid on interest-bearing liabilities combined with higher balances of interest-bearing liabilities due to the acquisition.

The Company's net interest margin (tax equivalent) increased from 4.18% for the year ended December 31, 2017 to 4.33% for the current year due primarily to higher yields on loans as well as higher loan volumes, partially offset by both the rise in the rates paid on deposits and other interest-bearing liabilities as well as the balance in these liabilities. The Company's operating net interest margin (tax equivalent) increased from 4.15% for the year ended December 31, 2017 to 4.30% for the current year due to higher volumes and rates on loans.

For a discussion of the methodologies used by management in recording interest income on loans, please see Note 1 to the Consolidated Financial Statements in "Item 8. Financial Statements and Supplementary Data" of this report.

Comparison of 2017 with 2016

Taxable-equivalent net interest income totaled $380.1 million in 2017, compared with $344.4 million for 2016. The increase in net interest income during 2017 resulted from the increase in the size of the loan and securities portfolios, primarily due to the Pacific Continental acquisition, partially offset by lower incremental accretion income from acquired loans.

The Company's net interest margin (tax equivalent) increased from 4.12% for the year ended December 31, 2016 to 4.18% for the year ended December 31, 2017 due primarily to higher yields on loans as well as higher loan volumes, partially offset by the decreased impact of accretion income on the loan portfolio. The Company's operating net interest margin (tax equivalent) increased from 4.01% for the year ended December 31, 2016 to 4.15% for 2017 due to higher volumes and rates on loans.

Provision for Loan and Lease Losses

The Company accounts for the credit risk associated with lending activities through its "Allowance for loan and lease losses" and "Provision for loan and lease losses." The provision is the expense recognized in the Consolidated Statements of Income to adjust the allowance to the levels deemed appropriate by management, as determined through its application of the Company's allowance methodology procedures. For discussion of the methodology used by management in determining the adequacy of the ALLL, see the "Allowance for Loan and Lease Losses and Unfunded Commitments and Letters of Credit" and "Critical Accounting Policies" sections of this discussion.

35

Table of Contents

The Company recorded provision expense of $14.8 million, $8.6 million and $10.8 million in 2018, 2017 and 2016, respectively. The provision recorded in 2018 included a large charge-off on an agricultural loan as well as management's ongoing assessment of the credit quality of the Company's loan portfolio. Factors affecting the provision include net charge-offs, credit quality migration, and size and composition of the loan portfolio and changes in the economic environment during the period. See "Allowance for Loan and Lease Losses and Unfunded Commitments and Letters of Credit" section of this discussion for further information on factors considered by the Company in assessing the credit quality of the loan portfolio and establishing the allowance for loan and lease losses.

For the years ended December 31, 2018, 2017 and 2016, net loan charge-offs amounted to $7.0 million, $3.0 million, and $8.9 million, respectively.

Noninterest Income

The following table presents the significant components of noninterest income and the related dollar and percentage change from period to period:

	Years ended December 31,						
	2018	$ Change	% Change	2017	$ Change	% Change	2016
	(dollars in thousands)						
Deposit account and treasury management fees	$36,072	$5,691	19 %	$30,381	$1,881	7 %	$28,500
Card revenue (1)	19,719	(5,908)	(23)%	25,627	2,007	8 %	23,620
Financial services and trust revenue	12,135	657	6 %	11,478	212	2 %	11,266
Loan revenue	11,866	(533)	(4)%	12,399	1,432	13 %	10,967
Merchant processing revenue	—	(4,283)	(100)%	4,283	(4,449)	(51)%	8,732
Bank owned life insurance (BOLI)	6,007	627	12 %	5,380	834	18 %	4,546
Investment securities gains (losses), net	(89)	(78)	709 %	(11)	(1,192)	(101)%	1,181
Change in Federal Deposit Insurance Corporation loss-sharing asset	—	447	(100)%	(447)	2,138	(83)%	(2,585)
Gain on sale of merchant card services portfolio	—	(14,000)	(100)%	14,000	14,000	100 %	—
Other	2,546	(4,006)	(61)%	6,552	4,697	253 %	1,855
Total noninterest income	$88,256	$(21,386)	(20)%	$109,642	$21,560	24 %	$88,082

(1) Beginning January 1, 2018 and pursuant to the adoption of new revenue recognition accounting guidance interchange revenue, included in "Card revenue" above, is presented net of related payment card network expenses. For the year ended December 31, 2018, $5.0 million of such expenses were netted from "Card revenue."

Comparison of 2018 with 2017

The $21.4 million decrease in noninterest income was principally from the $14.0 million one-time gain on sale of the merchant card services portfolio in 2017. As a result of the merchant card services portfolio sale, we now share with the buyer in merchant services revenue and include such amounts in "Card revenue." The decrease was also attributable to lower card revenue as we became subject to the interchange fee cap imposed under the Dodd-Frank Act on July 1, 2018, and the change to net presentation of interchange revenue pursuant to the adoption of new revenue recognition accounting guidance, which became effective on January 1, 2018. Specifically, $5.0 million of payment card network expenses for 2018 that would have historically been presented in "other noninterest expense" are now presented in "card revenue." Partially offsetting these decreases to noninterest income was an increase in deposit account and treasury management fees of $5.7 million, or 19%.

Table of Contents

Comparison of 2017 with 2016

The $21.6 million increase in noninterest income was principally from the $14 million gain on sale of the merchant card services portfolio on July 1, 2017. With that sale, we transitioned the delivery of those services from in-house to an outsourced model to better serve our business clients via a broader selection of competitive, best-in-class payment processing solutions. Subsequent to the sale, we ceased recording revenue in “Merchant processing revenue” and began recording our share of net merchant services revenue in “Card revenue.” For the year ended December 31, 2017, that revenue share was $1.1 million. Also contributing to the increase was higher other noninterest income, principally from a BOLI benefit of $4.2 million in 2017, compared to a BOLI benefit of $254 thousand in 2016. Finally, as a result of our termination of loss-sharing in 2017, the change in FDIC loss-sharing asset improved from a charge of $2.6 million in 2016 to a charge of $447 thousand in 2017. However, we also recognized in noninterest expense a $2.4 million charge related to loss-sharing termination.

Noninterest Expense

The following table presents the significant components of noninterest expense and the related dollar and percentage change from period to period:

	Years ended December 31,						
	2018	$ Change	% Change	2017	$ Change	% Change	2016
	(dollars in thousands)						
Compensation and employee benefits	$200,199	$30,525	18 %	$169,674	$19,392	13 %	$150,282
All other noninterest expense:							
Occupancy	36,576	4,169	13 %	32,407	(1,327)	(4)%	33,734
Merchant processing expense	—	(2,196)	(100)%	2,196	(2,134)	(49)%	4,330
Advertising and promotion	5,584	1,118	25 %	4,466	(132)	(3)%	4,598
Data processing	20,235	2,030	11 %	18,205	1,717	10 %	16,488
Legal and professional services	18,044	2,893	19 %	15,151	7,262	92 %	7,889
Taxes, license and fees	6,061	1,288	27 %	4,773	(412)	(8)%	5,185
Regulatory premiums	3,710	527	17 %	3,183	(594)	(16)%	3,777
Net cost of operation of other real estate owned	1,218	750	160 %	468	(83)	(15)%	551
Amortization of intangibles	12,236	5,903	93 %	6,333	387	7 %	5,946
Other (1)	36,627	2,466	7 %	34,161	5,799	20 %	28,362
Total all other noninterest expense	140,291	18,948	16 %	121,343	10,483	9 %	110,860
Total noninterest expense	$340,490	$49,473	17 %	$291,017	$29,875	11 %	$261,142

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(1) In the first quarter of 2018, there was a change to net presentation of interchange revenue pursuant to the adoption of new revenue recognition accounting guidance on January 1, 2018. As a result, card revenue for the twelve months ended December 31, 2018 includes $5.0 million of payment card network expenses that would have historically been presented in other noninterest expense.

Table of Contents

The following table shows the impact of the acquisition-related expenses for the periods indicated to the various components of noninterest expense:

	Years ended December 31,		
	2018	2017	2016
	(in thousands)		
Acquisition-related expenses:			
Compensation and employee benefits	$3,620	$8,014	$35
Occupancy	1,619	1,912	2,383
Advertising and promotion	537	467	—
Data processing	963	1,555	18
Legal and professional fees	1,028	4,618	291
Taxes, licenses and fees	—	10	—
Other	894	620	—
Total impact of acquisition-related costs to noninterest expense	$8,661	$17,196	$2,727
Acquisition-related expenses by transaction:			
Intermountain	—	—	2,436
Pacific Continental (1)	8,661	17,196	291
Total impact of acquisition-related costs to noninterest expense	$8,661	$17,196	$2,727

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(1) The Company completed the acquisition of Pacific Continental on November 1, 2017. See Note 2 to the Consolidated Financial Statements in "Item 8. Financial Statements and Supplementary Data" of this report for further information regarding this acquisition.

Comparison of 2018 with 2017

Noninterest expense was $340.5 million in 2018, an increase of $49.5 million, or 17%, over 2017. Included in noninterest expense were $8.7 million of acquisition-related expenses compared to $17.2 million in 2017. After removing the effect of acquisition-related expenses, noninterest expense increased $58.0 million due to higher compensation and employee benefits, amortization of intangibles, legal and professional fees, and other expenses. The increases in compensation and employee benefits and amortization of intangibles were driven by increases in salaries, benefits, and payroll taxes and amortization of core deposit intangibles. These increases were primarily due to the Pacific Continental acquisition, as 2018 included the full year of the acquired bank expenses compared to the inclusion of only two months of expenses in 2017. The increase in legal and professional fees was driven mainly by an increase in treasury management and legal fees related to nonperforming loans. Other noninterest expenses increased due to increases in software expense and sponsorships and other charitable contributions. These increases were partially offset by a decrease in merchant processing expense. As a result of the 2017 sale of our merchant card services portfolio, we no longer directly incur merchant processing costs.

Comparison of 2017 with 2016

Noninterest expense was $291.0 million in 2017, an increase of $29.9 million, or 11%, over 2016. This increase was driven by higher acquisition-related expenses in 2017 of $17.2 million compared to $2.7 million in 2016. After removing the effect of acquisition-related expenses, noninterest expense increased $15.4 million due to higher compensation and employee benefits stemming from additional personnel costs associated with the Pacific Continental acquisition. Also contributing to the increase was a $2.4 million charge related to termination of FDIC loss-sharing agreements which was recognized in other noninterest expense. Finally, legal and professional fees were higher due to costs from our investment in a customer relationship management application and the search to fill certain executive level positions. These increases were partially offset by a decrease in merchant processing expense. As a result of the 2017 sale of our merchant card services portfolio, we no longer directly incur merchant processing costs.

Table of Contents

Income Tax

For the years ended December 31, 2018, 2017 and 2016, we recorded income tax provisions of $39.0 million, $65.2 million and $44.9 million, respectively. The effective tax rate was 18% in 2018, 37% in 2017 and 30% in 2016. Our effective tax rate for 2018 was positively impacted by the Tax Cuts and Jobs Act which was enacted on December 22, 2017. On January 1, 2018, the Tax Cuts and Jobs Act reduced the federal tax rate for corporations from 35% to 21% and changed or limited certain deductions. Our effective tax rate for 2017 was impacted by the re-measurement of our deferred tax assets pursuant to the enactment of the Tax Cuts and Jobs Act. As a result of the lower corporate tax rate, during 2017, we recorded a re-measurement charge of $12.2 million to reduce our deferred tax assets. For 2018 and 2016, our effective tax rates were less than the 21% and 35% federal statutory rates, respectively, primarily due to tax-exempt municipal investment securities income, tax-exempt earnings from bank owned life insurance, and income from loans with favorable tax attributes. For additional information, see Note 23 to the Consolidated Financial Statements in “Item 8. Financial Statements and Supplementary Data” of this report.

Financial Condition

Our total assets increased 3% to $13.10 billion at December 31, 2018 from $12.72 billion at December 31, 2017. Increases in debt securities available for sale, loans and FHLB stock were partially offset by decreases in cash and cash equivalents and other intangible assets. Our available-for-sale debt securities portfolio increased $429.7 million as a result of purchases of securities throughout the year. The loan portfolio, net of the allowance for loan losses, increased $25.1 million as new loan production outpaced loan payoffs and our FHLB stock increased $15.5 million as a result of the required purchase of FHLB stock related to the increase in our FHLB advances. Partially offsetting these increases were decreases in cash and cash equivalents and other intangible assets of $64.9 million and $12.2 million, respectively. Cash and cash equivalents decreased $64.9 million while other intangible assets decreased $12.2 million due to the amortization of the of the core deposit intangible resulting from the acquisition of Pacific Continental Bank.

FHLB advances increased $387.9 million to $399.5 million to supplement the growth in our loan and securities portfolios. Deposit balances decreased $74.0 million, or 1%, to $10.46 billion and securities sold under agreements to repurchase decreased $18.0 million, or 23% to $61.1 million. Total shareholders’ equity increased $83.7 million to $2.03 billion.

Investment Portfolio

We invest in securities to generate revenue for the Company, to manage liquidity while minimizing interest rate risk and to provide collateral for certain public deposits and short-term borrowings. The amortized cost amounts represent the Company’s original cost for the investments, adjusted for accumulated amortization or accretion of any yield adjustments related to the security. The estimated fair values are the amounts we believe the securities could be sold for as of the dates indicated. At December 31, 2018 gross unrealized losses in our securities portfolio were $56.0 million related to 892 separate available for sale securities. Based on past experience with these types of securities and our own financial performance, we do not currently intend to sell any securities in a loss position nor does available evidence suggest it is more likely than not that management will be required to sell any securities currently in a loss position before the recovery of the amortized cost basis. We review these investments for other-than-temporary impairment on an ongoing basis.

Our investment portfolio increased $429.7 million from the prior year due to purchases of $965.6 million offset by maturities, repayments and sales of $498.0 million, $20.3 million in premium amortization and a $17.6 million increase in net unrealized loss of the investment portfolio.

At December 31, 2018, U.S. government agency and government-sponsored enterprise mortgage-backed securities (“MBS”) and collateralized mortgage obligations (“CMO”) comprised 69% of our investment portfolio, state and municipal securities were 18%, and government agency and government-sponsored enterprise securities were 13%. Our entire investment portfolio is categorized as available for sale and carried on our balance sheet at fair value. The average duration of our investment portfolio was approximately 4 years and 7 months at December 31, 2018. This duration takes into account calls, where appropriate, and consensus prepayment speeds.

Table of Contents

The following table presents the contractual maturities and weighted average yield of our investment portfolio:

	December 31, 2018		
	Amortized Cost	Fair Value	Yield
	(dollars in thousands)		
U.S. government agency and government-sponsored enterprise mortgage-backed securities & collateralized mortgage obligations (1)			
Due through 1 year	$1,377	$1,374	0.37%
Over 1 through 5 years	148,173	145,168	2.95%
Over 5 through 10 years	1,080,202	1,075,363	3.59%
Over 10 years	992,769	966,385	3.27%
Total	$2,222,521	$2,188,290	3.40%
State and municipal securities (2)			
Due through 1 year	$65,240	$65,438	3.51%
Over 1 through 5 years	174,650	174,088	2.58%
Over 5 through 10 years	217,128	215,092	2.88%
Over 10 years	122,737	119,705	3.34%
Total	$579,755	$574,323	2.96%
U.S. government agency and government-sponsored enterprise securities (1)			
Due through 1 year	$63,724	$63,181	1.40%
Over 1 through 5 years	243,559	240,344	2.13%
Over 5 through 10 years	100,805	101,062	2.86%
Total	$408,088	$404,587	2.20%
U.S. government securities (1)			
Due through 1 year	$251	$248	1.39%
Total	$251	$248	1.39%

(1) The maturities reported for mortgage-backed securities, collateralized mortgage obligations, government agency, government-sponsored enterprise, and government securities are based on contractual maturities and principal amortization.

(2) Yields on fully taxable equivalent basis.

For further information on our investment portfolio, see Note 4 to the Consolidated Financial Statements in "Item 8. Financial Statements and Supplementary Data" of this report.

Federal Home Loan Bank Stock

The FHLB of Des Moines stock is composed of two sub-classes: membership stock and activity based stock. Membership stock is stock we are required to purchase and hold as a condition of membership in the FHLB. The Company's membership stock purchase requirement is measured as a percentage of our year-end assets, subject to a $10 million cap. Activity based stock is stock we are required to purchase and hold in order to obtain an advance or participate in FHLB mortgage programs. The Company's activity based stock purchase requirement is measured as a percentage of our advance proceeds. At December 31, 2018 the Company held $26.0 million of FHLB Class B stock, $10.0 million of which was membership stock and the remaining $16.0 million was activity based. The FHLB stock is issued, transferred, redeemed, and repurchased at a par value of $100.

Table of Contents

Loan Portfolio

The Bank is a full service commercial bank, which originates a wide variety of loans, and focuses its lending efforts on originating commercial business and commercial real estate loans. The following table sets forth our loan portfolio by type of loan for the dates indicated:

	December 31,									
	2018	% of Total	2017	% of Total	2016	% of Total	2015	% of Total	2014	% of Total
	(dollars in thousands)									
Commercial business	$3,438,422	41.0 %	$3,377,324	40.4 %	$2,551,054	41.1 %	$2,362,575	40.6 %	$2,119,565	38.9
Real estate:										
One-to-four family residential	238,367	2.8 %	188,396	2.3 %	170,331	2.7 %	176,295	3.0 %	175,571	3.2
Commercial and multifamily residential	3,846,027	45.8 %	3,825,739	45.8 %	2,719,830	43.7 %	2,491,736	42.9 %	2,363,541	43.5
Total real estate	4,084,394	48.6 %	4,014,135	48.1 %	2,890,161	46.4 %	2,668,031	45.9 %	2,539,112	46.7
Real estate construction:										
One-to-four family residential	217,790	2.6 %	200,518	2.4 %	121,887	2.0 %	135,874	2.3 %	116,866	2.1
Commercial and multifamily residential	284,394	3.4 %	371,931	4.4 %	209,118	3.4 %	167,413	2.9 %	134,443	2.5
Total real estate construction	502,184	6.0 %	572,449	6.8 %	331,005	5.4 %	303,287	5.2 %	251,309	4.6
Consumer	318,945	3.8 %	334,190	4.0 %	329,261	5.3 %	342,601	5.9 %	364,182	6.7
Purchased credit impaired	89,760	1.1 %	112,670	1.3 %	145,660	2.3 %	180,906	3.1 %	230,584	4.2
Subtotal	8,433,705	100.5 %	8,410,768	100.6 %	6,247,141	100.5 %	5,857,400	100.7 %	5,504,752	101.
Less: Net unearned income	(42,194)	(0.5)%	(52,111)	(0.6)%	(33,718)	(0.5)%	(42,373)	(0.7)%	(59,374)	(1.1
Loans, net of unearned income (before Allowance for Loan and Lease Losses)	$8,391,511	100.0 %	$8,358,657	100.0 %	$6,213,423	100.0 %	$5,815,027	100.0 %	$5,445,378	100.
	$3,849		$5,766		$5,846		$4,509		$1,116	

Loans held
for sale

At December 31, 2018, total loans, gross of the ALLL were $8.39 billion compared with $8.36 billion in the prior year, an increase of $32.9 million, or 0.4% from the previous year. The increase in the loan portfolio was the result of organic loan production, partially offset by contractual payments and prepayments. Total loans, net of the ALLL represented 63% and 65% of total assets at December 31, 2018 and 2017, respectively.

Commercial Business Loans: We are committed to providing competitive commercial lending in our primary market areas. Management expects a continued focus within its commercial lending products and to emphasize, in particular, relationship banking with businesses and business owners.

Real Estate Loans: One-to-four family residential loans are secured by properties located within our primary market areas and, typically, have loan-to-value ratios of 80% or lower at origination. Our underwriting standards for commercial and multifamily residential loans generally require that the loan-to-value ratio for these loans not exceed 75% of appraised value, cost, or discounted cash flow value, as appropriate, and that commercial properties maintain debt coverage ratios (net operating income divided by annual debt servicing) of 1.2 or better. However, underwriting standards can be influenced by competition and other factors. We endeavor to maintain the highest practical underwriting standards while balancing the need to remain competitive in our lending practices.

Real Estate Construction Loans: We originate a variety of real estate construction loans. Underwriting guidelines for these loans vary by loan type but include loan-to-value limits, term limits and loan advance limits, as applicable. Our underwriting guidelines for commercial and multifamily residential real estate construction loans generally require that the loan-to-value ratio not exceed 75% and stabilized debt coverage ratios (net operating income divided by annual debt servicing) of 1.2 or better. As noted above, underwriting standards can be influenced by competition and other factors. However, we endeavor to maintain the highest practical underwriting standards while balancing the need to remain competitive in our lending practices.

Consumer Loans: Consumer loans include automobile loans, boat and recreational vehicle financing, home equity and home improvement loans and miscellaneous personal loans.

Foreign Loans: The Company has no material foreign activities. Substantially all of the Company’s loans and unfunded commitments are geographically concentrated in its service areas within the states of Washington, Oregon and Idaho.

Table of Contents

Purchased Credit Impaired Loans ("PCI Loans"): PCI loans are comprised of loans and loan commitments acquired in connection with the 2011 FDIC-assisted acquisitions of First Heritage Bank and Summit Bank, as well as the 2010 FDIC-assisted acquisitions of Columbia River Bank and American Marine Bank. PCI loans are generally accounted for under ASC Topic 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality ("ASC 310-30"). The Company did not acquire any loans accounted for under ASC 310-30 during 2018 or 2017.

Net unearned income: The following table provides additional detail related to the net discount of acquired and purchased loans, excluding PCI loans, by acquisition for the periods indicated:

	2018	2017	2016
Acquisition:	(in thousands)		
Pacific Continental	$18,526	$24,556	$—
Intermountain	2,303	3,892	6,599
West Coast	4,578	7,995	13,957
Other	725	(134)	(315)
Total net discount at period end	$26,132	$36,309	$20,241

For additional information on our loan portfolio, including amounts pledged as collateral on borrowings, see Note 5 to the Consolidated Financial Statements in "Item 8. Financial Statements and Supplementary Data" of this report.

Maturities and Sensitivities of Loans to Changes in Interest Rates

The following table presents the maturity distribution of our commercial and real estate construction loan portfolios and the sensitivity of these loans due after one year to changes in interest rates as of December 31, 2018:

	Maturing Due Through 1 Year	Over 1 Through 5 Years	Over 5 Years	Total
	(in thousands)			
Commercial business	$1,172,226	$1,024,819	$1,250,617	$3,447,662
Real estate construction	276,663	65,474	160,734	502,871
Total	$1,448,889	$1,090,293	$1,411,351	$3,950,533
Fixed rate loans due after 1 year		$727,902	$947,788	$1,675,690
Variable rate loans due after 1 year		362,391	463,563	825,954
Total		$1,090,293	$1,411,351	$2,501,644

Risk Elements

The extension of credit in the form of loans or other credit substitutes to individuals and businesses is one of our principal commerce activities. Our policies, applicable laws, and regulations require risk analysis as well as ongoing portfolio and credit management. We manage our credit risk through lending limit constraints, credit review, approval policies, and extensive, ongoing internal monitoring. We also manage credit risk through diversification of the loan portfolio by type of loan, type of industry, type of borrower, and by limiting the aggregation of debt to a single borrower.

In analyzing our existing portfolio, we review our consumer and residential loan portfolios by their performance as a pool of loans, since no single loan is individually significant or judged by its risk rating, size or potential risk of loss. In contrast, the monitoring process for the commercial business, real estate construction, and commercial real estate portfolios includes periodic reviews of individual loans with risk ratings assigned to each loan and performance judged on a loan by loan basis.

We review these loans to assess the ability of our borrowers to service all interest and principal obligations and, as a result, the risk rating may be adjusted accordingly. In the event that full collection of principal and interest is not reasonably assured, the loan is appropriately downgraded and, if warranted, placed on nonaccrual status even though the loan may be current as to principal and interest payments. Additionally, we assess whether an impairment of a loan warrants specific reserves or a write-down of the loan. For additional discussion on our methodology in managing credit risk within our loan portfolio see "Allowance for Loan and Lease Losses and Unfunded Commitments and Letters of Credit" section and Note 1 to the Consolidated Financial Statements in "Item 8. Financial Statements and

Supplementary Data" of this report.

Table of Contents

Loan policies, credit quality criteria, portfolio guidelines and other controls are established under the guidance of our Chief Credit Officer and approved, as appropriate, by the board of directors. Credit Administration, together with the management loan committee, has the responsibility for administering the credit approval process. As another part of its control process, we use an internal credit review and examination function to provide reasonable assurance that loans and commitments are made and maintained as prescribed by our credit policies. This includes a review of documentation when the loan is initially extended and subsequent examination to ensure continued performance and proper risk assessment.

Nonperforming Assets

Nonperforming assets consist of: (i) nonaccrual loans, which generally are loans placed on a nonaccrual basis when the loan becomes past due 90 days or when there are otherwise serious doubts about the collectability of principal or interest within the existing terms of the loan, (ii) OREO, and (iii) OPPO, if applicable. Nonperforming assets totaled $60.9 million, or 0.46% of year end assets at December 31, 2018, compared to $79.5 million, or 0.63% of year end assets at December 31, 2017.

The following table sets forth information with respect to our nonaccrual loans, total nonperforming assets, accruing loans past-due 90 days or more and potential problem loans:

	December 31,				
	2018	2017	2016	2015	2014
	(dollars in thousands)				
Nonaccrual:					
Commercial business	$35,513	$45,460	$11,555	$9,437	$16,799
Real estate:					
One-to-four family residential	1,158	785	568	820	2,822
Commercial and multifamily residential	14,904	13,941	11,187	9,513	7,847
Real estate construction:					
One-to-four family residential	318	1,854	563	928	465
Commercial and multifamily residential	—	—	—	—	480
Consumer	2,949	4,149	3,883	766	2,939
Total nonaccrual loans:	54,842	66,189	27,756	21,464	31,352
Other real estate owned and other personal property owned	6,049	13,298	5,998	13,738	22,225
Total nonperforming assets	$60,891	$79,487	$33,754	$35,202	$53,577
Accruing loans past-due 90 days or more	$—	$581	$—	$—	$1,386
Forgone interest on nonperforming loans	$3,615	$2,400	$1,919	$1,287	$2,196
Interest recognized on nonperforming loans	$1,138	$971	$237	$202	$1,327
Potential problem loans	$26,613	$41,642	$31,744	$23,654	$7,846
Allowance for loan and lease losses	$83,369	$75,646	$70,043	$68,172	$69,569
Nonperforming loans to year end loans	0.65 %	0.79 %	0.45 %	0.37 %	0.58 %
Nonperforming assets to year end assets	0.46 %	0.63 %	0.35 %	0.39 %	0.62 %

At December 31, 2018, nonperforming loans decreased to 0.65% of year end loans, down from 0.79% of year end loans at December 31, 2017. The largest decrease in nonperforming loans was in commercial business loans, which decreased from $45.5 million, or 69% of nonperforming loans at December 31, 2017 to $35.5 million, or 65% of nonperforming loans at year end 2018.

Table of Contents

The following table summarizes activity in nonperforming loans for the period indicated:

	Years Ended December 31,	
	2018	2017
	(in thousands)	
Balance, beginning of period	$66,189	$27,756
Established through acquisitions	—	9,413
Loans placed on nonaccrual or restructured	55,384	62,450
Advances	1,285	412
Charge-offs	(9,025)	(2,182)
Loans returned to accrual status	(11,483)	(8,566)
Repayments (including interest applied to principal)	(47,036)	(23,022)
Transfers to Other Real Estate Owned/Other Personal Property Owned	(472)	(72)
Balance, end of period	$54,842	$66,189

Loans are considered impaired when based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement or when a loan has been modified in a troubled debt restructuring. A loan is classified as a troubled debt restructuring when a borrower is experiencing financial difficulties that lead to a restructuring of the loan, and the Company grants concessions to the borrower in the restructuring that it would not otherwise consider. These concessions may include interest rate reductions, principal forgiveness, extension of maturity date and other actions intended to minimize potential losses. Generally, a nonaccrual loan that is restructured remains on nonaccrual status for a period of six months to demonstrate that the borrower can meet the restructured terms. If the borrower's performance under the new terms is not reasonably assured, the loan remains classified as a nonaccrual loan.

The assessment for impairment occurs when and while such loans are designated as classified per the Company's internal risk rating system or when and while such loans are on nonaccrual. All nonaccrual loans greater than $500,000 and all troubled debt restructured loans are considered impaired and analyzed individually on a quarterly basis. Classified loans with an outstanding balance greater than $500,000 are evaluated for potential impairment on a quarterly basis. The Company's policy is to record cash receipts on impaired loans first as reductions in principal and then as interest income.

The following table summarizes impaired loan financial data at December 31, 2018 and 2017:

	December 31,	
	2018	2017
	(in thousands)	
Impaired loans	$49,104	$69,205
Impaired loans with specific allocations	$13,351	$12,848
Amount of the specific allocations	$2,132	$2,360

Impaired loans with a carrying amount of $49.1 million at December 31, 2018 were subject to specific allocations of allowance for loan and lease losses of $2.1 million and partial charge-offs of $1.6 million during the year. Collateral dependent impaired loans without specific allocations at December 31, 2018 and 2017 either had collateral which exceeded the carrying value of the loans or reflected a partial charge-off to the market value of collateral (less costs to sell), as of the most recent appraisal date. Restructured loans accruing interest totaled $15.3 million and $16.4 million at December 31, 2018 and 2017, respectively.

When a loan with unique risk characteristics has been identified as being impaired, the amount of impairment will be measured by the Company using discounted cash flows, except when it is determined that the remaining source of repayment for the loan is the operation or liquidation of the underlying collateral. In these cases, the current fair value of the collateral, reduced by costs to sell, will be used in place of discounted cash flows. As a final alternative, the observable market price of the debt may be used to assess impairment. Predominately, the Company uses the fair value of collateral approach based upon a reliable valuation.

44

When a loan secured by real estate migrates to nonperforming and impaired status and it does not have a market valuation less than one year old, the Company secures an updated market valuation by a third-party appraiser that is reviewed by the Company's on-staff appraiser. Subsequently, the asset will be appraised annually by a third-party appraiser or the Company's on-staff appraiser. The evaluation may occur more frequently if management determines that there has been increased market deterioration within a specific geographical location. Upon receipt and verification of the market valuation, the Company will record the loan at the lower of cost or market (less costs to sell) by recording a charge-off to the allowance for loan and lease losses or by designating a specific reserve in accordance with accounting principles generally accepted in the United States.

For additional information on our nonperforming loans, see Note 5 to the Consolidated Financial Statements in "Item 8. Financial Statements and Supplementary Data" of this report.

Other Real Estate Owned and Other Personal Property Owned: As of December 31, 2018, there was $6.0 million in OREO and OPPO, which was primarily comprised of property from foreclosed real estate loans which decreased $7.3 million from $13.3 million at December 31, 2017. The decrease was primarily driven by $7.8 million in OREO sales. Properties acquired by foreclosure or deed in lieu of foreclosure are transferred to OREO and are recorded at fair value less estimated costs to sell, at the date of transfer of the property. If the carrying value exceeds the fair value at the time of the transfer, the difference is charged to the allowance for loan and lease losses. The fair value of the OREO property is based upon current appraisal. Subsequent losses that result from the ongoing periodic valuation of these properties are charged to the net cost of operation of OREO expense in the period in which they are identified. In general, improvements to the OREO are capitalized and holding costs are charged to the net cost of operation of OREO as incurred.

Potential Problem Loans: Potential problem loans are loans which are currently performing and are not on nonaccrual status, restructured or impaired, but about which there are significant doubts as to the borrower's future ability to comply with repayment terms and which may later be included in nonaccrual, past due, restructured or impaired loans. Potential problem loans totaled $26.6 million at year end 2018, compared to $41.6 million at year end 2017.

Allowance for Loan and Lease Losses and Unfunded Commitments and Letters of Credit

The allowance for loan and lease losses ("ALLL") is an accounting estimate of incurred credit losses in our loan portfolio at the balance sheet date. The provision for loan and lease losses is the expense recognized in the Consolidated Statements of Income to adjust the allowance to the levels deemed appropriate by management, as measured by the Company's credit loss estimation methodologies. The allowance for unfunded commitments and letters of credit is maintained at a level believed by management to be sufficient to absorb estimated probable losses related to these unfunded credit facilities at the balance sheet date.

Table of Contents

Analysis of the ALLL

The following table provides an analysis of our loan loss experience by loan type for the last five years:

Changes in Allowance for Loan and Lease Losses and
Unfunded Commitments and Letters of Credit

	December 31,				
	2018	2017	2016	2015	2014
	(dollars in thousands)				
Beginning balance, loans excluding PCI loans	$68,739	$59,528	$54,446	$53,233	$52,280
Beginning balance, PCI loans	6,907	10,515	13,726	16,336	20,174
Beginning balance	75,646	70,043	68,172	69,569	72,454
Charge-offs:					
Commercial business	(11,719)	(7,613)	(10,068)	(8,266)	(4,289)
Real estate:					
One-to-four family residential	—	(460)	(35)	(376)	(230)
Commercial and multifamily residential	(780)	(287)	(89)	(505)	(2,993)
Real estate construction:					
One-to-four family residential	—	(14)	(88)	—	—
Consumer	(1,194)	(1,474)	(1,238)	(2,066)	(2,774)
PCI loans	(4,862)	(6,812)	(9,944)	(13,854)	(14,436)
Total charge-offs	(18,555)	(16,660)	(21,462)	(25,067)	(24,722)
Recoveries:					
Commercial business	3,427	4,836	2,645	2,336	3,007
Real estate:					
One-to-four family residential	408	568	171	307	159
Commercial and multifamily residential	1,031	675	1,402	3,975	940
Real estate construction:					
One-to-four family residential	1,616	178	291	193	1,930
Commercial and multifamily residential	—	1	109	8	—
Consumer	1,180	1,187	933	931	1,353
PCI loans	3,847	6,187	7,004	7,329	7,721
Total recoveries	11,509	13,632	12,555	15,079	15,110
Net charge-offs	(7,046)	(3,028)	(8,907)	(9,988)	(9,612)
Provision for loan and lease losses, loans excluding PCI loans	17,050	11,614	11,049	4,676	3,850
Provision (recapture) for loan and lease losses, PCI loans	$(2,281)	$(2,983)	$(271)	$3,915	$2,877
Provision for loan and lease losses	$14,769	$8,631	$10,778	$8,591	$6,727
Ending balance, loans excluding PCI loans	$79,758	$68,739	$59,528	$54,446	$53,233
Ending balance, PCI loans	$3,611	$6,907	$10,515	$13,726	$16,336
Ending balance	$83,369	$75,646	$70,043	$68,172	$69,569
Loans outstanding at end of period (1)	$8,391,511	$8,358,657	$6,213,423	$5,815,027	$5,445,378
Average amount of loans outstanding (1)	$8,409,373	$6,682,259	$6,052,389	$5,609,261	$4,782,369
Allowance for loan and lease losses to period-end loans	0.99%	0.91%	1.13%	1.17%	1.28%
Net charge-offs to average loans outstanding	0.08%	0.05%	0.15%	0.18%	0.20%
Allowance for unfunded commitments and letters of credit					

Beginning balance	$3,130	$2,705	$2,930	$2,655	$2,505
Net changes in the allowance for unfunded commitments and letters of credit	1,200	425	(225)	275	150
Ending balance					