

PINNACLE FINANCIAL PARTNERS INC
Form 10-Q
November 02, 2018
Table of Contents

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

FORM 10-Q
(mark one)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2018
or

TRANSITION REPORT PURSUANT TO SECTION 13 OF 15(d) OF THE SECURITIES AND EXCHANGE ACT OF 1934

For the transition period from ____ to ____
Commission File Number: 000-31225

, Inc.
(Exact name of registrant as specified in its charter)
Tennessee 62-1812853
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)
150 Third Avenue South, Suite 900, Nashville, Tennessee 37201
(Address of principal executive offices) (Zip Code)
(615) 744-3700
(Registrant's telephone number, including area code)
Not Applicable
(Former name, former address and former fiscal year, if changes since last report)

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

Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for shorter period that the registrant was required to submit such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an 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. (Check one):

Large Accelerated Filer Accelerated Filer
Non-accelerated Filer Smaller reporting company
(do not check if you are a 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

As of October 31, 2018 there were 77,888,834 shares of common stock, \$1.00 par value per share, issued and outstanding.

Table of Contents

Pinnacle Financial Partners, Inc.
Report on Form 10-Q
September 30, 2018

TABLE OF CONTENTS	Page No.
<u>PART I – Financial Information:</u>	<u>4</u>
<u>Item 1. Consolidated Financial Statements (Unaudited)</u>	<u>4</u>
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>40</u>
<u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u>	<u>64</u>
<u>Item 4. Controls and Procedures</u>	<u>64</u>
<u>PART II – Other Information:</u>	<u>65</u>
<u>Item 1. Legal Proceedings</u>	<u>65</u>
<u>Item 1A. Risk Factors</u>	<u>65</u>
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>65</u>
<u>Item 3. Defaults Upon Senior Securities</u>	<u>65</u>
<u>Item 4. Mine Safety Disclosures</u>	<u>65</u>
<u>Item 5. Other Information</u>	<u>65</u>
<u>Item 6. Exhibits</u>	<u>66</u>
<u>Signatures</u>	<u>67</u>

Table of Contents

FORWARD-LOOKING STATEMENTS

All statements, other than statements of historical fact, included in this report, are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. The words "expect," "aim," "anticipate," "intend," "may", "should," "plan," "believe," "seek," "estimate" and similar expressions are intended to identify such forward-looking statements, but other statements not based on historical information may also be considered forward-looking statements. These forward-looking statements are subject to known and unknown risks, uncertainties and other factors that could cause the actual results to differ materially from the statements, including, but not limited to: (i) deterioration in the financial condition of borrowers resulting in significant increases in loan losses and provisions for those losses; (ii) the ability to grow and retain low-cost core deposits and retain large, uninsured deposits; (iii) the inability of Pinnacle Financial, or entities in which it has significant investments, like Bankers Healthcare Group, LLC (BHG), to maintain the historical growth rate of its, or such entities', loan portfolio; (iv) changes in loan underwriting, credit review or loss reserve policies associated with economic conditions, examination conclusions, or regulatory developments; (v) effectiveness of Pinnacle Financial's asset management activities in improving, resolving or liquidating lower-quality assets; (vi) the impact of competition with other financial institutions, including pricing pressures (including those resulting from the Tax Cuts and Jobs Act) and the resulting impact on Pinnacle Financial's results, including as a result of compression to net interest margin; (vii) greater than anticipated adverse conditions in the national or local economies including in Pinnacle Financial's markets throughout Tennessee, North Carolina, South Carolina and Virginia, particularly in commercial and residential real estate markets; (viii) fluctuations or unanticipated changes in interest rates on loans or deposits or that affect the yield curve; (ix) the results of regulatory examinations; (x) a merger or acquisition; (xi) risks of expansion into new geographic or product markets; (xii) any matter that would cause Pinnacle Financial to conclude that there was impairment of any asset, including goodwill or intangible assets; (xiii) reduced ability to attract additional financial advisors (or failure of such advisors to cause their clients to switch to Pinnacle Bank as quickly as anticipated or at all), to retain financial advisors (including as a result of the competitive environment resulting from the Tax Cuts and Jobs Act) or otherwise to attract customers from other financial institutions; (xiv) further deterioration in the valuation of other real estate owned and increased expenses associated therewith; (xv) inability to comply with regulatory capital requirements, including those resulting from changes to capital calculation methodologies, required capital maintenance levels or regulatory requests or directives, particularly if Pinnacle Financial's level of applicable commercial real estate loans exceed percentage levels of total capital in guidelines recommended by its regulators; (xvi) risks associated with litigation, including the applicability of insurance coverage; (xvii) approval of the declaration of any dividend by Pinnacle Financial's board of directors; (xviii) the vulnerability of Pinnacle Bank's network and online banking portals, and the systems of parties with whom Pinnacle Financial contracts, to unauthorized access, computer viruses, phishing schemes, spam attacks, human error, natural disasters, power loss and other security breaches; (xix) the possibility of increased compliance costs or other operational expenses as a result of increased regulatory oversight, including oversight of companies in which Pinnacle Financial or Pinnacle Bank have significant investments, like BHG, and the development of additional banking products for Pinnacle Bank's corporate and consumer clients; (xx) the risks associated with Pinnacle Financial and Pinnacle Bank being a minority investor in BHG, including the risk that the owners of a majority of the equity interests in BHG decide to sell the company if not prohibited from doing so by Pinnacle Financial or Pinnacle Bank; (xxi) changes in state and federal legislation, regulations or policies applicable to banks and other financial service providers, like BHG, including regulatory or legislative developments; (xxii) the availability and access to capital; (xxiii) adverse results (including costs, fines, reputational harm, inability to obtain necessary approvals and/or other negative effects) from current or future litigation, regulatory examinations or other legal and/or regulatory actions; and (xxiv) general competitive, economic, political and market conditions. Additional factors which could affect the forward looking statements can be found in Pinnacle Financial's Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, and Current Reports on Form 8-K filed with the SEC and available on the SEC's website at <http://www.sec.gov>. Pinnacle Financial disclaims any obligation to update or revise any forward-looking statements contained in this report, which speak only as of the date hereof, whether as a result of new information, future events

or otherwise.

3

Table of Contents

Item 1. Part I. Financial Information

PINNACLE FINANCIAL PARTNERS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS(Unaudited)
(in thousands)

	September 30, 2018	December 31, 2017
ASSETS		
Cash and noninterest-bearing due from banks	\$ 145,638	\$ 176,553
Interest-bearing due from banks	394,129	496,911
Federal funds sold and other	11,313	106,132
Cash and cash equivalents	551,080	779,596
Securities available-for-sale, at fair value	3,004,582	2,515,283
Securities held-to-maturity (fair value of \$192.5 million and \$20.8 million at Sept. 30, 2018 and Dec. 31, 2017, respectively)	194,997	20,762
Consumer loans held-for-sale	47,417	103,729
Commercial loans held-for-sale	11,402	25,456
Loans	17,464,009	15,633,116
Less allowance for loan losses	(79,985)	(67,240)
Loans, net	17,384,024	15,565,876
Premises and equipment, net	268,387	266,014
Equity method investment	221,302	221,667
Accrued interest receivable	73,366	57,440
Goodwill	1,807,121	1,808,002
Core deposits and other intangible assets	48,737	56,710
Other real estate owned	17,467	27,831
Other assets	927,663	757,334
Total assets	\$24,557,545	\$22,205,700
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits:		
Noninterest-bearing	\$4,476,925	\$4,381,386
Interest-bearing	3,195,657	2,987,291
Savings and money market accounts	7,262,968	6,548,964
Time	3,471,965	2,534,061
Total deposits	18,407,515	16,451,702
Securities sold under agreements to repurchase	130,217	135,262
Federal Home Loan Bank advances	1,520,603	1,319,909
Subordinated debt and other borrowings	465,487	465,505
Accrued interest payable	20,944	10,480
Other liabilities	115,738	114,890
Total liabilities	20,660,504	18,497,748
Stockholders' equity:		
Preferred stock, no par value; 10.0 million shares authorized; no shares issued and outstanding	—	—
	77,867	77,740

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Common stock, par value \$1.00; 180.0 million shares authorized at Sept. 30, 2018 and 90.0 million shares authorized at Dec. 31, 2017; 77.9 million and 77.7 million shares issued and outstanding at Sept. 30, 2018 and Dec. 31, 2017, respectively

Additional paid-in capital	3,123,323	3,115,304
Retained earnings	750,363	519,144
Accumulated other comprehensive loss, net of taxes	(54,512	) (4,236
Total stockholders' equity	3,897,041	3,707,952
Total liabilities and stockholders' equity	\$24,557,545	\$22,205,700

See accompanying notes to consolidated financial statements (unaudited).

Table of ContentsPINNACLE FINANCIAL PARTNERS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

(dollars in thousands, except per share data)

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Interest income:				
Loans, including fees	\$221,901	\$ 183,570	\$621,873	\$ 389,093
Securities:				
Taxable	12,209	12,067	35,179	26,765
Tax-exempt	10,074	4,620	25,709	8,533
Federal funds sold and other	3,926	1,639	7,861	3,376
Total interest income	248,110	201,896	690,622	427,767
Interest expense:				
Deposits	44,172	19,104	100,920	38,216
Securities sold under agreements to repurchase	165	148	438	277
Federal Home Loan Bank advances and other borrowings	14,353	9,734	43,137	20,984
Total interest expense	58,690	28,986	144,495	59,477
Net interest income	189,420	172,910	546,127	368,290
Provision for loan losses	8,725	6,920	25,058	17,384
Net interest income after provision for loan losses	180,695	165,990	521,069	350,906
Noninterest income:				
Service charges on deposit accounts	6,404	5,921	18,289	13,955
Investment services	5,237	3,660	15,250	9,592
Insurance sales commissions	2,126	2,123	7,293	5,444
Gain on mortgage loans sold, net	3,902	5,963	11,423	14,785
Gain on sale of investment securities, net	11	—	41	—
Trust fees	3,087	2,636	9,768	6,019
Income from equity method investment	14,236	8,937	33,286	25,514
Other noninterest income	16,475	14,008	48,250	33,392
Total noninterest income	51,478	43,248	143,600	108,701
Noninterest expense:				
Salaries and employee benefits	69,117	64,288	196,948	146,316
Equipment and occupancy	19,252	16,590	55,203	36,978
Other real estate expense	67	513	92	827
Marketing and other business development	3,293	2,222	8,084	6,228
Postage and supplies	1,654	1,755	5,984	4,074
Amortization of intangibles	2,616	3,077	7,973	5,745
Merger related expense	—	8,847	8,259	12,740
Other noninterest expense	17,991	12,444	50,935	30,679
Total noninterest expense	113,990	109,736	333,478	243,587
Income before income taxes	118,183	99,502	331,191	216,020
Income tax expense	24,436	35,060	67,069	68,839
Net income	\$93,747	\$ 64,442	\$264,122	\$ 147,181
Per share information:				

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Basic net income per common share	\$1.22	\$0.84	\$3.42	\$2.48
Diluted net income per common share	\$1.21	\$0.83	\$3.41	\$2.46
Weighted average shares outstanding:				
Basic	77,145,023	76,678,584	77,116,375	79,371,202
Diluted	77,490,977	77,232,098	77,442,555	79,910,344

See accompanying notes to consolidated financial statements (unaudited).

Table of Contents

PINNACLE FINANCIAL PARTNERS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)
(dollars in thousands)

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Net income	\$93,747	\$64,442	\$264,122	\$147,181
Other comprehensive income (loss), net of tax:				
Change in fair value on available-for-sale securities, net of tax	(16,899)	(967)	(53,167)	133
Change in fair value of cash flow hedges, net of tax	783	239	3,453	1,307
Amortization of net unrealized gains on securities transferred from available-for-sale to held-to-maturity, net of tax	(10)	(47)	(103)	(160)
Gain on cash flow hedges reclassified from other comprehensive income into net income, net of tax	(145)	(139)	(429)	(204)
Net gain on sale of investment securities reclassified from other comprehensive income into net income, net of tax	(8)	—	(30)	—
Total other comprehensive income (loss), net of tax	(16,279)	(914)	(50,276)	1,076
Total comprehensive income	\$77,468	\$63,528	\$213,846	\$148,257

See accompanying notes to consolidated financial statements (unaudited).

Table of ContentsPINNACLE FINANCIAL PARTNERS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(Unaudited)

(dollars and shares in thousands)

	Common Stock			Retained Earnings	Accumulated Other Comp. Income (Loss), net	Total Stockholder's Equity
	Shares	Amounts	Additional Paid-in Capital			
Balance at December 31, 2016	46,359	\$46,359	\$1,083,491	\$381,072	\$ (14,227)	\$ 1,496,695
Exercise of employee common stock options and related tax benefits	194	194	3,627	—	—	3,821
Common dividends paid	—	—	—	(24,983)	—	(24,983)
Issuance of restricted common shares, net of forfeitures	264	264	(264)	—	—	—
Issuance of common equity, net of costs	3,220	3,220	188,974	—	—	192,194
Common stock issued in conjunction with acquisition of BNC Bancorp, net of issuance costs	27,687	27,687	1,820,146	—	—	1,847,833
Restricted shares withheld for taxes and related tax benefit	(72)	(72)	(4,808)	—	—	(4,880)
Compensation expense for restricted shares	—	—	14,412	—	—	14,412
Net income	—	—	—	147,181	—	147,181
Other comprehensive income	—	—	—	—	1,076	1,076
Balance at September 30, 2017	77,652	\$77,652	\$3,105,578	\$503,270	\$ (13,151)	\$3,673,349
Balance at December 31, 2017	77,740	\$77,740	\$3,115,304	\$519,144	\$ (4,236)	\$3,707,952
Exercise of employee common stock options and related tax benefits	90	90	1,610	—	—	1,700
Common dividends paid	—	—	—	(32,903)	—	(32,903)
Issuance of restricted common shares, net of forfeitures	141	141	(141)	—	—	—
Restricted shares withheld for taxes and related tax benefit	(104)	(104)	(6,704)	—	—	(6,808)
Compensation expense for restricted shares	—	—	13,254	—	—	13,254
Net income	—	—	—	264,122	—	264,122
Other comprehensive loss	—	—	—	—	(50,276)	(50,276)
Balance at September 30, 2018	77,867	\$77,867	\$3,123,323	\$750,363	\$ (54,512)	\$3,897,041

See accompanying notes to consolidated financial statements (unaudited).

Table of ContentsPINNACLE FINANCIAL PARTNERS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(dollars in thousands)

	Nine months ended September 30,	
	2018	2017
Operating activities:		
Net income	\$264,122	\$147,181
Adjustments to reconcile net income to net cash provided by operating activities:		
Net amortization/accretion of premium/discount on securities	14,366	8,388
Depreciation, amortization and accretion	(20,959)	(14,848)
Provision for loan losses	25,058	17,384
Gain on mortgage loans sold, net	(11,423)	(14,785)
Investment gains on sales, net	(41)	—
Stock-based compensation expense	13,254	14,412
Deferred tax expense	17,339	15,646
Losses (gains) on dispositions of other real estate and other investments	(259)	74
Income from equity method investment	(33,286)	(25,514)
Dividends received from equity method investment	33,651	19,372
Excess tax benefit from stock compensation	(2,953)	(4,608)
Gain on commercial loans sold, net	(1,985)	(791)
Commercial loans held for sale:		
Loans originated	(226,551)	(116,013)
Loans sold	242,590	119,007
Consumer loans held for sale:		
Loans originated	(941,991)	(772,239)
Loans sold	964,747	756,729
Decrease (increase) in other assets	(31,805)	793
Increase (decrease) in other liabilities	14,626	(30,057)
Net cash provided by operating activities	318,500	120,131
Investing activities:		
Activities in securities available-for-sale:		
Purchases	(1,023,876)	(1,158,038)
Sales	22,702	7,492
Maturities, prepayments and calls	243,678	207,209
Activities in securities held-to-maturity:		
Maturities, prepayments and calls	5,280	4,115
Increase in loans, net	(1,757,157)	(1,194,966)
Purchases of software, premises and equipment	(18,478)	(36,045)
Proceeds from sales of software, premises and equipment	458	23
Proceeds from sale of other real estate	13,204	6,931
Acquisitions, net of cash acquired	—	155,142
Purchase of bank owned life insurance policies	(100,000)	(55,000)
Increase in other investments	(47,687)	(22,508)
Net cash used in investing activities	(2,661,876)	(2,085,645)
Financing activities:		
Net increase in deposits	1,957,566	825,060
Net decrease in securities sold under agreements to repurchase	(5,045)	(18,460)

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Advances from Federal Home Loan Bank:		
Issuances	1,439,906	1,934,750
Payments/maturities	(1,239,198)	(717,048)
Decrease in other borrowings, net	(240)	(190)
Principal payments of capital lease obligation	(118)	(111)
Proceeds from common stock issuance, net	—	192,194
Exercise of common stock options and stock appreciation rights, net of repurchase of restricted shares	(5,107)	(1,060)
Common stock dividends paid	(32,904)	(24,984)
Net cash provided by financing activities	2,114,860	2,190,151
Net increase (decrease) in cash and cash equivalents	(228,516)	224,637
Cash and cash equivalents, beginning of period	779,596	183,645
Cash and cash equivalents, end of period	\$551,080	\$408,282

See accompanying notes to consolidated financial statements (unaudited).

Table of Contents

PINNACLE FINANCIAL PARTNERS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1. Summary of Significant Accounting Policies

Nature of Business — Pinnacle Financial Partners, Inc. (Pinnacle Financial) is a bank holding company whose primary business is conducted by its wholly-owned subsidiary, Pinnacle Bank. Pinnacle Bank is a commercial bank headquartered in Nashville, Tennessee. Pinnacle Financial completed its acquisitions of CapitalMark Bank & Trust (CapitalMark), Magna Bank (Magna), Avenue Financial Holdings, Inc. (Avenue) and BNC Bancorp (BNC) on July 31, 2015, September 1, 2015, July 1, 2016 and June 16, 2017, respectively. Pinnacle Financial and Pinnacle Bank also collectively hold a 49% interest in Bankers Healthcare Group, LLC (BHG), a full-service commercial loan provider to healthcare and other professional practices. Pinnacle Bank provides a full range of banking services, including investment, mortgage, insurance, and comprehensive wealth management services, in its 11 primarily urban markets within Tennessee, the Carolinas and Virginia.

Basis of Presentation — The accompanying unaudited consolidated financial statements have been prepared in accordance with instructions to Form 10-Q and therefore do not include all information and footnotes necessary for a fair presentation of financial position, results of operations, and cash flows in conformity with U.S. generally accepted accounting principles (U.S. GAAP). All adjustments consisting of normally recurring accruals that, in the opinion of management, are necessary for a fair presentation of the financial position and results of operations for the periods covered by the report have been included. The accompanying unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes appearing in Pinnacle Financial's Annual Report on Form 10-K for the year ended December 31, 2017 (2017 10-K).

These consolidated financial statements include the accounts of Pinnacle Financial and its wholly-owned subsidiaries. Certain statutory trust affiliates of Pinnacle Financial, as noted in Note 12. Subordinated Debt and Other Borrowings are included in these consolidated financial statements pursuant to the equity method of accounting. Significant intercompany transactions and accounts are eliminated in consolidation.

Use of Estimates — The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities as of the balance sheet date and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term include the determination of the allowance for loan losses, determination of any impairment of intangible assets and the valuation of deferred tax assets. There have been no significant changes to Pinnacle Financial's significant accounting policies as disclosed in the 2017 10-K.

Goodwill — ASC 350-35-3 provides an entity the option to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If an entity determines that this is the case, it is required to perform the quantitative two-step goodwill impairment test to identify potential goodwill impairment and measure the amount of goodwill impairment loss to be recognized. Based on the qualitative assessment, if an entity determines that the fair value of a reporting unit is more than its carrying amount, the quantitative two-step goodwill impairment test is not required. Pinnacle Financial performed its annual qualitative assessment as of September 30, 2018. As a result of this assessment, Pinnacle Financial believes that it is not more likely than not that the fair value of our entity is less than book value, and accordingly, the assessment indicates there is no impairment of goodwill as of September 30, 2018. As such, the additional two-step quantitative assessment was not required.

Table of Contents

Cash Flow Information — Supplemental cash flow information addressing certain cash and noncash transactions for each of the nine months ended September 30, 2018 and September 30, 2017 was as follows (in thousands):

	For the nine months ended September 30,	
	2018	2017
Cash Transactions:		
Interest paid	\$ 136,154	\$ 56,804
Income taxes paid, net	55,525	53,199
Noncash Transactions:		
Loans charged-off to the allowance for loan losses	22,316	16,308
Loans foreclosed upon and transferred to other real estate owned	2,066	3,573
Loans foreclosed upon and transferred to other assets	1,580	641
Other real estate sales financed	276	—
Available-for-sale securities transferred to held-to-maturity portfolio	179,763	—
Held-for-sale loans transferred to held-for-investment loan portfolio	44,980	—
Common stock issued in connection with acquisition ⁽¹⁾	—	1,858,133

⁽¹⁾ See Note 2 to these consolidated financial statement for more detailed information.

Income Per Common Share — Basic net income per common share (EPS) is computed by dividing net income by the weighted average common shares outstanding for the period. Diluted EPS reflects the dilution that could occur if securities or other contracts to issue common stock were exercised or converted. The difference between basic and diluted weighted average shares outstanding is attributable to common stock options, common stock appreciation rights, restricted share awards, and restricted share unit awards. The dilutive effect of outstanding options, common stock appreciation rights, restricted share awards, and restricted share unit awards is reflected in diluted EPS by application of the treasury stock method.

The following is a summary of the basic and diluted net income per share calculations for the three and nine months ended September 30, 2018 and 2017 (in thousands, except per share data):

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Basic net income per share calculation:				
Numerator - Net income	\$ 93,747	\$ 64,442	\$ 264,122	\$ 147,181
Denominator - Weighted average common shares outstanding	77,145	76,679	77,116	59,371
Basic net income per common share	\$ 1.22	\$ 0.84	\$ 3.42	\$ 2.48
Diluted net income per share calculation:				
Numerator - Net income	\$ 93,747	\$ 64,442	\$ 264,122	\$ 147,181
Denominator - Weighted average common shares outstanding	77,145	76,679	77,116	59,371
Dilutive shares contingently issuable	346	554	326	539
Weighted average diluted common shares outstanding	77,491	77,232	77,443	59,910
Diluted net income per common share	\$ 1.21	\$ 0.83	\$ 3.41	\$ 2.46

On January 27, 2017, Pinnacle Financial completed the issuance and sale of 3,220,000 shares of common stock (including 420,000 shares issued as a result of the underwriter exercising its over-allotment option) in an underwritten public offering, which shares are included in the share count above. The net proceeds of the offering, after deducting the underwriting discount and offering expenses, were approximately \$192.2 million. Also, Pinnacle Financial issued 27,687,100 shares of common stock in conjunction with the acquisition of BNC on June 16, 2017.

Table of Contents

Recently Adopted Accounting Pronouncements — In August 2017, the FASB issued Accounting Standards Update No. 2017-12, Derivatives and Hedging: Targeted Improvements to Accounting for Hedging Activities. The amendments in this ASU make more financial and non-financial hedging strategies eligible for hedge accounting. It also amends the presentation and disclosure requirements and changes how companies assess effectiveness. The amendments will be effective for public companies for interim and annual periods beginning after December 15, 2018. Early adoption is permitted. Pinnacle Financial early adopted this standard in the first quarter of 2018 and subsequently entered into three hedging transactions during the nine months ended September 30, 2018, all of which are eligible for hedge accounting as a result of the new standard, as noted in Note 9. Derivative Instruments.

In March 2017, the FASB issued Accounting Standards Update No. 2017-08, Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities. The amendment in this ASU shortens the amortization period for certain callable debt securities held at a premium to the earliest call date. The amendment does not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity. The amendment is effective for fiscal years beginning after December 15, 2018, including interim periods within those periods. Early adoption is permitted with modified retrospective application. Pinnacle Financial elected to early adopt this standard in the first quarter of 2018 and it continues to have no material impact to its consolidated financial statements.

In January 2017, the FASB issued Accounting Standards Update 2017-01, Business Combinations (Topic 805): Clarifying the Definition of a Business. The amendment in this ASU clarifies the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The amendment is effective for fiscal years beginning after December 15, 2017, including interim periods within those periods. There has been no material impact on Pinnacle Financial's consolidated financial statements due to the adoption of this standard in the first quarter of 2018.

In August 2016, the FASB issued Accounting Standards Update 2016-15, Statement of Cash Flows (Topic 230) intended to reduce the diversity in practice around how certain transactions are classified within the statement of cash flows. The guidance became effective for public companies for annual periods beginning after December 15, 2017, including interim periods within those fiscal years. Pinnacle Financial adopted this standard in the first quarter of 2018 and it continues to have no material impact to its consolidated financial statements, with the exception of dividends received from its and Pinnacle Bank's equity method investments which were reclassified from cash flow from investments to operating cash flow.

In January 2016, the FASB issued Accounting Standards Update 2016-01, Financial Instruments – Overall (Subtopic 825-10) which, among other things, (i) requires equity investments, excluding those accounted for under the equity method or that result in consolidation, to be measured at fair value with changes in fair value recognized in net income, (ii) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment, (iii) eliminates the requirement for public business entities to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet, (iv) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes, (v) requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments, (vi) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements and (viii) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets. ASU 2016-01 became effective for Pinnacle Financial in the first quarter of 2018 and

continues to have no material impact on its consolidated financial statements. See Note 10. Fair Value of Financial Instruments for disclosure of the fair value of financial instruments based on an exit price notion as required by ASU 2016-01.

Table of Contents

In May 2014, the FASB issued Accounting Standards Update 2014-09, Revenue from Contracts with Customers (Topic 606), which was developed as a joint project with the International Accounting Standards Board to remove inconsistencies in revenue requirements and provide a more robust framework for addressing revenue issues. The ASU's core principle is that an entity should recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which an entity expects to be entitled in exchange for those goods or services. In August 2015, the FASB issued Accounting Standards Update 2015-14, which deferred the effective date by one year (i.e., interim and annual reporting periods beginning after December 15, 2017). Pinnacle Financial adopted the ASU during the first quarter of 2018, as required, using a modified retrospective approach. The majority of Pinnacle Financial's revenue stream is generated from interest income on loans and securities, which are outside the scope of Topic 606. Pinnacle Financial's sources of income that fall within the scope of Topic 606 include service charges on deposits, investment services, insurance sales commissions, trust fees, interchange fees and gains and losses on sales of other real estate, all of which are presented within noninterest income. Pinnacle Financial has evaluated the effect of Topic 606 on these fee-based income streams and concluded that adoption of the standard did not materially impact its financial statements. The following is a summary of the implementation considerations for the revenue streams that fall within the scope of Topic 606:

Service charges on deposits, investment services, trust fees and interchange fees — Fees from these services are either transaction based, for which the performance obligations are satisfied when the individual transaction is processed, or set periodic service charges, for which the performance obligations are satisfied over the period the service is provided. Transaction-based fees are recognized at the time the transaction is processed, and periodic service charges are recognized over the service period. The adoption of Topic 606 had no impact on Pinnacle Financial's revenue recognition practice for these services.

Insurance sales commissions — Insurance commissions are received from insurance companies in return for the placement of policies with customers. While additional services, such as claims assistance, may be provided over the term of the policy, the revenues are substantially earned at the time of policy placement. The only contingency in earning the revenue relates to the potential for subsequent cancellation of policies. Accordingly, revenue is recognized at the time of policy placement, net of an allowance for estimated policy cancellations. The adoption of Topic 606 had no impact on Pinnacle Financial's revenue recognition related to insurance sales commissions.

Gains on sales of other real estate — ASU 2014-09 also creates Topic 610-20, under which a gain on sale should be recognized when a contract for sale exists and control of the asset has been transferred to the buyer. Topic 606 lists several criteria which must exist to conclude that a contract for sale exists, including a determination that the institution will collect substantially all of the consideration to which it is entitled. This presents a key difference between the prior and new guidance related to the recognition of the gain when the institution finances the sale of the property. Rather than basing recognition on the amount of the buyer's initial investment, which was the primary consideration under prior guidance, the analysis is now based on various factors including not only the loan to value ratio, but also the credit quality of the borrower, the structure of the loan, and any other factors that may affect collectability. While these differences may affect the decision to recognize or defer gains on sales of other real estate in circumstances where Pinnacle Bank has financed the sale, the effects would not be material to Pinnacle Financial's consolidated financial statements.

Recently Issued Accounting Pronouncements, not yet adopted — In August 2018, the FASB issued Accounting Standards Update 2018-15, Intangibles-Goodwill and Other-Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement that is a Service Contract. ASU 2018-15 requires implementation costs incurred by customers in cloud computing arrangements (i.e., hosting arrangements) to be capitalized under the same premises of authoritative guidance for internal-use software, and deferred over the noncancellable term of the cloud computing arrangements plus any option renewal periods that are reasonably certain to be exercised by the customer or for which the exercise is controlled by the service provider. This

update is effective for fiscal years beginning after December 15, 2019, including interim periods within those periods. Early adoption is permitted. If this standard had been effective as of the date of the financial statements included in this report, there would have been no impact on Pinnacle Financial's consolidated financial statements.

In August 2018, the FASB issued Accounting Standards Update 2018-13, Fair Value Measurement (Topic 820): Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurements. This update is part of the disclosure framework project and eliminates certain disclosure requirements for fair value measurements, requires entities to disclose new information, and modifies existing disclosure requirements. The new disclosure guidance is effective for fiscal years beginning after December 15, 2019. Early adoption is permitted. Pinnacle Financial is currently evaluating the impact this change will have on its consolidated financial statements and disclosures.

Table of Contents

In February 2018, the FASB issued Accounting Standards Update 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. The amendments in this ASU addressed the income tax accounting treatment of the stranded tax effects within other comprehensive income due to the newly enacted federal corporate tax rate included in the Tax Cuts and Jobs Act issued December 22, 2017. These amendments allow an entity to make a reclassification from other comprehensive income to retained earnings for the difference between the historical corporate income tax rate and the newly enacted corporate income tax rate. The amendments are effective for fiscal years beginning after December 15, 2018, including interim periods within those years. Early adoption is permitted with retrospective application. This standard will not have a material impact on Pinnacle Financial's consolidated financial statements.

In January 2017, the FASB issued Accounting Standards Update No. 2017-04, Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment to simplify how entities other than private companies, such as public business entities and not-for-profit entities, are required to test goodwill for impairment by eliminating the comparison of the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. The amendments are effective for fiscal years beginning after December 15, 2019, including interim periods within those periods. If this standard had been effective as of the date of the financial statements included in this report, there would have been no impact on Pinnacle Financial's consolidated financial statements.

In February 2016, the FASB issued Accounting Standards Update 2016-02, Leases which requires recognition in the statement of financial position of lease assets and lease liabilities by lessees for those leases classified as operating leases under previous GAAP. The guidance requires that a lessee should recognize lease assets and lease liabilities as compared to previous GAAP that did not require lease assets and lease liabilities to be recognized for operating leases. The guidance becomes effective for Pinnacle Financial on January 1, 2019. Had this standard been effective as of September 30, 2018, we would have recorded a right of use asset and lease liability of approximately \$70 million. In July 2016, the FASB issued Accounting Standards Update 2018-10, Codification Improvements to Topic 842, Leases which provides technical corrections and improvements to ASU 2016-02. It is not anticipated that this update will have an impact on our adoption of ASU 2016-02. Also in July 2016, the FASB issued Accounting Standards Update 2018-11, Leases (Topic 842): Targeted Improvements which provides an optional transition method to adopt the new requirements of ASU 2016-02 as of the adoption date with no adjustment to the presentation or disclosure of comparative prior periods included in the financial statements in the period of adoption. Pinnacle Financial intends to elect the optional transition method which will result in presentation of periods prior to adoption under the prior lease guidance of ASC Topic 840.

In June 2016, the FASB issued Accounting Standards Update 2016-13, Financial Instruments - Credit Losses: Measurement of Credit Losses on Financial Instruments (CECL), which introduces the current expected credit losses methodology. Among other things, CECL requires the measurement of all expected credit losses for financial assets, including loans and held-to-maturity debt securities, held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. The new model will require institutions to calculate all probable and estimable losses that are expected to be incurred through the financial asset's entire life through a provision for credit losses, including loans obtained as a result of any acquisition not deemed to be purchased credit deteriorated (PCD). CECL also requires the allowance for credit losses for PCD loans to be determined in a manner similar to that of other financial assets measured at amortized cost; however, the initial allowance will be added to the purchase price rather than recorded as provision expense. The disclosure of credit quality indicators related to the amortized cost of financing receivables will be further disaggregated by year of origination (or vintage). Institutions are to apply the changes through a cumulative-effect adjustment to their retained earnings as of the beginning of the first reporting period in which the standard is effective. The amendments are effective for fiscal years beginning after December 15, 2019. Early application will be permitted

for fiscal years beginning after December 15, 2018. Pinnacle Financial is currently assessing the impact of the new guidance on its consolidated financial statements. An increase in the overall allowance for loan losses is likely upon adoption in order to provide for expected credit losses over the life of the loan portfolio.

Other than those pronouncements discussed above and those which have been recently adopted, we do not believe there were any other recently issued accounting pronouncements that are expected to materially impact Pinnacle Financial.

Subsequent Events — Accounting Standards Codification (ASC) Topic 855, Subsequent Events, establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued. Pinnacle Financial evaluated all events or transactions that occurred after September 30, 2018 through the date of the issued financial statements. Pinnacle Financial entered into multiple hedging transactions in October that have been more fully disclosed in Note 9. Derivative Instruments. Additionally, consistent with the investment policy, during the month of October, Pinnacle Financial sold \$119.9 million in available-for-sale securities for net unrealized losses, net of tax, of \$1.1 million. The net unrealized loss will be reclassified from accumulated other comprehensive income into net income. Other than the above-noted transaction, no other subsequent events were noted.

Table of Contents

Note 2. Acquisitions

BNC Bancorp. On June 16, 2017, Pinnacle Financial consummated its merger with BNC. Pursuant to the terms of the Agreement and Plan of Merger, dated as of January 22, 2017, by and between Pinnacle Financial and BNC, BNC merged with and into Pinnacle Financial, with Pinnacle Financial continuing as the surviving corporation (the BNC Merger). On that same day, Pinnacle Bank and Bank of North Carolina, BNC's wholly-owned bank subsidiary, merged, with Pinnacle Bank continuing as the surviving entity.

The following summarizes the consideration paid and an allocation of purchase price to net assets acquired (in thousands):

	Number of Shares	Amount
Equity consideration:		
Common stock issued	27,687,100	\$ 1,858,133
Total equity consideration		\$ 1,858,133
Non-equity consideration:		
Cash paid to redeem common stock		\$ 129
Total consideration paid		\$ 1,858,262
Allocation of total consideration paid:		
Fair value of net assets assumed including estimated identifiable intangible assets		\$ 602,689
Goodwill		1,255,573
		\$ 1,858,262

Pinnacle Financial recorded costs incurred in connection with the issuance of Pinnacle Financial common stock resulting from the BNC Merger of \$7.2 million, net of related tax benefits, as a reduction to additional paid in capital. Certain merger-related expenses resulting from cultural and systems integrations, as well as stock-based compensation expense incurred as a result of change-in-control provisions applicable to assumed equity-based awards were recorded as merger-related expense.

Goodwill originating from the BNC Merger resulted primarily from anticipated synergies arising from the combination of certain operational areas of the businesses of BNC and Pinnacle Financial as well as the purchase premium inherent in buying a complete and successful banking operation. Goodwill associated with the BNC Merger is not amortizable for book or tax purposes. Adjustments totaling \$82.0 million were recorded to goodwill to appropriately reflect the valuation of the acquired loan portfolio, OREO acquired, and certain liabilities assumed and have been included in the table below.

Table of Contents

Pinnacle Financial accounted for the BNC Merger under the acquisition method in accordance with ASC Topic 805. Accordingly, the purchase price is allocated to the fair value of the assets acquired and liabilities assumed as of the date of merger. Purchase price allocations related to the acquisition of BNC have been completed and are reflected in the following table (in thousands):

	As of June 16, 2017		As
	BNC Historical Cost Basis	Fair Value Adjustments ⁽¹⁾	Recorded by Pinnacle Financial
Assets			
Cash and cash equivalents	\$ 155,271	\$ —	\$ 155,271
Investment securities	643,875	1,667	645,542
Loans ⁽²⁾	5,782,720	(181,430)	) 5,601,290
Mortgage loans held for sale	27,026	—	27,026
Other real estate owned ⁽³⁾	20,143	1,382	21,525
Core deposit and other intangible ⁽⁴⁾	—	50,422	50,422
Property, plant and equipment ⁽⁵⁾	156,805	(3,341)	) 153,464
Other assets ⁽⁶⁾	320,988	54,057	375,045
Total Assets	\$ 7,106,828	\$ (77,243)	) \$ 7,029,585
Liabilities			
Interest-bearing deposits ⁽⁷⁾	\$ 5,003,653	\$ 4,355	\$ 5,008,008
Non-interest bearing deposits	1,199,342	—	1,199,342
Borrowings ⁽⁸⁾	183,389	(6,412)	) 176,977
Other liabilities ⁽⁹⁾	35,729	6,840	42,569
Total Liabilities	\$ 6,422,113	\$ 4,783	\$ 6,426,896
Net Assets Acquired	\$ 684,715	\$ (82,026)	) \$ 602,689

Explanation of certain fair value adjustments:

The amount represents the adjustment of the book value of BNC's assets and liabilities to their estimated fair value (1) on the date of acquisition. Fair value adjustments were updated subsequent to the merger date based on the results of finalized valuation assessments.

The amount represents the adjustment of the net book value of BNC's loans to their estimated fair value based on (2) interest rates and expected cash flows as of the date of acquisition, which includes estimates of expected credit losses inherent in the portfolio of approximately 2.6% of the 3.1% mark on the acquired loan portfolio.

(3) This adjustment reflects the Day 1 value of OREO properties.

The amount represents the fair value of the core deposit intangible asset representing the intangible value of the (4) deposit base acquired and the fair value of the customer relationship intangible assets representing the intangible value of customer relationships acquired.

(5) The amount represents the adjustment of the net book value of BNC's property, plant and equipment to estimated fair value based on market values of similar assets.

(6) The amount represents the deferred tax asset recognized on the fair value adjustment of BNC's acquired assets and assumed liabilities and an adjustment to the Day 1 fair value of an alternative investment.

The amount represents the adjustment necessary because the weighted average interest rate of BNC's deposits (7) exceeded the cost of similar funding at the time of acquisition. The fair value adjustment will be amortized to reduce future interest expense over the life of the portfolio.

(8) The amount represents the combined adjustment necessary because the weighted average interest rate of BNC's subordinated debt issuance exceeded the cost of similar funding at the time of acquisition and because the weighted

average interest rate of BNC's trust preferred securities issuances was lower than the cost of similar funding at the time of acquisition. The combined fair value adjustments will be amortized to increase future interest expense over the lives of the instruments.

- (9) The amount represents the adjustment to accrue obligations that existed but had not been recorded as of the acquisition date and the fair value of BNC lease obligations.

Table of Contents

Supplemental Pro Forma Combined Results of Operations

For the three months ended September 30, 2017, BNC was included in the operations of PNFP and, as such, no supplemental proforma information is necessary. The supplemental proforma information below for the nine months ended September 30, 2017 gives effect to the BNC acquisition as if it had occurred on January 1, 2017. These results combine the historical results of BNC into Pinnacle Financial's consolidated statement of income and, while certain adjustments were made for the estimated impact of certain fair value adjustments, they are not indicative of what would have occurred had the BNC Merger taken place on the indicated date nor are they intended to represent or be indicative of future results of operations. In particular, no adjustments have been made to eliminate the amount of BNC's provision for credit losses for the nine months ended September 30, 2017 that may not have been necessary had the acquired loans been recorded at fair value as of the beginning of 2017. Additionally, these financial statements were not adjusted for non-recurring expenses, such as merger-related expenses incurred by either Pinnacle Financial or BNC. Pinnacle Financial expects to achieve operating cost savings and other business synergies as a result of the acquisition which are also not reflected in the proforma amounts.

	Nine Months Ended September 30, 2017
(dollars in thousands)	
Revenue ⁽¹⁾	\$ 619,326
Income before income taxes	261,516

⁽¹⁾ Net interest income plus noninterest income.

Note 3. Equity method investment

A summary of BHG's financial position as of September 30, 2018 and December 31, 2017 and results of operations as of and for the three and nine months ended September 30, 2018 and 2017, were as follows (in thousands):

	As of	
	September 30, December 31,	
	2018	2017
Assets	\$436,693	\$ 330,030
Liabilities	322,323	224,837
Membership interests	114,370	105,193
Total liabilities and membership interests	\$436,693	\$ 330,030

	For the three months ended		For the nine months ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Revenues	\$59,133	\$41,997	\$151,937	\$113,244
Net income	\$30,933	\$20,428	\$69,039	\$54,453

At September 30, 2018, technology, trade name and customer relationship intangibles, net of related amortization, totaled \$11.3 million compared to \$13.4 million as of December 31, 2017. Amortization expense of \$693,000 and \$2.1 million, respectively, was included for the three and nine months ended September 30, 2018 compared to \$832,000 and \$2.5 million, respectively, for the same periods in the prior year. Accretion income of \$719,000 and \$2.2 million, respectively, was included in the three and nine months ended September 30, 2018 compared to \$758,000 and \$2.3 million, respectively, for the same periods in the prior year.

During the three and nine months ended September 30, 2018, Pinnacle Financial and Pinnacle Bank received dividends from BHG of \$10.2 million and \$33.7 million, respectively, in the aggregate compared to \$4.5 million and \$19.4 million, respectively, for the same periods in the prior year. Earnings from BHG are included in Pinnacle Financial's consolidated tax return. Profits from intercompany transactions are eliminated. No loans were purchased from BHG by Pinnacle Bank for the three and nine month periods ended September 30, 2018 or 2017, respectively.

Table of Contents

Note 4. Securities

The amortized cost and fair value of securities available-for-sale and held-to-maturity at September 30, 2018 and December 31, 2017 are summarized as follows (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2018:				
Securities available-for-sale:				
U.S. Treasury securities	\$30,573	\$ —	\$ 45	\$30,528
U.S. government agency securities	64,640	45	1,500	63,185
Mortgage-backed securities	1,334,640	3,268	43,363	1,294,545
State and municipal securities	1,240,136	1,995	29,860	1,212,271
Asset-backed securities	334,547	870	759	334,658
Corporate notes and other	69,738	617	960	69,395
	\$3,074,274	\$ 6,795	\$ 76,487	\$3,004,582
Securities held-to-maturity:				
State and municipal securities	\$194,997	\$ 9	\$ 2,506	\$192,500
	\$194,997	\$ 9	\$ 2,506	\$192,500
December 31, 2017:				
Securities available-for-sale:				
U.S. Treasury securities	\$30,505	\$—	\$ 60	\$30,445
U.S. government agency securities	182,500	67	1,766	180,801
Mortgage-backed securities	1,270,625	5,318	12,124	1,263,819
State and municipal securities	774,949	12,251	2,588	784,612
Asset-backed securities	173,346	262	316	173,292
Corporate notes and other	81,615	1,346	647	82,314
	\$2,513,540	\$19,244	17,501	\$2,515,283
Securities held-to-maturity:				
State and municipal securities	\$20,762	\$114	\$ 46	\$20,830
	\$20,762	\$114	\$ 46	\$20,830

During the third quarter of 2018, Pinnacle Financial transferred, at fair value, \$179.8 million of municipal securities from the available-for-sale portfolio to the held-to-maturity portfolio. The related unrealized after tax losses of \$2.2 million remained in accumulated other comprehensive income (loss) and will be amortized over the remaining life of the securities, offsetting the related amortization of discount on the transferred securities. No gains or losses were recognized at the time of transfer. At September 30, 2018, approximately \$1.35 billion of securities within Pinnacle Financial's investment portfolio were pledged to secure either public funds and other deposits or securities sold under agreements to repurchase. At September 30, 2018, repurchase agreements comprised of secured borrowings totaled \$130.2 million and were secured by \$130.2 million of pledged U.S. government agency securities, municipal securities, asset backed securities, and corporate debentures. As the fair value of securities pledged to secure repurchase agreements may decline, Pinnacle Financial regularly evaluates its need to pledge additional securities to remain adequately secured.

Table of Contents

The amortized cost and fair value of debt securities as of September 30, 2018 by contractual maturity are shown below. Actual maturities may differ from contractual maturities of mortgage- and asset-backed securities since the mortgages and assets underlying the securities may be called or prepaid with or without penalty. Therefore, these securities are not included in the maturity categories in the following summary (in thousands):

September 30, 2018:	Available-for-sale		Held-to-maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	\$34,856	\$34,802	\$315	\$316
Due in one year to five years	77,055	77,059	6,066	6,044
Due in five years to ten years	159,471	157,274	7,997	7,875
Due after ten years	1,133,705	1,106,244	180,619	178,265
Mortgage-backed securities	1,334,640	1,294,545	—	—
Asset-backed securities	334,547	334,658	—	—
	\$3,074,274	\$3,004,582	\$194,997	\$192,500

At September 30, 2018 and December 31, 2017, the following investments had unrealized losses. The table below classifies these investments according to the term of the unrealized losses of less than twelve months or twelve months or longer (in thousands):

	Investments with an Unrealized Loss of less than 12 months		Investments with an Unrealized Loss of 12 months or longer		Total Investments with an Unrealized Loss	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
At September 30, 2018						
U.S. Treasury securities	\$30,284	\$ 39	\$244	\$ 6	\$30,528	\$ 45
U.S. government agency securities	13,605	360	45,118	1,140	58,723	1,500
Mortgage-backed securities	289,149	5,951	807,418	37,412	1,096,567	43,363
State and municipal securities	1,144,600	29,599	108,653	5,663	1,253,253	35,262
Asset-backed securities	204,638	741	4,505	18	209,143	759
Corporate notes	22,329	260	18,681	700	41,010	960
Total temporarily-impaired securities	\$1,704,605	\$ 36,950	\$984,619	\$ 44,939	\$2,689,224	\$ 81,889

At December 31, 2017

U.S. Treasury securities	\$29,948	\$ 60	\$—	\$—	\$29,948	\$ 60
U.S. government agency securities	173,677	1,766	—	—	173,677	1,766
Mortgage-backed securities	607,408	5,042	285,561	7,082	892,969	12,124
State and municipal securities	115,403	1,408	50,083	1,226	165,486	2,634
Asset-backed securities	68,742	198	14,136	118	82,878	316
Corporate notes	22,168	547	11,944	100	34,112	647
Total temporarily-impaired securities	\$1,017,346	\$ 9,021	\$361,724	\$ 8,526	\$1,379,070	\$ 17,547

The applicable dates for determining when securities were in an unrealized loss position were September 30, 2018 and December 31, 2017. As such, it is possible that a security had a market value that exceeded its amortized cost on other days during the past twelve-month periods ended September 30, 2018 and December 31, 2017, but is not in the "Investments with an Unrealized Loss of less than 12 months" category above.

As shown in the tables above, including both available-for-sale and held-to-maturity investment securities, at September 30, 2018, Pinnacle Financial had approximately \$81.9 million in unrealized losses on \$2.69 billion of securities. The unrealized losses associated with the \$179.8 million of municipal securities transferred from the available-for-sale portfolio to the held-to-maturity portfolio represent unrealized losses since the date of purchase, independent of the impact associated with changes in the cost basis upon transfer between portfolios. The unrealized losses associated with these investment securities are driven by changes in interest rates and are not due to the credit quality of the securities. These securities will continue to be monitored as a part of Pinnacle Financial's ongoing impairment analysis. Management evaluates the financial performance of the issuers on a quarterly basis to determine if it is probable that the issuers can make all contractual principal and interest payments. Because Pinnacle Financial currently does not intend to sell those securities that have an unrealized loss at September 30, 2018, and it is not more-likely-than-not that Pinnacle Financial will be required to sell the securities before recovery of their amortized cost bases, which may be maturity, Pinnacle Financial does not consider these securities to be other-than-temporarily impaired at September 30, 2018.

Table of Contents

Periodically, available-for-sale securities may be sold or the composition of the portfolio realigned to improve yields, quality or marketability, or to implement changes in investment or asset/liability strategy, including maintaining collateral requirements and raising funds for liquidity purposes. Additionally, if an available-for-sale security loses its investment grade or tax-exempt status, the underlying credit support is terminated or collection otherwise becomes uncertain based on factors known to management, Pinnacle Financial will consider selling the security, but will review each security on a case-by-case basis as these factors become known. Consistent with the investment policy, during the nine months ended September 30, 2018 available-for-sale securities of approximately \$22.7 million were sold and net unrealized gains, net of tax, of \$30,000 were reclassified from accumulated other comprehensive income into net income.

The carrying values of Pinnacle Financial's investment securities could decline in the future if the financial condition of issuers deteriorates and management determines it is probable that Pinnacle Financial will not recover the entire amortized cost bases of the securities. As a result, there is a risk that other-than-temporary impairment charges may occur in the future. Additionally, there is a risk that other-than-temporary impairment charges may occur in the future if management's intention to hold these securities to maturity and/or recovery changes.

Note 5. Loans and Allowance for Loan Losses

For financial reporting purposes, Pinnacle Financial classifies its loan portfolio based on the underlying collateral utilized to secure each loan. This classification is consistent with those utilized in the Quarterly Report of Condition and Income filed by Pinnacle Bank with the Federal Deposit Insurance Corporation (FDIC).

Pinnacle Financial uses five loan categories: commercial real estate mortgage, consumer real estate mortgage, construction and land development, commercial and industrial, and consumer and other.

Commercial real estate mortgage loans. Commercial real estate mortgage loans are categorized as such based on investor exposures where repayment is largely dependent upon the operation, refinance, or sale of the underlying real estate. Commercial real estate mortgage loans also includes owner occupied commercial real estate which Pinnacle Financial believes shares a similar risk profile to Pinnacle Financial's commercial and industrial products.

Consumer real estate mortgage loans. Consumer real estate mortgage consists primarily of loans secured by 1-4 family residential properties, including home equity lines of credit.

Construction and land development loans. Construction and land development loans include loans where the repayment is dependent on the successful operation of the related real estate project. Construction and land development loans include 1-4 family construction projects and commercial construction endeavors such as warehouses, apartments, office and retail space and land acquisition and development.

Commercial and industrial loans. Commercial and industrial loans include loans to business enterprises issued for commercial, industrial and/or other professional purposes.

Consumer and other loans. Consumer and other loans include all loans issued to individuals not included in the consumer real estate mortgage classification. Examples of consumer and other loans are automobile loans, credit cards and loans to finance education, among others.

Commercial loans receive risk ratings assigned by a financial advisor and approved by a senior credit officer subject to validation by Pinnacle Financial's independent loan review department. Risk ratings are categorized as pass, special mention, substandard, substandard-nonaccrual or doubtful-nonaccrual. Pinnacle Financial believes that its categories follow those used by Pinnacle Bank's primary regulators. At September 30, 2018, approximately 81.2% of Pinnacle Financial's loan portfolio was analyzed as a commercial loan type with a specifically assigned risk rating. Consumer loans and small business loans are generally not assigned an individual risk rating but are evaluated as either accrual or nonaccrual based on the performance of the individual loans. However, certain consumer real estate

mortgage loans and certain consumer and other loans receive a specific risk rating due to the loan proceeds being used for commercial purposes even though the collateral may be of a consumer loan nature.

Risk ratings are subject to continual review by a financial advisor and a senior credit officer. At least annually, Pinnacle Financial's credit procedures require that every risk rated loan of \$1.0 million or more be subject to a formal credit risk review process by the assigned financial advisor. Each loan's risk rating is also subject to review by Pinnacle Financial's independent loan review department, which reviews a substantial portion of Pinnacle Financial's risk rated portfolio annually. Included in the coverage are independent loan reviews of loans in targeted higher-risk portfolio segments such as certain commercial and industrial loans, land loans and/or loan types in certain geographies.

Table of Contents

The following table presents Pinnacle Financial's loan balances by primary loan classification and the amount within each risk rating category. Pass rated loans include all credits other than those included in special mention, substandard, substandard-nonaccrual and doubtful-nonaccrual which are defined as follows:

Special mention loans have potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in Pinnacle Financial's credit position at some future date.

Substandard loans are inadequately protected by the current net worth and financial capacity of the obligor or of the collateral pledged, if any. Assets so classified must have a well-defined weakness or weaknesses that jeopardize collection of the debt. Substandard loans are characterized by the distinct possibility that Pinnacle Financial could sustain some loss if the deficiencies are not corrected.

Substandard-nonaccrual loans are substandard loans that have been placed on nonaccrual status.

Doubtful-nonaccrual loans have all the characteristics of substandard-nonaccrual loans with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable.

The following table outlines the amount of each loan classification categorized into each risk rating category as of September 30, 2018 and December 31, 2017 (in thousands):

	Commercial real estate - mortgage	Consumer real estate - mortgage	Construction and land development	Commercial and industrial	Consumer and other	Total
September 30, 2018						
Pass	\$7,058,133	\$2,766,126	\$2,046,299	\$4,866,409	\$366,723	\$17,103,690
Special Mention	30,291	10,534	3,002	31,213	724	75,764
Substandard ⁽¹⁾	96,729	13,234	6,313	90,345	66	206,687
Substandard-nonaccrual	29,966	25,266	3,395	18,280	961	77,868
Doubtful-nonaccrual	—	—	—	—	—	—
Total loans	\$7,215,119	\$2,815,160	\$2,059,009	\$5,006,247	\$368,474	\$17,464,009
December 31, 2017						
Pass	\$6,487,368	\$2,503,688	\$1,880,704	\$4,014,656	\$351,359	\$15,237,775
Special Mention	94,134	18,356	8,148	46,898	1,177	168,713
Substandard ⁽¹⁾	72,044	21,053	13,468	62,529	79	169,173
Substandard-nonaccrual	16,064	18,117	5,968	17,258	48	57,455
Doubtful-nonaccrual	—	—	—	—	—	—
Total loans	\$6,669,610	\$2,561,214	\$1,908,288	\$4,141,341	\$352,663	\$15,633,116

Potential problem loans represent those loans with a well-defined weakness and where information about possible credit problems of borrowers has caused management to have doubts about the borrower's ability to comply with present repayment terms. This definition is believed to be substantially consistent with the standards established by Pinnacle Bank's primary regulators for loans classified as substandard, excluding the impact of nonaccrual loans and troubled debt restructurings. Potential problem loans, which are not included in nonaccrual loans, amounted to approximately \$202.5 million at September 30, 2018, compared to \$164.0 million at December 31, 2017.

Loans acquired with deteriorated credit quality are recorded pursuant to the provisions of ASC 310-30, and are referred to as purchase credit impaired loans. The following table provides a rollforward of purchase credit impaired loans from December 31, 2017 through September 30, 2018 (in thousands):

Accretable Nonaccretable

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	Gross Carrying Value	Yield	Yield	Net Carrying Value
December 31, 2017	\$74,324	\$ (132)	\$ (31,537)	\$42,655
Year-to-date settlements	(21,332)	21	12,262	(9,049)
September 30, 2018	\$52,992	\$ (111)	\$ (19,275)	\$33,606

20

Table of Contents

Certain of these loans have been deemed to be collateral dependent and, as such, no accretable yield has been recorded for these loans. The carrying value is adjusted for additional draws, pursuant to contractual arrangements, offset by loan paydowns. Year-to-date settlements include both loans that were charged-off as well as loans that were paid off, typically as a result of refinancings at other institutions.

For the three and nine months ended September 30, 2018, the average balance of impaired loans was \$82.3 million and \$73.3 million, respectively, compared to \$39.5 million and \$36.3 million for the same periods in 2017. Pinnacle Financial's policy is that the accrual of interest income will be discontinued when (1) there is a significant deterioration in the financial condition of the borrower and full repayment of principal and interest is not expected or (2) the principal or interest is more than 90 days past due, unless the loan is both well secured and in the process of collection. As such, at the date the above mentioned loans were placed on nonaccrual status, Pinnacle Financial reversed all previously accrued interest income against current year earnings. Pinnacle Financial's policy is that once a loan is placed on nonaccrual status each subsequent payment is reviewed on a case-by-case basis to determine if the payment should be applied to interest or principal pursuant to regulatory guidelines. Pinnacle Financial recognized no interest income from cash payments received on nonaccrual loans during the nine months ended September 30, 2018 compared to no interest income from cash payments received on nonaccrual loans during the three months ended September 30, 2017 and approximately \$65,000 during the nine months ended September 30, 2017. Had these nonaccruing loans been on accruing status, interest income would have been higher by \$1.1 million and \$2.8 million, respectively, for the three and nine months ended September 30, 2018 compared to \$849,000 and \$2.1 million, respectively, higher for the three and nine months ended September 30, 2017.

Impaired loans, as disclosed in the table below, include troubled debt restructurings, nonaccrual loans, and loans deemed to be impaired but that continue to accrue interest. The following tables detail the recorded investment, unpaid principal balance and related allowance of Pinnacle Financial's impaired loans at September 30, 2018 and December 31, 2017 by loan classification (in thousands):

	At September 30, 2018			At December 31, 2017		
	Recorded investment	Unpaid principal balances	Related allowance	Recorded investment	Unpaid principal balances	Related allowance
Impaired loans with an allowance:						
Commercial real estate – mortgage	\$10,282	\$10,305	\$ 461	\$1,850	\$1,863	\$ 95
Consumer real estate – mortgage	15,746	15,808	490	8,028	8,079	410
Construction and land development	563	564	15	2,522	2,528	66
Commercial and industrial	8,908	8,939	1,265	12,521	12,644	1,627
Consumer and other	961	980	147	—	—	—
Total	\$36,460	\$36,596	\$ 2,378	\$24,921	\$25,114	\$ 2,198
Impaired loans without an allowance:						
Commercial real estate – mortgage	\$21,457	\$21,481	\$ —	\$16,364	\$16,514	\$ —
Consumer real estate – mortgage	6,382	6,419	—	4,144	4,174	—
Construction and land development	2,884	2,883	—	2,645	2,650	—
Commercial and industrial	16,678	16,662	—	10,905	10,902	—
Consumer and other	—	—	—	—	—	—
Total	\$47,401	\$47,445	\$ —	\$34,058	\$34,240	\$ —
Total impaired loans	\$83,861	\$84,041	\$ 2,378	\$58,979	\$59,354	\$ 2,198

Table of Contents

The following table details the average recorded investment and the amount of interest income recognized on a cash basis for the three and nine months ended September 30, 2018 and 2017, respectively, of impaired loans by loan classification (in thousands):

	For the three months ended September 30,		For the nine months ended September 30,	
	2018	2017	2018	2017
	Average Interest recorded income investment recognized	Average Interest recorded income investment recognized	Average Interest recorded income investment recognized	Average Interest recorded income investment recognized
Impaired loans with an allowance:				
Commercial real estate – mortgage	\$13,474	\$ —	\$ —	\$ —
Consumer real estate – mortgage	14,162	4,593	11,476	4,230
Construction and land development	1,150	81	1,301	78
Commercial and industrial	7,470	12,235	9,345	10,068
Consumer and other	912	362	651	532
Total	\$37,168	\$ —	\$ —	\$ —
Impaired loans without an allowance:				
Commercial real estate – mortgage	\$22,029	\$ —	\$ —	\$ —
Consumer real estate – mortgage	5,699	7,003	5,034	6,122
Construction and land development	1,442	1,324	1,382	1,702
Commercial and industrial	16,008	6,673	16,096	8,573
Consumer and other	—	—	—	—
Total	\$45,178	\$ —	\$ —	\$ —
Total impaired loans	\$82,346	\$ —	\$ —	\$ —

At September 30, 2018 and December 31, 2017, there were \$6.1 million and \$6.6 million, respectively, of troubled debt restructurings that were performing as of their restructure date and which were accruing interest. Troubled commercial loans are restructured by specialists within Pinnacle Bank's Special Assets Group, and all restructurings are approved by committees and/or credit officers separate and apart from the normal loan approval process. These specialists are charged with reducing Pinnacle Financial's overall risk and exposure to loss in the event of a restructuring by obtaining some or all of the following: improved documentation, additional guaranties, increase in curtailments, reduction in collateral release terms, additional collateral or other similar strategies.

The following table outlines the amount of each loan category where troubled debt restructurings were made during the three and nine months ended September 30, 2018 and 2017 (dollars in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	Pre Modification Number of Outstanding Recorded Investment, net of related allowance	Post Modification Number of Outstanding Recorded Investment, net of related allowance	Pre Modification Number of Outstanding Recorded Investment, net of related allowance	Post Modification Number of Outstanding Recorded Investment, net of related allowance
2018				
Commercial real estate – mortgage	—	—	—	—
Consumer real estate – mortgage	1	169	2	206

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Construction and land development	1 348	348	1 348	348
Commercial and industrial	—	—	—	—
Consumer and other	—	—	—	—
	2 \$ 517	\$ 517	3 \$ 554	\$ 554

2017

Commercial real estate – mortgage	—\$ —	\$ —	—\$ —	\$ —
Consumer real estate – mortgage	—	—	1 7	5
Construction and land development	—	—	—	—
Commercial and industrial	1 501	145	3 2,472	1,773
Consumer and other	—	—	—	—
	1 \$ 501	\$ 145	4 \$ 2,479	\$ 1,778

22

Table of Contents

During the nine months ended September 30, 2018 and 2017, Pinnacle Financial did not have any troubled debt restructurings that subsequently defaulted within twelve months of the restructuring.

At both September 30, 2018 and December 31, 2017, the allowance for loan losses included no allowance specifically related to accruing troubled debt restructurings, which are classified as impaired loans pursuant to U.S. GAAP, but which loans continued to accrue interest at contractual rates at those dates.

In addition to the loan metrics above, Pinnacle Financial analyzes its commercial loan portfolio to determine if a concentration of credit risk exists to any industries. Pinnacle Financial utilizes broadly accepted industry classification systems in order to classify borrowers into various industry classifications. Pinnacle Financial has a credit exposure (loans outstanding plus unfunded lines of credit) exceeding 25% of Pinnacle Bank's total risk-based capital to borrowers in the following industries at September 30, 2018 with the comparative exposures for December 31, 2017 (in thousands):

	September 30, 2018			Total Exposure at December 31, 2017
	Outstanding Principal Balances	Unfunded Commitments	Total exposure	
Lessors of nonresidential buildings	\$3,146,798	\$ 692,316	\$3,839,114	\$ 3,483,597
Lessors of residential buildings	983,084	269,344	1,252,428	1,151,676
Hotels (except Casino Hotels) and Motels	760,355	157,315	917,670	836,320
New Housing For-Sale Builders	459,501	567,914	1,027,415	780,137

Additionally, Pinnacle Financial monitors two ratios regarding construction and commercial real estate lending as part of its concentration management processes. Both ratios are calculated by dividing certain types of loan balances for each of the two categories by Pinnacle Bank's total risk-based capital. At September 30, 2018 and December 31, 2017, Pinnacle Bank's construction and land development loans as a percentage of total risk-based capital were 87.8% and 89.4%, respectively. Non-owner occupied commercial real estate and multifamily loans (including construction and land development loans) as a percentage of total risk-based capital were 287.6% and 297.1% as of September 30, 2018 and December 31, 2017, respectively. Banking regulations have established guidelines for the construction ratio of less than 100% of total risk-based capital and for the non-owner occupied ratio of less than 300% of total risk-based capital. When a bank's ratios are in excess of one or both of these guidelines, banking regulations generally require an increased level of monitoring in these lending areas by bank management. While Pinnacle Bank was in excess of the 300% guideline for the first six months of 2018, at September 30, 2018, Pinnacle Bank was within the 100% and 300% guidelines and has established what it believes to be appropriate controls to monitor its lending in these areas as it aims to keep the level of these loans to below the 100% and 300% thresholds.

The table below presents past due balances by loan classification and segment at September 30, 2018 and December 31, 2017, allocated between accruing and nonaccrual status (in thousands):

	Accruing			Purchase credit impaired	Nonaccruing		Total loans	
	30-89 days past due and accruing	90 days or more past due and accruing	Total past due and accruing		Nonaccruing ⁽¹⁾	Nonaccruing purchase credit impaired		
September 30, 2018								
Commercial real estate:								
Owner-occupied	\$7,756	\$ —	\$ 7,756	\$2,656,228	\$ 2,769	\$ 19,738	\$ 1,754	\$2,688,245

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All other	2,633	—	2,633	4,504,385	11,382	5,591	2,883	4,526,874
Consumer real estate – mortgage	13,358	—	13,358	2,772,801	3,735	19,165	6,101	2,815,160
Construction and land development	3,368	—	3,368	2,049,468	2,778	2,024	1,371	2,059,009
Commercial and industrial	10,741	1,128	11,869	4,975,290	808	18,256	24	5,006,247
Consumer and other	4,361	645	5,006	362,507	—	961	—	368,474
Total	\$42,217	\$ 1,773	\$ 43,990	\$ 17,320,679	\$ 21,472	\$ 65,735	\$ 12,133	\$ 17,464,009

23

Table of Contents

December 31, 2017	Accruing			Current and accruing	Purchase credit impaired	Nonaccruing		Total loans
	30-89 days past due and accruing	90 days or more past due and accruing	Total past due and accruing			Nonaccruing ⁽¹⁾	purchase credit impaired	
Commercial real estate:								
Owner-occupied	\$6,772	\$ 104	\$ 6,876	\$2,435,819	\$ 4,820	\$ 11,395	\$ 1,105	\$2,460,015
All other	16,559	—	16,559	4,177,454	12,018	704	2,860	4,209,595
Consumer real estate – mortgage	14,835	1,265	16,100	2,521,748	5,249	9,320	8,797	2,561,214
Construction and land development	4,136	146	4,282	1,894,560	3,478	2,878	3,090	1,908,288
Commercial and industrial	7,406	1,348	8,754	4,114,127	1,154	17,222	84	4,141,341
Consumer and other	6,311	1,276	7,587	345,076	—	—	—	352,663
Total	\$56,019	\$ 4,139	\$ 60,158	\$ 15,488,784	\$ 26,719	\$ 41,519	\$ 15,936	\$ 15,633,116

(1) Approximately \$54.6 million and \$45.8 million of nonaccrual loans as of September 30, 2018 and December 31, 2017, respectively, were performing pursuant to their contractual terms at those dates.

The following table details the changes in the allowance for loan losses for the three and nine months ended September 30, 2018 and 2017, respectively, by loan classification (in thousands):

	Commercial real estate - mortgage	Consumer real estate - mortgage	Construction and land development	Commercial and industrial	Consumer and other	Unallocated	Total
Three months ended September 30, 2018:							
Balance at June 30, 2018	\$ 24,848	\$ 5,853	\$ 10,984	\$ 28,338	\$ 5,172	\$ 475	\$ 75,670
Charged-off loans	(1,968)	(262)	(24)	(3,336)	(1,359)	—	(6,949)
Recovery of previously charged-off loans	63	987	70	1,037	382	—	2,539
Provision for loan losses	3,574	149	(48)	4,085	618	347	8,725
Balance at September 30, 2018	\$ 26,517	\$ 6,727	\$ 10,982	\$ 30,124	\$ 4,813	\$ 822	\$ 79,985
Three months ended September 30, 2017:							
Balance at June 30, 2017	\$ 16,002	\$ 7,835	\$ 5,126	\$ 24,235	\$ 7,549	\$ 1,197	\$ 61,944
Charged-off loans	(572)	(395)	(99)	(1,625)	(3,296)	—	(5,987)
Recovery of previously charged-off loans	169	565	716	562	270	—	2,282
Provision for loan losses	5,191	(2,702)	1,780	235	2,396	20	6,920
Balance at September 30, 2017	\$ 20,790	\$ 5,303	\$ 7,523	\$ 23,407	\$ 6,919	\$ 1,217	\$ 65,159
Nine months ended September 30, 2018:							
Balance at December 31, 2017	\$ 21,188	\$ 5,031	\$ 8,962	\$ 24,863	\$ 5,874	\$ 1,322	\$ 67,240
Charged-off loans	(2,930)	(1,533)	(36)	(7,600)	(10,217)	—	(22,316)
	1,517	2,190	1,645	2,492	2,159	—	10,003

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Recovery of previously charged-off loans

Provision for loan losses	6,742	1,039	411	10,369	6,997	(500) 25,058
Balance at September 30, 2018	\$ 26,517	\$ 6,727	\$ 10,982	\$ 30,124	\$ 4,813	\$ 822	\$ 79,985

Nine months ended September 30, 2017:

Balance at December 31, 2016	\$ 13,655	\$ 6,564	\$ 3,624	\$ 24,743	\$ 9,520	\$ 874	\$ 58,980
Charged-off loans	(581	) (663	) (99	) (3,278	) (11,687	) —	(16,308)
Recovery of previously charged-off loans	184	1,147	845	1,264	1,663	—	5,103
Provision for loan losses	7,532	(1,745	) 3,153	678	7,423	343	17,384
Balance at September 30, 2017	\$ 20,790	\$ 5,303	\$ 7,523	\$ 23,407	\$ 6,919	\$ 1,217	\$ 65,159

Table of Contents

The following table details the allowance for loan losses and recorded investment in loans by loan classification and by impairment evaluation method as of September 30, 2018 and December 31, 2017, respectively (in thousands):

	Commercial real estate - mortgage	Consumer real estate - mortgage	Construction and land development	Commercial and industrial	Consumer and other	Unallocated	Total
September 30, 2018							
Allowance for Loan Losses:							
Collectively evaluated for impairment	\$26,047	\$6,235	\$10,967	\$28,859	\$4,666		\$76,774
Individually evaluated for impairment	461	490	15	1,265	147		2,378
Loans acquired with deteriorated credit quality ⁽¹⁾	9	2	—	—	—		11
Total allowance for loan losses	\$26,517	\$6,727	\$10,982	\$30,124	\$4,813	\$822	\$79,985
Loans:							
Collectively evaluated for impairment	\$7,164,591	\$2,783,196	\$2,051,413	\$4,979,829	\$367,513		\$17,346,542
Individually evaluated for impairment	31,739	22,128	3,447	25,586	961		83,861
Loans acquired with deteriorated credit quality	18,789	9,836	4,149	832	—		33,606
Total loans	\$7,215,119	\$2,815,160	\$2,059,009	\$5,006,247	\$368,474		\$17,464,009
December 31, 2017							
Allowance for Loan Losses:							
Collectively evaluated for impairment	\$20,753	\$4,460	\$8,879	\$23,181	\$5,874		\$63,147
Individually evaluated for impairment	95	410	66	1,627	—		2,198
Loans acquired with deteriorated credit quality ⁽¹⁾	340	161	17	55	—		573
Total allowance for loan losses	\$21,188	\$5,031	\$8,962	\$24,863	\$5,874	\$1,322	\$67,240
Loans:							
Collectively evaluated for impairment	\$6,630,593	\$2,534,996	\$1,896,553	\$4,116,677	\$352,663		\$15,531,482
Individually evaluated for impairment	18,214	12,172	5,167	23,426	—		58,979
Loans acquired with deteriorated credit quality	20,803	14,046	6,568	1,238	—		42,655
Total loans	\$6,669,610	\$2,561,214	\$1,908,288	\$4,141,341	\$352,663		\$15,633,116

⁽¹⁾ Loans acquired with deteriorated credit quality are recorded at fair value at the time of acquisition. An allowance for loan losses is recorded resulting from subsequent credit deterioration.

The adequacy of the allowance for loan losses is assessed at the end of each calendar quarter. The level of the allowance is based upon evaluation of the loan portfolio, current asset quality trends, known and inherent risks in the

portfolio, adverse situations that may affect the borrowers' ability to repay (including the timing of future payment), the estimated value of any underlying collateral, composition of the loan portfolio, economic conditions, historical loss experience, industry and peer bank loan quality indications and other pertinent factors, including regulatory recommendations. The allowance for loan losses for purchased loans is calculated similarly to the method utilized for legacy Pinnacle Bank loans. Pinnacle Financial's accounting policy is to compare the computed allowance for loan losses for purchased loans on a loan-by-loan basis to any remaining fair value adjustment. If the computed allowance is greater than the remaining fair value adjustment, the excess is added to the allowance for loan losses by a charge to the provision for loan losses.

At September 30, 2018, Pinnacle Bank had granted loans and other extensions of credit amounting to approximately \$38.6 million to current directors, executive officers, and their related entities, of which \$19.6 million had been drawn upon. At December 31, 2017, Pinnacle Bank had granted loans and other extensions of credit amounting to approximately \$26.4 million to directors, executive officers, and their related entities, of which approximately \$16.1 million had been drawn upon. None of these loans to directors, executive officers, and their related entities were impaired at September 30, 2018 or December 31, 2017.

At September 30, 2018, Pinnacle Financial had approximately \$11.4 million in commercial loans held for sale compared to \$25.5 million at December 31, 2017, which primarily included commercial real estate and apartment loans originated for sale to a third-party as part of a multi-family loan program. Such loans are closed under a pass-through commitment structure wherein Pinnacle Bank's loan commitment to the borrower is the same as the third party's take-out commitment to Pinnacle Bank and the third party purchase typically occurs within thirty days of Pinnacle Bank closing with the borrowers.

Table of Contents

Residential Lending

At September 30, 2018, Pinnacle Financial had approximately \$46.3 million of mortgage loans held-for-sale compared to approximately \$102.7 million at December 31, 2017. Total loan volumes sold during the nine months ended September 30, 2018 were approximately \$917.9 million compared to approximately \$756.7 million for the nine months ended September 30, 2017. During the three and nine months ended September 30, 2018, Pinnacle Financial recognized \$3.9 million and \$11.4 million, respectively, in gains on the sale of these loans, net of commissions paid, compared to \$6.0 million and \$14.8 million, respectively, net of commissions paid, during the three and nine months ended September 30, 2017.

These mortgage loans held-for-sale are originated internally and are primarily to borrowers in Pinnacle Bank's geographic markets. These sales are typically on a mandatory basis to investors that follow conventional government sponsored entities (GSE) and the Department of Housing and Urban Development/U.S. Department of Veterans Affairs (HUD/VA) guidelines.

Each purchaser of a mortgage loan held-for-sale has specific guidelines and criteria for sellers of loans and the risk of credit loss with regard to the principal amount of the loans sold is generally transferred to the purchasers upon sale. While the loans are sold without recourse, the purchase agreements require Pinnacle Bank to make certain representations and warranties regarding the existence and sufficiency of file documentation and the absence of fraud by borrowers or other third parties such as appraisers in connection with obtaining the loan. If it is determined that the loans sold were in breach of these representations or warranties, Pinnacle Bank has obligations to either repurchase the loan for the unpaid principal balance and related investor fees or make the purchaser whole for the economic benefits of the loan. To date, Pinnacle Bank's liability pursuant to the terms of these representations and warranties has been insignificant to Pinnacle Bank.

Note 6. Income Taxes

ASC 740, Income Taxes, defines the threshold for recognizing the benefits of tax return positions in the financial statements as "more-likely-than-not" to be sustained by the taxing authority. This section also provides guidance on the derecognition, measurement and classification of income tax uncertainties, along with any related interest and penalties, and includes guidance concerning accounting for income tax uncertainties in interim periods.

The unrecognized tax benefit related to uncertain tax positions related to state income tax filings was \$2.8 million at September 30, 2018 compared to \$1.3 million at September 30, 2017. No change was recorded to the unrecognized tax benefit related to uncertain tax positions in each of the three and nine month periods ended September 30, 2018 and 2017.

Pinnacle Financial's policy is to recognize interest and/or penalties related to income tax matters in income tax expense. For both the three and nine months ended September 30, 2018 there were no interest and penalties recorded in the income statement compared to no interest and penalties for the three months ended and \$22,000 in interest and penalties for the nine months ended September 30, 2017, respectively.

Pinnacle Financial's effective tax rate for the three and nine months ended September 30, 2018 was 20.7% and 20.3%, respectively, compared to 35.2% and 31.9%, respectively, for the three and nine months ended September 30, 2017, primarily due to the reduction in the statutory corporate tax rate following the enactment of the Tax Cuts and Jobs Act in December 2017. The difference between the effective tax rate and the federal and state income tax statutory rate of 26.14% at September 30, 2018 and 39.23% at September 30, 2017 is primarily due to investments in bank qualified municipal securities, tax benefits of Pinnacle Financial's real estate investment trust subsidiary, participation in the Tennessee Community Investment Tax Credit (CITC) program, and tax benefits associated with share-based

compensation, bank-owned life insurance and our captive insurance subsidiary, offset in part by the limitation on deductibility of meals and entertainment expense and FDIC premiums.

Additionally, in March 2016, the FASB issued updated guidance to Accounting Standards Update, 2016-09 Stock Compensation Improvements to Employee Share-Based Payment Activity (ASU 2016-09) intended to simplify and improve several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of such awards as either equity or liabilities and classification of such awards on the statement of cash flows. The guidance became effective for Pinnacle Financial on January 1, 2017. Included in income tax expense for the three and nine months ended September 30, 2018 were excess tax benefits of \$199,000 and \$3.0 million, respectively, recognized upon the lapse of restrictions on stock awards and stock options exercises, compared to \$59,000 and \$4.6 million, respectively, for the three and nine months ended September 30, 2017.

Table of Contents

Note 7. Commitments and Contingent Liabilities

In the normal course of business, Pinnacle Bank has entered into off-balance sheet financial instruments which include commitments to extend credit (i.e., including unfunded lines of credit) and standby letters of credit. Commitments to extend credit are usually the result of lines of credit granted to existing borrowers under agreements that the total outstanding indebtedness will not exceed a specific amount during the term of the indebtedness. Typical borrowers are commercial concerns that use lines of credit to supplement their treasury management functions, and thus their total outstanding indebtedness may fluctuate during any time period based on the seasonality of their business and the resultant timing of their cash flows. Other typical lines of credit are related to home equity loans granted to consumers. Commitments to extend credit generally have fixed expiration dates or other termination clauses and may require payment of a fee. At September 30, 2018, these commitments amounted to \$6.46 billion, of which approximately \$949.9 million related to home equity lines of credit.

Standby letters of credit are generally issued on behalf of an applicant (Pinnacle Bank's customer) to a specifically named beneficiary and are the result of a particular business arrangement that exists between the applicant and the beneficiary. Standby letters of credit have fixed expiration dates and are usually for terms of two years or less unless terminated beforehand due to criteria specified in the standby letter of credit. A typical arrangement involves the applicant routinely being indebted to the beneficiary for such items as inventory purchases, insurance, utilities, lease guarantees or other third party commercial transactions. The standby letter of credit would permit the beneficiary to obtain payment from Pinnacle Bank under certain prescribed circumstances. Subsequently, Pinnacle Bank would then seek reimbursement from the applicant pursuant to the terms of the standby letter of credit. At September 30, 2018, these commitments amounted to \$177.8 million.

Pinnacle Bank typically follows the same credit policies and underwriting practices when making these commitments as it does for on-balance sheet instruments. Each customer's creditworthiness is typically evaluated on a case-by-case basis, and the amount of collateral obtained, if any, is based on management's credit evaluation of the customer. Collateral held varies but may include cash, real estate and improvements, marketable securities, accounts receivable, inventory, equipment and personal property.

The contractual amounts of these commitments are not reflected in the consolidated financial statements and only amounts drawn upon would be reflected in the future. Since many of the commitments are expected to expire without being drawn upon, the contractual amounts do not necessarily represent future cash requirements. However, should the commitments be drawn upon and should Pinnacle Bank's customers default on their resulting obligation to Pinnacle Bank, the maximum exposure to credit loss, without consideration of collateral, is represented by the contractual amount of those commitments. At September 30, 2018, Pinnacle Financial had accrued \$2.9 million for the inherent risks associated with these off-balance sheet commitments compared to \$3.1 million at December 31, 2017.

Various legal claims also arise from time to time in the normal course of business. In the opinion of management, the resolution of these claims outstanding at September 30, 2018 will not have a material adverse impact on Pinnacle Financial's consolidated financial condition, operating results or cash flows.

Note 8. Stock Options and Restricted Shares

At Pinnacle Financial's annual shareholders' meeting on April 17, 2018, the shareholders of Pinnacle Financial adopted the 2018 Omnibus Equity Incentive Plan (the "2018 Plan"). The 2018 Plan subsumed the then existing Pinnacle Financial Partners, Inc. 2014 Equity Incentive Plan (the "2014 Plan") including the approximately 500,000 shares in the aggregate that remained available for issuance thereunder on the date the 2018 Plan was approved by shareholders and increased the maximum number of shares of common stock that may be issued to associates,

directors and contractors of Pinnacle Financial and Pinnacle Bank by an additional 1.2 million shares. The 2018 Plan permits Pinnacle Financial to reissue outstanding awards that are subsequently forfeited, settled in cash, withheld by Pinnacle Financial to cover withholding taxes or expire unexercised and returned to the 2018 Plan. At September 30, 2018, there were approximately 1.7 million shares available for issuance under the 2018 Plan.

The BNC Bancorp 2013 Amended and Restated Omnibus Stock Incentive Plan (the "BNC Plan") was assumed by Pinnacle Financial in connection with the BNC Merger. As of September 30, 2018, the BNC Plan had approximately 9,000 shares remaining available for issuance to existing associates that were previously BNC associates in future periods. No new awards may be granted under plans other than the 2018 Plan except for shares remaining available for issuance to the former BNC associates pursuant to the BNC Plan.

Table of Contents

Upon the acquisition of CapitalMark, Pinnacle Financial assumed approximately 858,000 stock options under the CapitalMark Option Plan. No further shares remain available for issuance under the CapitalMark Option Plan. No options were assumed upon the acquisition of Magna, Avenue or BNC as all preexisting Magna, Avenue and BNC stock options were converted to cash upon acquisition. At September 30, 2018, all of the remaining options outstanding were granted under the CapitalMark Option Plan.

Common Stock Options

A summary of the stock option activity within the equity incentive plans during the nine months ended September 30, 2018 and information regarding expected vesting, contractual terms remaining, intrinsic values and other matters is as follows:

	Number	Weighted-Average Exercise Price	Weighted-Average Contractual Remaining Term (in years)	Aggregate Intrinsic Value (000's)	
Outstanding at December 31, 2017	274,586	\$ 21.40	3.06	\$ 12,329	(1)
Granted	—				
Exercised	(90,497)				
Forfeited	—				
Outstanding at September 30, 2018	184,089	\$ 22.67	3.54	\$ 6,900	(2)
Options exercisable at September 30, 2018	184,089	\$ 22.67	3.54	\$ 6,900	(2)

The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards (1) and the quoted closing price of Pinnacle Financial common stock of \$66.30 per common share at December 31, 2017 for the 274,586 options that were in-the-money at December 31, 2017.

The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards (2) and the quoted closing price of Pinnacle Financial common stock of \$60.15 per common share at September 30, 2018 for the 184,089 options that were in-the-money at September 30, 2018.

Compensation costs related to stock options granted under Pinnacle Financial's equity incentive plans have been fully recognized and all outstanding option awards are fully vested.

Restricted Share Awards

A summary of activity for unvested restricted share awards for the nine months ended September 30, 2018 is as follows:

	Number	Grant Date Weighted-Average Cost
Unvested at December 31, 2017	936,135	\$ 50.08
Shares awarded	160,638	
Conversion of previously awarded restricted share units to restricted share awards	6,200	
Restrictions lapsed and shares released to associates/directors	(352,595)	
Shares forfeited (1)	(25,547)	
Unvested at September 30, 2018	724,831	\$ 55.77

(1) Represents shares forfeited due to employee termination and/or retirement. No shares were forfeited due to failure to meet performance targets.

Pinnacle Financial has granted restricted share awards to associates, senior management and outside directors with a combination of time and, in the case of senior management, performance vesting criteria. The following table outlines restricted stock grants that were awarded, grouped by similar vesting criteria, during the nine months ended September 30, 2018:

Grant Year	Group ⁽¹⁾	Vesting Period in years	Shares awarded	Restrictions Lapsed and shares released to participants	Shares Forfeited by participants ⁽⁶⁾	Shares Unvested
Time Based Awards						
2018	Associates ⁽²⁾	3 - 5	127,789	224	2,783	124,782
2018	Associates ⁽³⁾	3 - 5	16,777	—	500	16,277
Performance Based Awards						
2018	Leadership team ⁽⁴⁾	3	6,200	4,340	1,860	—
Outside Director Awards ⁽⁵⁾						
2018	Outside directors	1	16,072	1,148	—	14,924

Table of Contents

- Groups include employees (referred to as associates above), the leadership team which includes our named executive officers and other key senior leadership members, and outside directors. When the restricted shares are awarded, a participant receives voting rights and forfeitable dividend rights with respect to the shares, but is not able to transfer the shares until the restrictions have lapsed. Once the restrictions lapse, the participant is taxed on the value of the award and may elect to sell some shares (or have Pinnacle Financial withhold some shares) to pay the applicable income taxes associated with the award. Alternatively, the recipient can pay the withholding taxes in cash. For time-based vesting restricted share awards, dividends paid on shares for which the forfeiture restrictions do not lapse will be recouped by Pinnacle Financial at the time of termination. For performance-based vesting awards and time-based vesting awards to Pinnacle Financial's executive officers, dividends are placed into escrow until the forfeiture restrictions on such shares lapse.
- (1) The forfeiture restrictions on these restricted share awards lapse in equal annual installments on the anniversary date of the grant.
 - (2) Restricted share awards issued to associates that were former associates of BNC pursuant to legacy BNC incentive plans assumed by Pinnacle Financial.
Reflects conversion of restricted share units issued in prior years to restricted share awards. The forfeiture restrictions on these restricted share awards lapse in separate equal installments should Pinnacle Financial achieve certain soundness targets over each year of the subsequent vesting period. See further details of these awards under the caption "Restricted Share Units" below.
 - (3) Restricted share awards are issued to the outside members of the board of directors in accordance with their board compensation plan. Restrictions lapse on February 28, 2019 based on each individual board member meeting their attendance goals for the various board and board committee meetings to which each member was scheduled to attend.
 - (4) These shares represent forfeitures resulting from recipients whose employment or board membership is terminated during the year-to-date period ended September 30, 2018 or for which the performance criteria applicable to the award are not achieved. Any dividends paid on shares for which the forfeiture restrictions do not lapse will be recouped by Pinnacle Financial at the time of termination or will not be distributed from escrow, as applicable.
 - (5)
 - (6)

Restricted Share Units

The following table details the restricted share unit awards outstanding at September 30, 2018:

Grant year	Named Executive Officers (NEOs) ⁽¹⁾	Leadership Team other than NEOs	Units Awarded			Shares settled into RSAs as of period end ⁽²⁾
			Applicable Performance Periods associated with each tranche (fiscal year)	Service period per tranche (in years)	Subsequent holding period per tranche (in years)	
2018	96,878-145,339	25,990	2018	2	3	N/A
			2019	2	2	N/A
			2020	2	1	N/A
2017	72,537-109,339	24,916	2017	2	3	N/A
			2018	2	2	N/A
			2019	2	1	N/A
2016	73,474-110,223	26,683	2016	2	3	N/A
			2017	2	2	N/A
			2018	2	1	N/A
2015	58,200-101,850	28,378	2015	2	3	N/A
			2016	2	2	N/A
			2017	2	1	N/A

- (1) The named executive officers are awarded a range of awards that may be earned based on attainment of goals between a target level of performance and a maximum level of performance.
- Restricted share unit awards granted in 2018, 2017, 2016 and 2015 will be earned if certain performance targets (and service periods) are achieved. Additional forfeiture restrictions may thereafter lapse based on Pinnacle Financial's attainment of certain soundness thresholds in future periods and thereafter the unit awards will be settled in shares of Pinnacle Financial common stock.
- (2)

Stock compensation expense related to restricted share awards and restricted share units for the three and nine months ended September 30, 2018 was \$4.5 million and \$13.3 million, respectively, compared to \$5.8 million and \$14.4 million for the three and nine months ended September 30, 2017. As of the September 30, 2018, the total compensation cost related to unvested restricted share awards and restricted share units not yet recognized was \$35.7 million. This expense is expected to be recognized over a weighted-average period of 2.9 years.

Note 9. Derivative Instruments

Financial derivatives are reported at fair value in other assets or other liabilities. The accounting for changes in the fair value of a derivative depends on whether it has been designated and qualifies as part of a hedging relationship. For derivatives not designated as hedges, the gain or loss is recognized in current period earnings.

Table of Contents

Non-hedge derivatives

Pinnacle Financial enters into interest rate swaps (swaps) to facilitate customer transactions and meet their financing needs. Upon entering into these instruments to meet customer needs, Pinnacle Financial enters into offsetting positions in order to minimize the risk to Pinnacle Financial. These swaps are derivatives, but are not designated as hedging instruments. The income statement impact of the offsetting positions is limited to changes in the reserve for counterparty risk. A summary of Pinnacle Financial's interest rate swaps related to customers as of September 30, 2018 and December 31, 2017 is included in the following table (in thousands):

	Balance Sheet Location	September 30, 2018		December 31, 2017	
		Notional Amount	Estimated Fair Value	Notional Amount	Estimated Fair Value
Interest rate swap agreements:					
Pay fixed / receive variable swaps	Other assets	\$972,816	\$24,592	\$748,625	\$13,771
Pay variable / receive fixed swaps	Other liabilities	972,816	(28,436)	748,625	(13,866)
Open trade equity	Other assets	—	3,707	—	—
Total		\$1,945,632	\$(137)	\$1,497,250	\$(95)
		Amount of Gain (Loss) Recognized in Income			
	Location of Gain (Loss) Recognized in Income	Three Months Ended September 30,		Nine Months Ended September 30,	
	Other	2018	2017	2018	2017
Interest rate swap agreements	noninterest income	\$ (8)	\$ 7	\$ (42)	\$ 20

Derivatives designated as cash flow hedges

For derivative instruments that are designated and qualify as a cash flow hedge, the aggregate fair value of the derivative instrument is recorded in other assets or other liabilities with any gain or loss related to changes in fair value recorded in accumulated other comprehensive income, net of tax. The gain or loss is reclassified into earnings in the same period during which the hedged asset or liability affects earnings and is presented in the same income statement line item as the earnings effect of the hedged asset or liability. Pinnacle Financial uses forward cash flow hedge relationships in an effort to manage future interest rate exposure. The hedging strategy converts the LIBOR-based variable interest rate on forecasted borrowings to a fixed interest rate and is used in an effort to protect Pinnacle Financial from floating interest rate variability. A summary of Pinnacle Financial's cash flow hedge relationships as of September 30, 2018 and December 31, 2017 are as follows (in thousands):

	Balance Sheet Location	Weighted Average Remaining Maturity (In Years)	Weighted Average Pay Rate	Receive Rate	September 30, 2018		December 31, 2017	
					Notional Amount	Estimated Fair Value	Notional Amount	Estimated Fair Value
Asset derivatives								
Interest rate swap agreements	Other assets	2.51	2.61%	3 month LIBOR	\$134,000	\$982	\$—	\$—
Liability derivatives								
	Other assets	3.89	3.14%		\$66,000	\$(311)	\$200,000	\$(4,583)

Interest rate swap agreements 3 month LIBOR

The effects of Pinnacle Financial's cash flow hedge relationships on the statement of comprehensive income (loss) during the three and nine months ended September 30, 2018 and 2017 were as follows:

	Amount of Gain Recognized in Other Comprehensive Income			
	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
	2018	2017	2018	2017
Interest rate swap agreements	\$783	\$239	\$3,453	\$1,307

Table of Contents

The cash flow hedges were determined to be highly effective during the periods presented and as a result qualify for hedge accounting treatment. If a hedge was deemed to be ineffective, the amount included in accumulated other comprehensive (loss) income would be reclassified into a line item within the statement of income that impacts operating results. The hedge would no longer be considered effective if a portion of the hedge becomes ineffective, the item hedged is no longer in existence or Pinnacle Financial discontinues hedge accounting. Pinnacle Financial expects the hedges to continue to be highly effective and qualify for hedge accounting during the remaining terms of the swaps. No amounts were reclassified from accumulated other comprehensive income into net income related to these derivatives during the nine months ended September 30, 2018 or 2017, and no amounts are expected to be reclassified from accumulated other comprehensive income into net income over the next twelve months. On October 24, 2018, cash flow swaps with a notional amount of \$101.0 million were terminated resulting in a cash settlement equal to previously unrealized gains of \$1.0 million. These gains are included in accumulated other comprehensive income and will be amortized into net income over the remaining contractual terms of the swaps.

Derivatives designated as fair value hedges

For derivative instruments that are designated and qualify as a fair value hedge, the gain or loss on the derivative instrument as well as the offsetting loss or gain on the hedged asset or liability attributable to the hedged risk are recognized in current earnings. The gain or loss on the derivative instrument is presented on the same income statement line item as the earnings effect of the hedged item. Pinnacle Financial utilizes interest rate swaps designated as fair value hedges to mitigate the effect of changing interest rates on the fair values of fixed rate callable securities available-for-sale and fixed rate prepayable loans. The hedging strategy on securities converts the fixed interest rates to LIBOR-based variable interest rates. These derivatives are designated as partial term hedges of selected cash flows covering specified periods of time prior to the call dates of the hedged securities. Pinnacle Financial has elected early adoption of FASB ASU 2017-12, which allows such partial term hedge designations. Pinnacle Financial also utilizes interest rate swaps designated as fair value hedges to mitigate the effect of changing interest rates on the fair values of the loans. As allowed under FASB ASU 2017-12, a specified portion of the prepayable loans have been designated as the hedged assets under the "last-of-layer" method. Such hedging designations are allowed on the portion of a closed portfolio of prepayable assets that is not expected to be affected by prepayments, defaults, and other factors affecting the timing and amount of cash flows.

A summary of Pinnacle Financial's fair value hedge relationships as of September 30, 2018 and December 31, 2017 are as follows (in thousands):

	Balance Sheet Location	Weighted Average Remaining Maturity (In Years)	Weighted Average Pay Rate	Receive Rate	September 30, 2018 Notional Amount	September 30, 2018 Estimated Fair Value	December 31, 2017 Notional Amount	December 31, 2017 Estimated Fair Value
Asset derivatives								
Interest rate swap agreements - securities								
	Other assets	7.14	2.89%	3 month LIBOR	\$ 154,145	\$ 1,991	\$ —	—
Interest rate swap agreements - loans								
	Other assets	2.89	2.77%	3 month LIBOR	900,000	3,358	—	—
		3.51	2.79%		\$ 1,054,145	\$ 5,349	\$ —	—

The effects of Pinnacle Financial's fair value hedge relationships on the income statement during the three and nine months ended September 30, 2018 and 2017 were as follows:

Amount of Gain Recognized
in Income

Location of Gain
on Derivative

		Three Months Ended September 30, 2018	2017	Nine Months Ended September 30, 2018	2017
Asset derivatives					
Interest rate swap agreements - securities	Interest income on securities	\$1,755	\$	-\$1,991	\$ —
Interest rate swap agreements - loans	Interest income on loans	\$2,236	\$	-\$3,358	\$ —
		Amount of Loss Recognized in Income			
		Location of Loss on Hedged Item		Three Months Ended September 30, 2018	Nine Months Ended September 30, 2017
Asset derivatives					
Interest rate swap agreements - securities	Interest income on securities	\$(1,755)	\$	\$(1,991)	\$ —
Interest rate swap agreements - loans	Interest income on loans	\$(2,236)	\$	\$(3,358)	\$ —

Table of Contents

The following amounts were recorded on the balance sheet related to cumulative basis adjustments for fair value hedges at September 30, 2018 and December 31, 2017:

Line item on the balance sheet	Carrying Amount of the Hedged Assets	Cumulative Amount of Fair Value Hedging Adjustment Included in the Carrying Amount of the Hedged Assets	
		September 30, 2018	December 31, 2017
Securities available-for-sale	\$ 147,155 \$	—\$(1,991) \$	—
Loans ⁽¹⁾	\$ 896,642 \$	—\$(3,358) \$	—

(1) The carrying amount as shown represents the designated last-of-layer. At September 30, 2018, the total amortized cost basis of the closed portfolio of loans designated in these hedging relationships was \$2.8 billion.

On October 23, 2018, Pinnacle Financial entered into an additional swap transaction with a notional amount of \$176.8 million designated as fair value hedges. These derivatives are intended to protect against the effects of changing interest rates on the fair values of fixed rate securities. As allowed under FASB ASU 2017-12, these derivatives are designated as partial term hedges covering specified periods of time prior to the call dates of the hedged securities.

Note 10. Fair Value of Financial Instruments

FASB ASC 820, Fair Value Measurements and Disclosures, defines fair value, establishes a framework for measuring fair value in U.S. GAAP and expands disclosures about fair value measurements. The definition of fair value focuses on the exit price, i.e., the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, not the entry price, i.e., the price that would be paid to acquire the asset or received to assume the liability at the measurement date. The statement emphasizes that fair value is a market-based measurement; not an entity-specific measurement. Therefore, the fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability.

Valuation Hierarchy

FASB ASC 820 establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

Level 1 – inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 – inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3 – inputs to the valuation methodology are unobservable and significant to the fair value measurement.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The following is a description of the valuation methodologies used for assets and liabilities measured at fair value, as well as the general classification of such assets and liabilities pursuant

to the valuation hierarchy.

Assets

Securities available-for-sale – Where quoted prices are available for identical securities in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities include highly liquid government securities and certain other financial products. If quoted market prices are not available, then fair values are estimated by using pricing models that use observable inputs or quoted prices of securities with similar characteristics and are classified within Level 2 of the valuation hierarchy. In certain cases where there is limited activity or less transparency around inputs to the valuation and more complex pricing models or discounted cash flows are used, securities are classified within Level 3 of the valuation hierarchy.

Table of Contents

Other investments – Included in other investments are investments recorded at fair value primarily in certain nonpublic investments and funds. The valuation of these nonpublic investments requires management judgment due to the absence of observable quoted market prices, inherent lack of liquidity and the long-term nature of such assets. These investments are valued initially based upon transaction price. The carrying values of other investments are adjusted either upwards or downwards from the transaction price to reflect expected exit values as evidenced by financing and sale transactions with third parties, or when determination of a valuation adjustment is confirmed through ongoing reviews by senior investment managers. A variety of factors are reviewed and monitored to assess positive and negative changes in valuation including, but not limited to, current operating performance and future expectations of the particular investment, industry valuations of comparable public companies and changes in market outlook and the third-party financing environment over time. In determining valuation adjustments resulting from the investment review process, emphasis is placed on current company performance and market conditions. These investments are included in Level 3 of the valuation hierarchy if the entities and funds are not widely traded and the underlying investments are in privately-held and/or start-up companies for which market values are not readily available. Certain investments in funds for which the underlying assets of the fund represent publicly traded investments are included in Level 2 of the valuation hierarchy.

Other assets – Included in other assets are certain assets carried at fair value, including interest rate swap agreements, cash flow hedge agreements and interest rate locks associated with the mortgage loan pipeline. The carrying amount of interest rate swap agreements is based on Pinnacle Financial's pricing models that utilize observable market inputs. The fair value of the cash flow hedge agreements is determined by calculating the difference between the discounted fixed rate cash flows and the discounted variable rate cash flows. The fair value of the mortgage loan pipeline is based upon the projected sales price of the underlying loans, taking into account market interest rates and other market factors at the measurement date, net of the projected fallout rate. Pinnacle Financial reflects these assets within Level 2 of the valuation hierarchy as these assets are valued using similar transactions that occur in the market.

Impaired loans – A loan is classified as impaired when it is probable Pinnacle Financial will be unable to collect all principal and interest payments due in accordance with the contractual terms of the loan agreement. Impaired loans are measured based on the present value of expected payments using the loan's original effective rate as the discount rate, the loan's observable market price, or the fair value of the collateral less selling costs if the loan is collateral dependent. If the recorded investment in the impaired loan exceeds the measure of fair value, a valuation allowance may be established as a component of the allowance for loan losses or the difference may be recognized as a charge-off. Impaired loans are classified within Level 3 of the hierarchy due to the unobservable inputs used in determining their fair value such as collateral values and the borrower's underlying financial condition.

Other real estate owned – Other real estate owned (OREO) represents real estate foreclosed upon by Pinnacle Bank through loan defaults by customers or acquired by deed in lieu of foreclosure. Substantially all of these amounts relate to lots, homes and development projects that are either completed or are in various stages of construction for which Pinnacle Financial believes it has adequate collateral. Upon foreclosure, the property is recorded at the lower of cost or fair value, based on appraised value, less selling costs estimated as of the date acquired with any loss recognized as a charge-off through the allowance for loan losses. Additional OREO losses for subsequent valuation downward adjustments are determined on a specific property basis and are included as a component of noninterest expense along with holding costs. Any gains or losses realized at the time of disposal are also reflected in noninterest expense, as applicable. OREO is included in Level 3 of the valuation hierarchy due to the lack of observable market inputs into the determination of fair value as appraisal values are property-specific and sensitive to the changes in the overall economic environment.

Liabilities

Other liabilities – Pinnacle Financial has certain liabilities carried at fair value including certain interest rate swap agreements to facilitate customer transactions and the cash flow hedge and interest rate locks associated with the funding for its mortgage loan originations. The fair value of these liabilities is based on Pinnacle Financial's pricing models that utilize observable market inputs and is reflected within Level 2 of the valuation hierarchy.

Table of Contents

The following tables present financial instruments measured at fair value on a recurring basis as of September 30, 2018 and December 31, 2017, by caption on the consolidated balance sheets and by FASB ASC 820 valuation hierarchy (as described above) (in thousands):

	Total carrying value in the consolidated balance sheet	Quoted market prices in an active market (Level 1)	Models with significant observable market parameters (Level 2)	Models with significant unobservable market parameters (Level 3)
September 30, 2018				
Investment securities available-for-sale:				
U.S. Treasury securities	\$ 30,528	\$	—\$ 30,528	\$ —
U.S. government agency securities	63,185			