EAST WEST BANCORP INC
Form 10-Q
November 07, 2018

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

FORM 10-Q

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

For the quarterly period ended September 30, 2018

Commission file number 000-24939

EAST WEST BANCORP, INC.
(Exact name of registrant as specified in its charter)

Delaware	95-4703316
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

135 North Los Robles Ave., 7th Floor, Pasadena, California 91101
(Address of principal executive offices)(Zip Code)

Registrant's telephone number, including area code:
(626) 768-6000

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).
Yes x No ¨

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

Large accelerated filer	x	Accelerated filer	¨
Non-accelerated filer	¨	Smaller reporting company	¨
		Emerging growth company	¨

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

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

Number of shares outstanding of the issuer’s common stock on the latest practicable date: 144,959,368 shares as of October 31, 2018.

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PART I — FINANCIAL INFORMATION
ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

EAST WEST BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET
($ in thousands, except shares)

	September 30, 2018 (Unaudited)	December 31, 2017
ASSETS		
Cash and due from banks	$408,049	$457,181
Interest-bearing cash with banks	1,810,738	1,717,411
Cash and cash equivalents	2,218,787	2,174,592
Interest-bearing deposits with banks	400,900	398,422
Securities purchased under resale agreements (“resale agreements”)	1,035,000	1,050,000
Securities:		
Available-for-sale investment securities, at fair value (includes assets pledged as collateral of $429,823 in 2018 and $534,327 in 2017)	2,676,510	3,016,752
Restricted equity securities, at cost	73,729	73,521
Loans held-for-sale	3,114	85
Loans held-for-investment (net of allowance for loan losses of $310,041 in 2018 and $287,128 in 2017; includes assets pledged as collateral of $20,387,387 in 2018 and $18,880,598 in 2017)	30,900,144	28,688,590
Investments in qualified affordable housing partnerships, net	148,097	162,824
Investments in tax credit and other investments, net	232,194	224,551
Premises and equipment (net of accumulated depreciation of $115,919 in 2018 and $111,898 in 2017)	120,265	121,209
Goodwill	465,547	469,433
Branch assets held-for-sale	—	91,318
Other assets	798,819	678,952
TOTAL	$39,073,106	$37,150,249
LIABILITIES		
Deposits:		
Noninterest-bearing	$10,794,370	$10,887,306
Interest-bearing	22,834,754	20,727,757
Total deposits	33,629,124	31,615,063
Branch liability held-for-sale	—	605,111
Short-term borrowings	56,411	—
Federal Home Loan Bank (“FHLB”) advances	325,596	323,891
Securities sold under repurchase agreements (“repurchase agreements”)	50,000	50,000
Long-term debt	156,770	171,577
Accrued expenses and other liabilities	610,355	542,656
Total liabilities	34,828,256	33,308,298
COMMITMENTS AND CONTINGENCIES (Note 11)		
STOCKHOLDERS’ EQUITY		
	166	165

Common stock, $0.001 par value, 200,000,000 shares authorized; 165,601,141 and 165,214,770 shares issued in 2018 and 2017, respectively		
Additional paid-in capital	1,766,055	1,755,330
Retained earnings	3,020,792	2,576,302
Treasury stock, at cost — 20,671,710 shares as of both 2018 and 2017	(452,327)	(452,327)
Accumulated other comprehensive loss (“AOCI”), net of tax	(89,836)	(37,519)
Total stockholders’ equity	4,244,850	3,841,951
TOTAL	$39,073,106	$37,150,249

See accompanying Notes to Consolidated Financial Statements.

EAST WEST BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF INCOME
($ and shares in thousands, except per share data)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
INTEREST AND DIVIDEND INCOME				
Loans receivable, including fees	$385,538	$306,939	$1,088,997	$872,039
Investment securities	15,180	14,828	45,695	43,936
Resale agreements	7,393	7,901	21,509	25,222
Restricted equity securities	721	612	2,155	1,859
Interest-bearing cash and deposits with banks	13,353	9,630	36,013	22,298
Total interest and dividend income	422,185	339,910	1,194,369	965,354
INTEREST EXPENSE				
Deposits	65,032	31,086	155,433	81,803
Federal funds purchased and other short-term borrowings	643	212	774	877
FHLB advances	2,732	1,947	7,544	5,738
Repurchase agreements	3,366	2,122	8,714	7,538
Long-term debt	1,692	1,388	4,812	4,030
Total interest expense	73,465	36,755	177,277	99,986
Net interest income before provision for credit losses	348,720	303,155	1,017,092	865,368
Provision for credit losses	10,542	12,996	46,296	30,749
Net interest income after provision for credit losses	338,178	290,159	970,796	834,619
NONINTEREST INCOME				
Branch fees	9,777	10,393	30,347	30,638
Letters of credit fees and foreign exchange income	14,649	10,564	39,924	34,370
Ancillary loan fees and other income	6,795	5,987	18,217	16,876
Wealth management fees	3,535	3,461	10,989	11,177
Derivative fees and other income	4,595	6,663	17,855	12,934
Net gains on sales of loans	1,145	2,360	5,081	6,660
Net gains on sales of available-for-sale investment securities	35	1,539	2,374	6,733
Net gains on sales of fixed assets	3,402	1,043	5,602	74,092
Net gain on sale of business	—	3,807	31,470	3,807
Other fees and operating income	2,569	3,653	7,355	15,255
Total noninterest income	46,502	49,470	169,214	212,542
NONINTEREST EXPENSE				
Compensation and employee benefits	96,733	79,583	285,832	244,930
Occupancy and equipment expense	17,292	16,635	50,879	47,829
Deposit insurance premiums and regulatory assessments	6,013	5,676	18,118	17,384
Legal expense	1,544	3,316	6,636	8,930
Data processing	3,289	3,004	10,017	9,009
Consulting expense	2,683	4,087	10,155	10,775
Deposit related expense	2,600	2,413	8,201	7,283
Computer software expense	5,478	4,393	16,081	13,823
Other operating expense	23,394	21,411	61,780	60,166
Amortization of tax credit and other investments	20,789	23,827	58,670	66,059

Total noninterest expense	179,815	164,345	526,369	486,188
INCOME BEFORE INCOME TAXES	204,865	175,284	613,641	560,973
INCOME TAX EXPENSE	33,563	42,624	82,958	140,247
NET INCOME	$171,302	$132,660	$530,683	$420,726
EARNINGS PER SHARE (“EPS”)				
BASIC	$1.18	$0.92	$3.66	$2.91
DILUTED	$1.17	$0.91	$3.63	$2.88
WEIGHTED-AVERAGE NUMBER OF SHARES OUTSTANDING				
BASIC	144,921	144,498	144,829	144,412
DILUTED	146,173	145,882	146,158	145,849

See accompanying Notes to Consolidated Financial Statements.

EAST WEST BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
($ in thousands)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net income	$171,302	$132,660	$530,683	$420,726
Other comprehensive (loss) income, net of tax:				
Net changes in unrealized (losses) gains on available-for-sale investment securities	(13,608)	(1,906)	(41,261)	7,916
Foreign currency translation adjustments	(4,761)	3,870	(4,785)	8,013
Other comprehensive (loss) income	(18,369)	1,964	(46,046)	15,929
COMPREHENSIVE INCOME	$152,933	$134,624	$484,637	$436,655

See accompanying Notes to Consolidated Financial Statements.

EAST WEST BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
($ in thousands, except shares)
(Unaudited)

	Common Stock and Additional Paid-in Capital		Retained Earnings	Treasury Stock	AOCI, Net of Tax	Total Stockholders' Equity
	Shares	Amount				
BALANCE, JULY 1, 2018	144,904,629	$1,754,877	$2,883,201	$(452,327)	$(71,467)	$4,114,284
Net income	—	—	171,302	—	—	171,302
Other comprehensive loss	—	—	—	—	(18,369)	(18,369)
Stock compensation costs	—	10,986	—	—	—	10,986
Net activity of common stock pursuant to various stock compensation plans and agreements	24,802	358	—	—	—	358
Cash dividends on common stock ($0.23 per share)	—	—	(33,711)	—	—	(33,711)
BALANCE, SEPTEMBER 30, 2018	144,929,431	$1,766,221	$3,020,792	$(452,327)	$(89,836)	$4,244,850
BALANCE, JULY 1, 2017	144,486,326	$1,738,721	$2,417,367	$(451,646)	$(34,181)	$3,670,261
Net income	—	—	132,660	—	—	132,660
Other comprehensive income	—	—	—	—	1,964	1,964
Stock compensation costs	—	5,665	—	—	—	5,665
Net activity of common stock pursuant to various stock compensation plans and agreements	24,617	960	—	(404)	—	556
Cash dividends on common stock ($0.20 per share)	—	—	(29,210)	—	—	(29,210)
BALANCE, SEPTEMBER 30, 2017	144,510,943	$1,745,346	$2,520,817	$(452,050)	$(32,217)	$3,781,896

	Common Stock and Additional Paid-in Capital		Retained Earnings	Treasury Stock	AOCI, Net of Tax	Total Stockholders' Equity
	Shares	Amount				
BALANCE, JANUARY 1, 2018	144,543,060	$1,755,495	$2,576,302	$(452,327)	$(37,519)	$3,841,951
Cumulative effect of change in accounting principle related to marketable equity securities (1)	—	—	(545)	—	385	(160)
Reclassification of tax effects in AOCI resulting from the new federal corporate income tax rate (2)	—	—	6,656	—	(6,656)	—
Net income	—	—	530,683	—	—	530,683
Other comprehensive loss	—	—	—	—	(46,046)	(46,046)
Stock compensation costs	—	24,201	—	—	—	24,201
Net activity of common stock pursuant to various stock compensation plans and agreements	386,371	(13,475)	—	—	—	(13,475)
	—	—	(92,304)	—	—	(92,304)

Cash dividends on common stock ($0.63 per share)						
BALANCE, SEPTEMBER 30, 2018	144,929,431	$1,766,221	$3,020,792	$(452,327)	$(89,836)	$4,244,850
BALANCE, JANUARY 1, 2017	144,167,451	$1,727,598	$2,187,676	$(439,387)	$(48,146)	$3,427,741
Net income	—	—	420,726	—	—	420,726
Other comprehensive income	—	—	—	—	15,929	15,929
Stock compensation costs	—	15,780	—	—	—	15,780
Net activity of common stock pursuant to various stock compensation plans and agreements	343,492	1,968	—	(12,663)	—	(10,695)
Cash dividends on common stock ($0.60 per share)	—	—	(87,585)	—	—	(87,585)
BALANCE, SEPTEMBER 30, 2017	144,510,943	$1,745,346	$2,520,817	$(452,050)	$(32,217)	$3,781,896

(1) Represents the impact of the adoption of Accounting Standards Update (“ASU”) 2016-01, Financial Instruments — Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities in the first quarter of 2018. Refer to Note 2 — Current Accounting Developments to the Consolidated Financial Statements for additional information.

(2) Represents amounts reclassified from AOCI to retained earnings due to the early adoption of ASU 2018-02, Income Statement — Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income in the first quarter of 2018. Refer to Note 2 — Current Accounting Developments to the Consolidated Financial Statements for additional information.

See accompanying Notes to Consolidated Financial Statements.

EAST WEST BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CASH FLOWS
($ in thousands)
(Unaudited)

	Nine Months Ended September 30,	
	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$530,683	$420,726
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	95,777	123,008
Accretion of discount and amortization of premiums, net	(14,471)	(19,237)
Stock compensation costs	24,201	15,780
Deferred income tax expense (benefit)	1,371	(14,500)
Provision for credit losses	46,296	30,749
Net gains on sales of loans	(5,081)	(6,660)
Net gains on sales of available-for-sale investment securities	(2,374)	(6,733)
Net gains on sales of premises and equipment	(5,602)	(74,092)
Net gain on sale of business	(31,470)	(3,807)
Originations and purchases of loans held-for-sale	(17,642)	(15,069)
Proceeds from sales and paydowns/payoffs in loans held-for-sale	16,652	15,792
Proceeds from distributions received from equity method investees	2,670	2,329
Net change in accrued interest receivable and other assets	(38,164)	105,350
Net change in accrued expenses and other liabilities	92,036	95,432
Other net operating activities	(1,566)	385
Total adjustments	162,633	248,727
Net cash provided by operating activities	693,316	669,453
CASH FLOWS FROM INVESTING ACTIVITIES		
Net increase in:		
Loans held-for-investment	(2,160,858)	(2,967,873)
Interest-bearing deposits with banks	(24,925)	(74,254)
Investments in qualified affordable housing partnerships, tax credit and other investments	(72,983)	(130,061)
Payment for sale of business, net of cash transferred	(503,687)	—
Purchases of:		
Resale agreements	(160,000)	(550,000)
Available-for-sale investment securities	(514,622)	(501,669)
Loans held-for-investment	(451,037)	(441,141)
Premises and equipment	(9,418)	(11,598)
Proceeds from sale of:		
Available-for-sale investment securities	296,252	676,776
Loans held-for-investment	363,209	448,679
Other real estate owned (“OREO”)	3,602	5,431
Premises and equipment	—	116,021
Business, net of cash transferred	—	3,633
Paydowns and maturities of resale agreements	175,000	1,000,000
Proceeds from distributions received from equity method investees	4,264	6,142
Repayments, maturities and redemptions of available-for-sale investment securities	404,070	323,463
Other net investing activities	(3,002)	25,773

Net cash used in investing activities	(2,654,135)	(2,070,678)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase (decrease) in:		
Deposits	2,092,022	1,385,625
Short-term borrowings	63,131	(36,604)
Proceeds from:		
Issuance of common stock pursuant to various stock compensation plans and agreements	1,328	1,008
Payments for:		
Repayment of long-term debt	(15,000)	(10,000)
Withholding taxes paid related to net share settlement of equity awards	(15,502)	(12,663)
Cash dividends on common stock	(92,632)	(87,880)
Net cash provided by financing activities	2,033,347	1,239,486
Effect of exchange rate changes on cash and cash equivalents	(28,333)	19,985
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS	44,195	(141,754)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	2,174,592	1,878,503
CASH AND CASH EQUIVALENTS, END OF PERIOD	$2,218,787	$1,736,749

See accompanying Notes to Consolidated Financial Statements.

EAST WEST BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CASH FLOWS
($ in thousands)
(Unaudited)

	Nine Months Ended September 30,	
	2018	2017
SUPPLEMENTAL CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest	$166,422	$98,409
Income taxes, net	$71,064	$11,800
Noncash investing and financing activities:		
Loans transferred from held-for-investment to held-for-sale	$363,591	$418,489
Loans transferred from held-for-sale to held-for-investment	$2,306	$—
Investment security transferred from held-to-maturity to available-for-sale	$—	$115,615

See accompanying Notes to Consolidated Financial Statements.

EAST WEST BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1 — Basis of Presentation

East West Bancorp, Inc. (referred to herein on an unconsolidated basis as “East West” and on a consolidated basis as the “Company”) is a registered bank holding company that offers a full range of banking services to individuals and businesses through its subsidiary bank, East West Bank and its subsidiaries (“East West Bank” or the “Bank”). The unaudited interim Consolidated Financial Statements in this Form 10-Q include the accounts of East West, East West Bank and East West’s subsidiaries. Intercompany transactions and accounts have been eliminated in consolidation. As of September 30, 2018, East West also has six wholly-owned subsidiaries that are statutory business trusts (the “Trusts”). In accordance with Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) Topic 810, the Trusts are not included on the Consolidated Financial Statements.

The unaudited interim Consolidated Financial Statements are presented in accordance with United States Generally Accepted Accounting Principles (“GAAP”), applicable guidelines prescribed by regulatory authorities, and general practices in the banking industry. They reflect all adjustments that, in the opinion of management, are necessary for fair statement of the interim period Consolidated Financial Statements. Certain items on the Consolidated Financial Statements and notes for the prior periods have been reclassified to conform to the current period presentation.

The current period’s results of operations are not necessarily indicative of results that may be expected for any other interim period or for the year as a whole. Events subsequent to the Consolidated Balance Sheet date have been evaluated through the date the Consolidated Financial Statements are issued for inclusion in the accompanying Consolidated Financial Statements. The unaudited interim Consolidated Financial Statements should be read in conjunction with the audited Consolidated Financial Statements and notes thereto, included in the Company’s annual report on Form 10-K for the year ended December 31, 2017, filed with the U.S. Securities and Exchange Commission on February 27, 2018 (the “Company’s 2017 Form 10-K”).

Note 2 — Current Accounting Developments

New Accounting Pronouncements Adopted

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606), which clarifies the principles for recognizing revenue for contracts to provide goods or services to customers. The guidance also requires new quantitative and qualitative disclosures including the disaggregation of revenues and descriptions of performance obligations. The Company’s revenue is comprised of net interest income and noninterest income. The scope of this new guidance explicitly excludes net interest income, as well as other revenues from financial instruments including loans, leases, securities and derivatives. Accordingly, the majority of the Company’s revenues are not affected. In addition, the new guidance does not materially impact the timing or measurement of the Company’s revenue recognition as it is consistent with the Company’s previously existing accounting for contracts within the scope of the new standard. The Company adopted this guidance as of January 1, 2018 using the modified retrospective method where there was no cumulative effect adjustment to retained earnings as a result of adopting this new guidance. Overall, the guidance did not have a material impact on the Company’s consolidated financial statements. The Company has provided a disaggregation of the significant categories of revenues within the scope of this guidance and expanded the qualitative disclosures of the Company’s noninterest income. See Note 12 — Revenue from Contracts with Customers for additional information.

In January 2016, the FASB issued ASU 2016-01, Financial Instruments — Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. With the exception of the amendments related to equity investments without readily determinable fair values and the use of exit price to measure the fair value of financial instruments for disclosure purposes that were adopted prospectively, the Company adopted all other amendments of the standard effective January 1, 2018 on a modified retrospective basis. The guidance requires investments in marketable equity securities to be accounted for at fair value with unrealized gains or losses reflected in earnings. As of the date of adoption, the Company reclassified approximately $31.9 million of marketable equity securities that were previously classified as Available-for-sale investment securities, at fair value to Investments in tax credits and other investments, net. In addition, the Company recorded a cumulative-effect adjustment as of January 1, 2018 that reduced retained earnings by $545 thousand and increased AOCI by $385 thousand. The guidance also provides a measurement alternative for equity securities without readily determinable fair values to be measured at cost less impairment (if any), plus or minus observable price changes from an identical or similar investment of the same issuer. Such price changes (if any) are reflected in earnings beginning in the period of adoption. As of January 1, 2018, the Company elected the measurement alternative for its privately held cost method investments, which was not a material amount. The Company’s investments in the Federal Reserve Bank of San Francisco (“FRB”) and FHLB stock are not subject to this guidance and continue to be accounted for at cost. In addition, the guidance eliminates the requirement to disclose methods and significant assumptions used to estimate the fair value of financial instruments measured at amortized cost on the Consolidated Balance Sheet. Furthermore, for purposes of disclosing the fair value of financial instruments carried at amortized cost, the Company has updated its valuation methods as necessary to conform to an exit price concept as required by the guidance as of January 1, 2018.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments, to provide guidance on eight specific issues related to classification on the Consolidated Statement of Cash Flows. The specific issues cover cash payments for debt prepayment or debt extinguishment costs; cash outflows for settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowings; contingent consideration payments that are not made soon after a business combination; proceeds from the settlement of insurance claims; proceeds from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies; distributions received from equity method investees; and beneficial interests received in securitization transactions. The guidance also clarifies that in instances of cash flows with multiple aspects that cannot be separately identified, the classification should be based on the activity that is likely to be the predominant source or use of the cash flows. The Company adopted this guidance in the first quarter of 2018 on a retrospective basis. The adoption of this guidance did not have a material impact on the Company’s Consolidated Financial Statements.

In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash, which requires those amounts that are deemed to be restricted cash and restricted cash equivalents to be included in cash and cash equivalents balances on the Consolidated Statement of Cash Flows. In addition, the Company is required to explain the changes in the combined total of restricted and unrestricted balances on the Consolidated Statement of Cash Flows. The Company adopted this guidance in the first quarter of 2018 on a retrospective basis. The adoption of this guidance did not have an impact on the Company’s Consolidated Financial Statements.

In January 2017, the FASB issued ASU 2017-01, Business Combinations (Topic 805): Clarifying the Definition of a Business, which narrows the definition of a business by adding an initial screen to determine if substantially all of the fair value of the gross assets acquired is concentrated in a single asset or group of similar assets (a “set”). If the screen is met, the set is not a business. ASU 2017-01 also specifies the minimum inputs and processes required for a set to be considered a business, and it removes the requirement to evaluate a market participant’s ability to replace missing elements when all of the inputs or processes that the seller used in operating a business were not obtained. The Company adopted this guidance in the first quarter of 2018 prospectively. The adoption of this guidance did not have an impact on the Company’s Consolidated Financial Statements.

In March 2017, the FASB issued ASU 2017-08, Receivables — Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities, which amends the amortization period for certain purchased callable debt securities held at a premium, shortening such period to the earliest call date. The guidance does not require any accounting changes for debt securities held at a discount. The discount continues to be amortized as an adjustment of yield over the contractual life (to maturity) of the instrument. ASU 2017-08 is effective on January 1, 2019, with early adoption permitted. The guidance should be applied using a modified retrospective transition method, with the cumulative-effect adjustment recognized to retained earnings as of the beginning of the period of adoption. The Company early adopted this guidance in the first quarter of 2018. The adoption of this guidance did not have an impact on the Company’s Consolidated Financial Statements.

In May 2017, the FASB issued ASU 2017-09, Compensation — Stock Compensation (Topic 718): Scope of Modification Accounting, which amends the scope of modification accounting for share-based payment arrangements. Specifically, an entity would not apply modification accounting if the fair value, vesting conditions and classification of the awards are the same immediately before and after the modification. The Company adopted the guidance in the first quarter of 2018 prospectively. The adoption of this guidance did not have an impact on the Company's Consolidated Financial Statements.

In August 2017, the FASB issued ASU 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities, which better aligns the Company's risk management activities and financial reporting for hedging relationships through changes to both the description and measurement guidance for qualifying hedging relationships. The guidance also changes the presentation of hedge results, expands and refines hedge accounting for both nonfinancial and financial risk components, and aligns the recognition and presentation of the effects of the hedging instrument and the hedged item on the Consolidated Financial Statements. ASU 2017-12 is effective on January 1, 2019, with early adoption permitted. The guidance should be applied using a modified retrospective transition method. The Company early adopted this guidance in the first quarter of 2018, and the adoption of this guidance did not have a material impact on the Company's Consolidated Financial Statements.

In February 2018, the FASB issued ASU 2018-02, Income Statement — Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. On December 22, 2017, the Tax Cuts and Jobs Act (the "Tax Act") was signed into law. Under current GAAP, deferred tax assets and liabilities are to be adjusted for the effect of a change in tax laws or rates in net income of the reporting period that includes the enactment date. This accounting treatment resulted in the tax effect of items within AOCI not reflecting the appropriate tax rate. This guidance permits companies to reclassify the stranded tax effects resulting from the Tax Act from AOCI to retained earnings. The guidance is effective on January 1, 2019, with early adoption permitted. The Company early adopted this guidance in the first quarter of 2018 retrospectively. The Company has identified the unrealized losses for available-for-sale securities to be the only item in AOCI with stranded tax effects, and made a policy election to reclassify the related stranded tax effects using the "investment-by-investment" approach. The adoption of the guidance resulted in a cumulative-effect adjustment as of January 1, 2018 that increased retained earnings by $6.7 million and reduced AOCI by the same amount.

Recent Accounting Pronouncements

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), which is intended to increase transparency and comparability in the accounting for lease transactions. The guidance requires lessees to recognize right-of-use assets and related lease liabilities for all leases with lease terms of more than 12 months on the Consolidated Balance Sheet, and provide quantitative and qualitative disclosures regarding key information about the leasing arrangements. For short-term leases with a term of 12 months or less, lessees can make a policy election not to recognize lease assets and lease liabilities. Lessor accounting is largely unchanged. ASU 2016-02 is effective on January 1, 2019, with early adoption permitted. In July 2018, the FASB issued ASU 2018-11, Leases (Topic 842): Targeted Improvements, which provides companies the option to continue to apply the legacy guidance in ASC 840, Leases, including its disclosure requirements, in the comparative periods presented in the year they adopt ASU 2016-02. Companies that elect this transition option recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption rather than in the earliest period presented. The Company expects to adopt this guidance in the first quarter of 2019 using the optional transition method with a cumulative effect adjustment to retained earnings without restating prior period financial statements for comparable amounts. The Company has completed its review of its existing lease contracts and service contracts that may include embedded leases, and is in the process of implementing a new system to address this guidance and updating processes and internal controls for leasing activities. Based on current estimates, the Company expects to recognize right-of-use lease assets and liabilities within a range of approximately $95.0 million and $105.0 million at the date of adoption. The final financial statement impacts will depend on the Company's

lease portfolio at the time of adoption. The Company does not expect material changes to the recognition of operating lease expense on its Consolidated Statement of Income.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments — Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The new current expected credit loss (“CECL”) impairment model applies to most financial assets measured at amortized cost and certain other instruments, including trade and other receivables, loan receivables, available-for-sale and held-to-maturity debt securities, net investments in leases and off-balance sheet credit exposures. The CECL model utilizes a lifetime “expected credit loss” measurement objective for the recognition of credit losses at the time the financial asset is originated or acquired. The expected credit losses are adjusted in each period for changes in expected lifetime credit losses. ASU 2016-13 also expands the disclosure requirements regarding an entity’s assumptions, models and methods for estimating the allowance for loan and lease losses, and requires disclosure of the amortized cost balance for each class of financial asset by credit quality indicator, disaggregated by the year of origination (i.e., by vintage year). ASU 2016-13 is effective on January 1, 2020, with early adoption permitted on January 1, 2019. The guidance should be applied using a modified retrospective approach through a cumulative-effect adjustment to retained earnings as of the beginning of the reporting period of adoption. While the Company is still evaluating the impact on its Consolidated Financial Statements, the Company expects that ASU 2016-13 may result in an increase in the allowance for credit losses due to the following factors: 1) the allowance for credit losses provides for expected credit losses over the remaining expected life of the loan portfolio, and will consider expected future changes in macroeconomic conditions; 2) the nonaccretable difference on the purchased credit-impaired (“PCI”) loans will be recognized as an allowance, offset by an increase in the carrying value of the PCI loans; and 3) an allowance may be established for estimated credit losses on available-for-sale debt securities. The Company’s implementation efforts include, but are not limited to, identifying key interpretive issues, assessing its processes, identifying the system requirements against the new guidance to determine what modifications may be required, evaluating modeling methodologies for its portfolio segments and assessing potential macroeconomic factors that will be used to determine the reasonable and supportable forecast period.

In January 2017, the FASB issued ASU 2017-04, Intangibles — Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment, to simplify the accounting for goodwill impairment. Under this guidance, an entity will no longer perform a hypothetical purchase price allocation to measure goodwill impairment. Instead, an impairment loss will be recognized when the carrying amount of a reporting unit exceeds its fair value. The guidance also eliminates the requirement to perform a qualitative assessment for any reporting units with a zero or negative carrying amount. ASU 2017-04 is effective on January 1, 2020 and should be applied prospectively. Early adoption is permitted for interim or annual goodwill impairment tests with measurement dates after January 1, 2017. The Company does not expect the adoption of this guidance to have a material impact on the Company’s Consolidated Financial Statements.

In July 2018, the FASB issued ASU 2018-09, Codification Improvements, to make improvements to various Codification Topics. Some of the improvements include: 1) clarifying that the excess tax benefits for share-based compensation awards should be recognized in the period in which the amount of the deduction is determined; 2) one of the criteria “the intent to set off” under ASC 210-20-45-1 is not required to offset derivative assets and liabilities for certain amounts arising from derivative instruments recognized at fair value and executed with the same counterparty under a master netting agreement; and 3) clarifying the measurement of certain financial instruments. ASU 2018-09 is effective immediately upon issuance for amendments that do not require transition guidance. For the changes that have transitional guidance, the amendments are effective January 1, 2019. For the amendments that are effective immediately, there is no material impact on the Company’s Consolidated Financial Statements. The Company is in the process of evaluating the impact of the other amendments that are effective on January 1, 2019 on its Consolidated Financial Statements.

In August 2018, the FASB issued ASU 2018-13, Fair Value Measurement (Topic 820): Disclosures Framework - Changes to the Disclosure Requirements for Fair Value Measurement, that eliminates, adds and modifies certain fair value measurement disclosure requirements. ASU 2018-13 is effective on January 1, 2020 with early adoption permitted. The guidance on changes in unrealized gains and losses for the period included in other comprehensive

income for recurring Level 3 measurements, the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements, and the narrative description of measurement uncertainty are to be applied prospectively. All other amendments should be applied retrospectively. The Company will adopt this guidance on January 1, 2020 prospectively.

Note 3 — Dispositions and Held-for-Sale

In the first quarter of 2017, the Company completed the sale and leaseback of a commercial property in San Francisco, California for cash consideration of $120.6 million, and entered into a leaseback with the buyer for part of the property, consisting of a retail branch and office facilities. The net book value of the property was $31.6 million at the time of the sale, resulting in a pre-tax gain of $85.4 million after considering $3.6 million in selling costs. As the leaseback is an operating lease, $71.7 million of the gain was recognized on the closing date, and $13.7 million was deferred and will be recognized over the term of the lease agreement.

In the third quarter of 2017, the Company sold the insurance brokerage business of its subsidiary, East West Insurance Services, Inc. (“EWIS”), for $4.3 million, and recorded a pre-tax gain of $3.8 million. EWIS remains a subsidiary of East West and continues to maintain its insurance broker license.

The Company reports a business as held-for-sale when management has approved or received approval to sell the business and is committed to a formal plan, the business is available for immediate sale, the business is being actively marketed, the sale is anticipated to occur during the next 12 months and certain other specific criteria are met. A business classified as held-for-sale is recorded at the lower of its carrying amount or estimated fair value less costs to sell. If the carrying amount of the business exceeds its estimated fair value, a loss is recognized. Depreciation and amortization expense are not recorded with respect to the assets of a business after it is classified as held-for-sale.

On November 11, 2017, the Bank entered into a Purchase and Assumption Agreement to sell all of its eight Desert Community Bank (“DCB”) branches located in the High Desert area of Southern California, and related assets and liability to Flagstar Bank, a wholly-owned subsidiary of Flagstar Bancorp, Inc. The Company determined that this transaction met the criteria for held-for-sale as of December 31, 2017. Branch assets held-for-sale as of December 31, 2017 were largely comprised of $78.1 million in loans held-for-sale and $8.0 million in premises and equipment, net. Branch liability held-for-sale as of December 31, 2017 was comprised of $605.1 million in deposits.

The sale of the Bank’s eight DCB branches was completed on March 17, 2018. The assets and liability of the DCB branches that were sold in this transaction primarily consisted of $613.7 million of deposits, $59.1 million of loans, $9.0 million of cash and cash equivalents and $7.9 million of premises and equipment. The transaction resulted in a net cash payment of $499.9 million by the Company to Flagstar Bank. After transaction costs, the sale resulted in a pre-tax gain of $31.5 million during the nine months ended September 30, 2018, which was reported as Net gain on sale of business on the Consolidated Statement of Income.

Note 4 — Fair Value Measurement and Fair Value of Financial Instruments

Fair Value Determination

Fair value is defined as the price that would be received to sell an asset or the price that would be paid to transfer a liability in an orderly transaction between market participants at the measurement date. In determining the fair value of financial instruments, the Company uses various methods including market and income approaches. Based on these approaches, the Company utilizes certain assumptions that market participants would use in pricing an asset or a liability. These inputs can be readily observable, market corroborated or generally unobservable. The Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. The fair value hierarchy noted below is based on the quality and reliability of the information used to determine fair value. The fair value hierarchy gives the highest priority to quoted prices available in active markets and the lowest priority to data lacking transparency. The fair value of the Company’s assets and liabilities is classified and disclosed in one of the following three categories:

- Level 1 — Valuation is based on quoted prices for identical instruments traded in active markets.
- Level 2 — Valuation is based on quoted prices for similar instruments traded in active markets; quoted prices for identical or similar instruments traded in markets that are not active; and model-derived valuations whose inputs are observable and can be corroborated by market data.
- Level 3 — Valuation is based on significant unobservable inputs for determining the fair value of assets or liabilities. These significant unobservable inputs reflect assumptions that market participants may use in pricing the assets or liabilities.

The classification of assets and liabilities within the hierarchy is based on whether inputs to the valuation methodology used are observable or unobservable, and the significance of those inputs in the fair value measurement. The Company’s assets and liabilities are classified in their entirety based on the lowest level of input that is significant to their fair value measurements.

Level 3 Assets and Liabilities Valuation Process

The Company generally determines the fair value of Level 3 assets and liabilities by using internal valuation methodologies, which primarily include discounted cash flows techniques that require both observable and unobservable inputs. Unobservable inputs (such as volatility and liquidity discount) are generally derived from historic performance of similar instruments or determined from previous market trades in similar instruments. Such inputs can be derived from similar portfolios with known historic experience or recent trades where particular unobservable inputs may be implied. The Company compares each unobservable input to historic experience and other third-party data where available. The models developed under internal valuation methodologies are subject to review according to the Company's risk management policies and procedures, which include model validation. Model validation includes review of supporting documentation and key components such as inputs, logic, processing components and output results. Validation also includes ensuring significant unobservable model inputs are appropriate given observable market transactions or other market data within the same or similar asset classes. The Company has ongoing monitoring procedures in place for Level 3 assets and liabilities that use internal valuation methodologies, which include but are not limited to the following:

- review of valuation results against expectations, including review of significant or unusual value fluctuations; and
- quarterly analysis related to market data, where available.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following section describes the valuation methodologies used by the Company to measure financial assets and liabilities on a recurring basis, as well as the general classification of these instruments pursuant to the fair value hierarchy.

Available-for-Sale Investment Securities — When available, the Company uses quoted market prices to determine the fair value of available-for-sale investment securities, which are classified as Level 1. Level 1 available-for-sale investment securities are primarily comprised of United States ("U.S.") Treasury securities. The fair value of other available-for-sale investment securities is generally determined by independent external pricing service providers who have experience in valuing these securities or by the average quoted market prices obtained from independent external brokers. In obtaining such valuation information from third parties, the Company reviewed the methodologies used to develop the resulting fair value. The available-for-sale investment securities valued using such methods are classified as Level 2.

Equity Securities — Equity securities were comprised of mutual funds as of both September 30, 2018 and December 31, 2017. The Company uses Net Asset Value ("NAV") information to determine the fair value of these equity securities. When NAV is available periodically and the equity securities can be put back to the transfer agents at the publicly available NAV, the fair value of the equity securities is classified as Level 1. When NAV is available periodically but the equity securities may not be readily marketable at its periodic NAV in the secondary market, the fair value of these equity securities is classified as Level 2.

Interest Rate Contracts — The Company enters into interest rate swap and option contracts with its borrowers to lock in attractive intermediate and long-term interest rates, resulting in the customer obtaining a synthetic fixed rate loan. To economically hedge against the interest rate risks in the products offered to its customers, the Company enters into mirrored offsetting interest rate contracts with third-party financial institutions. The Company also enters into interest rate swap contracts with institutional counterparties to hedge against certificates of deposit issued. This product allows the Company to lock in attractive floating rate funding. The fair value of the interest rate swaps is determined using the market standard methodology of netting the discounted future fixed cash payments (or receipts) and the discounted expected variable cash receipts (or payments). The fair value of the interest rate options, which consist of floors and

caps, is determined using the market standard methodology of discounting the future expected cash receipts that would occur if variable interest rates fall below (rise above) the strike rate of the floors (caps). In addition, to comply with the provisions of ASC 820, Fair Value Measurement, the Company incorporates credit valuation adjustments to appropriately reflect both its own nonperformance risk and the respective counterparty’s nonperformance risk in the fair value measurements of its derivatives. The credit valuation adjustments associated with the Company’s derivatives utilize model-derived credit spreads are Level 3 inputs. As of September 30, 2018 and December 31, 2017, the Company has assessed the significance of the impact of the credit valuation adjustments on the overall valuation of these interest rate contracts and has determined that the credit valuation adjustments are not significant to the overall valuation of its derivative portfolios. As a result, the Company classifies these derivative instruments as Level 2 due to the observable nature of the significant inputs utilized.

Foreign Exchange Contracts — The Company enters into foreign exchange contracts to accommodate the business needs of its customers. For a majority of the foreign exchange contracts entered into with its customers, the Company entered into offsetting foreign exchange contracts with third-party financial institutions to manage its exposure. The Company also utilizes foreign exchange contracts that are not designated as hedging instruments to mitigate the economic effect of fluctuations in certain foreign currency on-balance sheet assets and liabilities, primarily foreign currency denominated deposits that it offers to its customers. The fair value is determined at each reporting period based on changes in the foreign exchange rates. These are over-the-counter contracts where quoted market prices are not readily available. Valuation is measured using conventional valuation methodologies with observable market data. Due to the short-term nature of the majority of these contracts, the counterparties' credit risks are considered nominal and result in no adjustments to the valuation of the foreign exchange contracts. Due to the observable nature of the inputs used in deriving the fair value of these contracts, the valuation of foreign exchange contracts are classified as Level 2. During the nine months ended September 30, 2018, the Company entered into foreign currency swap contracts to hedge its net investment in its China subsidiary, East West Bank (China) Limited, a non-U.S. Dollar ("USD") functional currency subsidiary in China. These foreign currency swap contracts were designated as net investment hedges. As of December 31, 2017, foreign exchange forward contracts were used to economically hedge the Company's net investment in East West Bank (China) Limited. The fair value of foreign currency contracts is valued by comparing the contracted foreign exchange rate to the current market foreign exchange rate. Key inputs of the current market exchange rate include forward rates and the interest rate curves of the domestic and foreign currency. Interest rate forward curves are used to determine which forward rate pertains to a specific maturity. Due to the observable nature of the inputs used in deriving the estimated fair value, these instruments are classified as Level 2.

Credit Contracts — The Company may periodically enter into credit risk participation agreement ("RPA") contracts to manage the credit exposure on interest rate contracts associated with syndicated loans. The Company may enter into protection sold or protection purchased RPAs with institutional counterparties. The fair value of RPAs is calculated by determining the total expected asset or liability exposure of the derivatives to the borrowers and applying the borrowers' credit spread to that exposure. Total expected exposure incorporates both the current and potential future exposure of the derivatives, derived from using observable inputs, such as yield curves and volatilities. Accordingly, RPAs fall within Level 2.

Equity Contracts — The Company obtained equity warrants to purchase preferred and common stock of technology and life sciences companies, as part of the loan origination process. As of September 30, 2018 and December 31, 2017, the warrants included on the Consolidated Financial Statements were from both public and private companies. The Company valued these warrants based on the Black-Scholes option pricing model. For equity warrants from public companies, the model uses the underlying stock price, stated strike price, warrant expiration date, risk-free interest rate based on a duration-matched U.S. Treasury rate and market-observable company-specific option volatility as inputs to value the warrants. Due to the observable nature of the inputs used in deriving the estimated fair value, warrants from public companies are classified as Level 2. For warrants from private companies, the model uses inputs such as the offering price observed in the most recent round of funding, stated strike price, warrant expiration date, risk-free interest rate based on duration-matched U.S. Treasury rate and option volatility. The model values are then adjusted for a general lack of liquidity due to the private nature of the underlying companies. Due to the unobservable nature of the option volatility and liquidity discount assumptions used in deriving the estimated fair value, warrants from private companies are classified as Level 3. On a quarterly basis, the changes in the fair value of warrants from private companies are reviewed for reasonableness, and a sensitivity analysis on the option volatility and liquidity discount assumptions is performed.

Commodity Contracts — In 2018, the Company entered into energy commodity contracts in the form of swaps and options with its commercial loan customers to allow them to hedge against the risk of fluctuation in energy commodity prices. The fair value of the commodity option contracts is determined using the Black's model and

assumptions that include expectations of future commodity price and volatility. The future commodity contract price is derived from observable inputs such as the market price of the commodity. Commodity swaps are structured as an exchange of fixed cash flows for floating cash flows. The fixed cash flows are predetermined based on the known volumes and fixed price as specified in the swap agreement. The floating cash flows are correlated with the change of forward commodity prices, which is derived from market corroborated futures settlement prices. The fair value of the commodity swaps is determined using the market standard methodology of netting the discounted future fixed cash payments (or receipts) and the discounted expected variable cash receipts (or payments) based on the market prices of the commodity. As a result, the Company classifies these derivative instruments as Level 2 due to the observable nature of the significant inputs utilized.

The following tables present financial assets and liabilities that are measured at fair value on a recurring basis as of September 30, 2018 and December 31, 2017:

($ in thousands)	Assets and Liabilities Measured at Fair Value on a Recurring Basis as of September 30, 2018			
	Fair Value Measurements	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available-for-sale investment securities:				
U.S. Treasury securities	$ 603,926	$ 603,926	$ —	$ —
U.S. government agency and U.S. government sponsored enterprise debt securities	228,656	—	228,656	—
U.S. government agency and U.S. government sponsored enterprise mortgage-backed securities:				
Commercial mortgage-backed securities	365,070	—	365,070	—
Residential mortgage-backed securities	903,449	—	903,449	—
Municipal securities	72,824	—	72,824	—
Non-agency mortgage-backed securities:				
Commercial mortgage-backed securities:				
Investment grade	15,926	—	15,926	—
Residential mortgage-backed securities:				
Investment grade	10,362	—	10,362	—
Corporate debt securities:				
Investment grade	10,942	—	10,942	—
Foreign bonds:				
Investment grade	452,843	—	452,843	—
Asset-backed securities:				
Investment grade	12,512	—	12,512	—
Total available-for-sale investment securities	$ 2,676,510	$ 603,926	$ 2,072,584	$ —
Investments in tax credit and other investments:				
Equity securities with readily determinable fair value (1)	$ 30,849	$ 20,373	$ 10,476	$ —
Total investments in tax credit and other investments	$ 30,849	$ 20,373	$ 10,476	$ —
Derivative assets:				
Interest rate contracts	$ 72,618	$ —	$ 72,618	$ —
Foreign exchange contracts	11,095	—	11,095	—
Credit contracts	1	—	1	—
Equity contracts	2,409	—	1,737	672
Commodity contracts	12,980	—	12,980	—
Total derivative assets	$ 99,103	$ —	$ 98,431	$ 672
Derivative liabilities:				
Interest rate contracts	$ 114,658	$ —	$ 114,658	$ —
Foreign exchange contracts	11,075	—	11,075	—
Credit contracts	57	—	57	—

Commodity contracts	7,912	—	7,912	—
Total derivative liabilities	$ 133,702	$ —	$ 133,702	$ —

(1) Equity securities with readily determinable fair value were comprised of mutual funds as of September 30, 2018.

($ in thousands)	Assets and Liabilities Measured at Fair Value on a Recurring Basis as of December 31, 2017			
	Fair Value Measurements	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available-for-sale investment securities:				
U.S. Treasury securities	$ 640,280	$ 640,280	$ —	$ —
U.S. government agency and U.S. government sponsored enterprise debt securities	203,392	—	203,392	—
U.S. government agency and U.S. government sponsored enterprise mortgage-backed securities:				
Commercial mortgage-backed securities	318,957	—	318,957	—
Residential mortgage-backed securities	1,190,271	—	1,190,271	—
Municipal securities	99,982	—	99,982	—
Non-agency mortgage-backed securities:				
Residential mortgage-backed securities:				
Investment grade	9,117	—	9,117	—
Corporate debt securities:				
Investment grade	37,003	—	37,003	—
Foreign bonds:				
Investment grade	486,408	—	486,408	—
Other securities	31,342	20,735	10,607	—
Total available-for-sale investment securities	$ 3,016,752	$ 661,015	$ 2,355,737	$ —
Derivative assets:				
Interest rate contracts	$ 58,633	$ —	$ 58,633	$ —
Foreign exchange contracts	5,840	—	5,840	—
Credit contracts	1	—	1	—
Equity contracts	1,672	—	993	679
Total derivative assets	$ 66,146	$ —	$ 65,467	$ 679
Derivative liabilities:				
Interest rate contracts	$ 64,757	$ —	$ 64,757	$ —
Foreign exchange contracts	10,170	—	10,170	—
Credit contracts	8	—	8	—
Total derivative liabilities	$ 74,935	$ —	$ 74,935	$ —

At each reporting period, all assets and liabilities for which the fair value measurement is based on significant unobservable inputs are classified as Level 3. As of September 30, 2018 and December 31, 2017, the only assets measured on a recurring basis that were classified as Level 3 were equity warrants issued by private companies. The following table presents a reconciliation of the beginning and ending balances of these warrants for the three and nine months ended September 30, 2018:

($ in thousands)	Three Months Ended September 30, 2018	Nine Months Ended September 30, 2018
Equity warrants		
Beginning balance	$ 648	$ 679
Total (losses) gains included in earnings [(1)]	(7)	161
Issuances	31	65
Settlements	—	(233)
Ending balance	$ 672	$ 672

(1) Includes unrealized (losses) gains of $(7) thousand and $224 thousand for the three and nine months ended September 30, 2018, respectively. The realized/unrealized (losses) gains are included in Ancillary loan fees and other income on the Consolidated Statement of Income.

Transfers into or out of fair value hierarchy classifications are made if the significant inputs used in the financial models measuring the fair value of the assets and liabilities become observable or unobservable in the current marketplace. The Company's policy, with respect to transfers between levels of the fair value hierarchy, is to recognize transfers into and out of each level as of the end of the reporting period. There were no transfers of assets and liabilities measured on a recurring basis into and out of Level 1, Level 2 or Level 3 during the three and nine months ended September 30, 2018 and 2017.

The following table presents quantitative information about the significant unobservable inputs used in the valuation of assets measured on a recurring basis classified as Level 3 as of September 30, 2018. The significant unobservable inputs presented in the table below are those that the Company considers significant to the fair value of the Level 3 assets. The Company considers unobservable inputs to be significant if, by their exclusion, the fair value of the Level 3 assets would be impacted by a predetermined percentage change.

($ in thousands)	Fair Value Measurements (Level 3)	Valuation Technique	Unobservable Input(s)	Weighted-Average
Derivative assets:				
Equity warrants	$ 672	Black-Scholes option pricing model	Volatility	48%
			Liquidity discount	47%

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

From time to time, the Company may be required to measure certain assets at fair value on a nonrecurring basis in accordance with GAAP. The adjustments to fair value generally require the assets to be recorded at the lower of cost or fair value, or assessed for impairment.

Assets measured at fair value on a nonrecurring basis include certain non-PCI loans that are impaired, OREO and loans held-for-sale. These fair value adjustments result from impairment on certain non-PCI loans, application of fair value less costs to sell on OREO, or application of lower of cost or fair value on loans held-for-sale.

Non-PCI Impaired Loans — The Company typically adjusts the carrying amount of impaired loans when there is evidence of probable loss and when the expected fair value of the loan is less than its carrying amount. Impaired loans with specific reserves are classified as Level 3 assets. The following two methods are used to derive the fair value of impaired loans:

- Discounted cash flows valuation techniques generally consist of developing an expected stream of cash flows over the life of the loans and then valuing the loans at the present value by discounting the expected cash flows at a designated discount rate.
- A specific reserve is established for an impaired loan based on the fair value of the underlying collateral, which may take the form of real estate, inventory, equipment, contracts or guarantees. The fair value of the underlying collateral is generally based on third-party appraisals, or an internal evaluation if a third-party appraisal is not required by regulations, which utilize one or more valuation techniques such as income, market and/or cost approaches.

Other Real Estate Owned — The Company's OREO represents properties acquired through foreclosure, or through full or partial satisfaction of loans held-for-investment. These OREO properties are recorded at estimated fair value less the costs to sell at the time of foreclosure or at the lower of cost or estimated fair value less the costs to sell subsequent to acquisition. On a monthly basis, the current fair market value of each OREO property is reviewed to ensure that the current carrying value is appropriate. OREO properties are classified as Level 3.

The following tables present the carrying amounts of assets included on the Consolidated Balance Sheet that had fair value changes measured on a nonrecurring basis as of September 30, 2018 and December 31, 2017:

	Assets Measured at Fair Value on a Nonrecurring Basis as of September 30, 2018			
($ in thousands)	Fair Value Measurements	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Non-PCI impaired loans:				
Commercial lending:				
Commercial and industrial ("C&I")	$ 37,453	$ —	$ —	$ 37,453
Commercial real estate ("CRE")	4,726	—	—	4,726
Consumer lending:				
Single-family residential	2,567	—	—	2,567
Home equity lines of credit ("HELOCs")	735	—	—	735
Total non-PCI impaired loans	$ 45,481	$ —	$ —	$ 45,481

	Assets Measured at Fair Value on a Nonrecurring Basis as of December 31, 2017			
($ in thousands)	Fair Value Measurements	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Non-PCI impaired loans:				
Commercial lending:				
C&I	$ 31,404	$ —	$ —	$ 31,404
CRE	2,667	—	—	2,667
Construction and land	3,973	—	—	3,973
Consumer lending:				
Single-family residential	144	—	—	144
Total non-PCI impaired loans	$ 38,188	$ —	$ —	$ 38,188
OREO	$ 9	$ —	$ —	$ 9

The following table presents the total change in value of assets for which a fair value adjustment has been included on the Consolidated Statement of Income for the three and nine months ended September 30, 2018 and 2017 and held as of those dates:

($ in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Non-PCI impaired loans:				
Commercial lending:				
C&I	$(8,508)	$(16,954)	$(7,204)	$(17,648)
CRE	50	6	61	81
Multifamily residential	—	(6)	—	(112)
Construction and land	—	—	—	(147)
Consumer lending:				
Single-family residential	—	3	15	161
HELOCs	(188)	—	(262)	25
Total non-PCI impaired loans nonrecurring fair value losses	$(8,646)	$(16,951)	$(7,390)	$(17,640)
OREO nonrecurring fair value losses	$—	$(285)	$—	$(286)

The following table presents the quantitative information about the significant unobservable inputs used in the valuation of assets measured on a nonrecurring basis classified as Level 3 as of September 30, 2018 and December 31, 2017:

($ in thousands)	Fair Value Measurements (Level 3)	Valuation Technique(s)	Unobservable Input(s)	Range(s) of Input(s)	Weighted-Average
September 30, 2018					
Non-PCI impaired loans	$ 19,814	Discounted cash flows	Discount	4% — 7%	6%
	$ 4,453	Fair value of property	Selling cost	8%	8%
	$ 2,132	Fair value of collateral	Discount	100%	100%
	$ 19,082	Fair value of collateral	Contract value	NM	NM
December 31, 2017					
Non-PCI impaired loans	$ 22,802	Discounted cash flows	Discount	4% — 10%	6%
	$ 9,773	Fair value of property	Selling cost	8%	8%
	$ 3,207	Fair value of collateral	Discount	20% — 32%	29%
	$ 2,406	Fair value of collateral	Contract value	NM	NM
OREO	$ 9	Fair value of property	Selling cost	8%	8%

NM — Not meaningful.