CHEMICAL FINANCIAL CORP
Form 10-Q
July 28, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)
þ Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended June 30, 2016

¨ Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from ____________ to ____________
Commission File Number: 000-08185
CHEMICAL FINANCIAL CORPORATION
(Exact Name of Registrant as Specified in Its Charter)

Michigan	38-2022454
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

235 E. Main Street Midland, Michigan	48640
(Address of Principal Executive Offices)	(Zip Code)

(989) 839-5350
(Registrant's Telephone Number, Including Area Code)

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 þ No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No þ
The number of shares outstanding of the registrant's Common Stock, $1 par value, as of July 21, 2016, was 38,268,487 shares.

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Forward-Looking Statements

This report contains forward-looking statements that are based on management's beliefs, assumptions, current expectations, estimates and projections about the financial services industry, the economy and the Corporation. Words and phrases such as "anticipates," "believes," "continue," "estimates," "expects," "forecasts," "future," "intends," "is likely," "judgment," "look ahead," "look forward," "on schedule," "opinion," "opportunity," "plans," "potential," "predicts," "probable," "projects," "should," "strategic," "trend," "will," and variations of such words and phrases or similar expressions are intended to identify such forward-looking statements. Such statements are based upon current beliefs and expectations and involve substantial risks and uncertainties which could cause actual results to differ materially from those expressed or implied by such forward-looking statements. These statements include, among others, statements related to future levels of loan charge-offs, future levels of provisions for loan losses, real estate valuation, future levels of nonperforming assets, the rate of asset dispositions, future capital levels, future dividends, future growth and funding sources, future liquidity levels, future profitability levels, future deposit insurance premiums, future asset levels, the effects on earnings of future changes in interest rates, the future level of other revenue sources, future economic trends and conditions, future initiatives to expand the Corporation’s market share, expected performance and cash flows from acquired loans, future effects of new or changed accounting standards, future opportunities for acquisitions, opportunities to increase top line revenues, the Corporation’s ability to grow its core franchise, future cost savings and the Corporation’s ability to maintain adequate liquidity and capital based on the requirements adopted by the Basel Committee on Banking Supervision and U.S. regulators. All statements referencing future time periods are forward-looking.

Management's determination of the provision and allowance for loan losses; the carrying value of acquired loans, goodwill and mortgage servicing rights; the fair value of investment securities (including whether any impairment on any investment security is temporary or other-than-temporary and the amount of any impairment); and management's assumptions concerning pension and other postretirement benefit plans involve judgments that are inherently forward-looking. There can be no assurance that future loan losses will be limited to the amounts estimated. All of the information concerning interest rate sensitivity is forward-looking. The future effect of changes in the financial and credit markets and the national and regional economies on the banking industry, generally, and on the Corporation, specifically, are also inherently uncertain. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions ("risk factors") that are difficult to predict with regard to timing, extent, likelihood and degree of occurrence. Therefore, actual results and outcomes may materially differ from what may be expressed or forecasted in such forward-looking statements. The Corporation undertakes no obligation to update, amend or clarify forward-looking statements, whether as a result of new information, future events or otherwise.

This report also contains forward-looking statements regarding Chemical's outlook or expectations with respect to its planned merger with Talmer Bancorp, Inc. ("Talmer"), the expected costs to be incurred in connection with the transaction, the expected impact of the transaction on Chemical's future financial performance and consequences of the integration of Talmer into Chemical.

Risk factors relating both to the transaction and the integration of Talmer into Chemical after closing include, without limitation:

- Completion of the transaction is dependent on, among other things, receipt of regulatory approvals, the timing of which cannot be predicted with precision at this point and which may not be received at all.
- The impact of the completion of the transaction on Chemical's financial statements will be affected by the timing of the transaction.
- The transaction may be more expensive to complete and the anticipated benefits, including anticipated cost savings and strategic gains, may be significantly harder or take longer to achieve than expected or may not be achieved in their entirety as a result of unexpected factors or events.
- The integration of Talmer’s business and operations into Chemical, which will include conversion of Talmer’s operating systems and procedures, may take longer than anticipated or be more costly than anticipated or have unanticipated adverse results relating to Chemical's or Talmer’s existing businesses.
- Chemical’s ability to achieve anticipated results from the transaction is dependent on the state of the economic and financial markets going forward. Specifically, Chemical may incur more credit losses than expected and customer and employee attrition may be greater than expected.

- The outcome of pending or threatened litigation, whether currently existing or commencing in the future, including litigation related to the transaction.
- The effect of divestitures that may be required by regulatory authorities in certain markets in which Chemical and Talmer compete.
- The challenges of integrating, retaining and hiring key personnel.
- Failure to attract new customers and retain existing customers in the manner anticipated.

In addition, risk factors include, but are not limited to, the risk factors described in Item 1A of Chemical's Annual Report on Form 10-K for the year ended December 31, 2015. These and other factors are representative of the risk factors that may emerge and could cause a difference between an ultimate actual outcome and a preceding forward-looking statement.

Part I. Financial Information

Item 1. Financial Statements
Chemical Financial Corporation
Consolidated Statements of Financial Position

	June 30, 2016 (Unaudited)	December 31, 2015	June 30, 2015 (Unaudited)
Assets	(In thousands, except share data)		
Cash and cash equivalents:			
Cash and cash due from banks	$179,310	$194,136	$167,054
Interest-bearing deposits with the Federal Reserve Bank and other banks	53,650	44,653	47,980
Total cash and cash equivalents	232,960	238,789	215,034
Investment securities:			
Available-for-sale, at fair value	458,552	553,731	685,706
Held-to-maturity (fair value - $568,415 at June 30, 2016, $512,705 at December 31, 2015 and $466,578 at June 30, 2015)	552,828	509,971	469,837
Total investment securities	1,011,380	1,063,702	1,155,543
Loans held-for-sale, at fair value	13,990	10,327	7,798
Loans	7,647,269	7,271,147	7,034,743
Allowance for loan losses	(71,506)	(73,328)	(74,941)
Net loans	7,575,763	7,197,819	6,959,802
Premises and equipment (net of accumulated depreciation of $121,890 at June 30, 2016, $120,382 at December 31, 2015 and $112,530 at June 30, 2015)	102,709	106,317	111,968
Goodwill	286,867	287,393	285,512
Other intangible assets	34,270	38,104	41,201
Interest receivable and other assets	256,233	246,346	243,867
Total Assets	$9,514,172	$9,188,797	$9,020,725
Liabilities and Shareholders' Equity			
Deposits:			
Noninterest-bearing	$2,007,629	$1,934,583	$1,860,863
Interest-bearing	5,457,017	5,522,184	5,432,116
Total deposits	7,464,646	7,456,767	7,292,979
Interest payable and other liabilities	71,417	76,466	66,174
Securities sold under agreements to repurchase with customers	256,213	297,199	305,291
Short-term borrowings	300,000	100,000	227,000
Long-term borrowings	371,597	242,391	148,490
Total liabilities	8,463,873	8,172,823	8,039,934
Shareholders' equity:			
Preferred stock, no par value:			
Authorized – 2,000,000 shares, none issued	—	—	—
Common stock, $1 par value per share:			
Authorized — 60,000,000 shares			
Issued and outstanding — 38,267,118 shares at June 30, 2016, 38,167,861 shares at December 31, 2015 and 38,110,136 shares at June 30, 2015	38,267	38,168	38,110
Additional paid-in capital	727,145	725,280	722,329
Retained earnings	310,585	281,558	251,456
Accumulated other comprehensive loss	(25,698)	(29,032)	(31,104)
Total shareholders' equity	1,050,299	1,015,974	980,791

Total Liabilities and Shareholders’ Equity	$9,514,172	$9,188,797	$9,020,725

See accompanying notes to consolidated financial statements (unaudited).

Chemical Financial Corporation
Consolidated Statements of Income (Unaudited)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2016	2015	2016	2015
	(In thousands, except per share data)			
Interest Income				
Interest and fees on loans	$77,578	$64,613	$151,979	$122,710
Interest on investment securities:				
Taxable	1,798	2,202	3,727	4,509
Tax-exempt	2,640	2,185	5,305	4,091
Dividends on nonmarketable equity securities	777	551	1,033	749
Interest on deposits with the Federal Reserve Bank and other banks	144	128	357	250
Total interest income	82,937	69,679	162,401	132,309
Interest Expense				
Interest on deposits	4,260	3,630	8,319	6,982
Interest on short-term borrowings	226	101	326	199
Interest on long-term borrowings	956	213	1,931	213
Total interest expense	5,442	3,944	10,576	7,394
Net Interest Income	77,495	65,735	151,825	124,915
Provision for loan losses	3,000	1,500	4,500	3,000
Net interest income after provision for loan losses	74,495	64,235	147,325	121,915
Noninterest Income				
Service charges and fees on deposit accounts	6,337	6,445	12,057	12,361
Wealth management revenue	5,782	5,605	10,983	10,676
Other charges and fees for customer services	6,463	6,516	12,855	12,506
Mortgage banking revenue	1,595	1,688	3,000	3,091
Gain on sale of investment securities	18	28	37	607
Other	702	392	1,384	708
Total noninterest income	20,897	20,674	40,316	39,949
Operating Expenses				
Salaries, wages and employee benefits	33,127	31,711	67,017	60,964
Occupancy	5,514	4,386	10,419	8,812
Equipment and software	4,875	4,480	9,279	8,878
Merger and acquisition-related transaction expenses	3,054	3,457	5,648	4,819
Other	12,515	12,751	25,609	24,332
Total operating expenses	59,085	56,785	117,972	107,805
Income before income taxes	36,307	28,124	69,669	54,059
Federal income tax expense	10,600	9,100	20,700	17,200
Net Income	$25,707	$19,024	$48,969	$36,859
Net Income Per Common Share:				
Basic	$0.67	$0.54	$1.28	$1.08
Diluted	0.67	0.54	1.27	1.08
Cash Dividends Declared Per Common Share	0.26	0.24	0.52	0.48

See accompanying notes to consolidated financial statements (unaudited).

Chemical Financial Corporation
Consolidated Statements of Comprehensive Income (Unaudited)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2016	2015	2016	2015
	(In thousands)			
Net income	$25,707	$19,024	$48,969	$36,859
Other comprehensive income (loss), net of tax:				
Net unrealized gains (losses) on investment securities available-for-sale, net of tax expense (benefit) of $742 and $(1,084) for the three months ended June 30, 2016 and 2015, respectively, and $2,212 and $177 for the six months ended June 30, 2016 and 2015, respectively	1,379	(2,014)	4,108	331
Reclassification adjustment for realized gain on sale of investment securities available-for-sale included in net income, net of tax expense of $6 and $10 for the three months ended June 30, 2016 and 2015, respectively, and $13 and $212 for the six months ended June 30, 2016 and 2015, respectively	(12)	(18)	(24)	(395)
Adjustment for pension and other postretirement benefits, net of tax expense (benefit) of $(202) and $380 for the three months ended June 30, 2016 and 2015, respectively, and $(404) and $761 for the six months ended June 30, 2016 and 2015, respectively	(375)	707	(750)	1,413
Total other comprehensive income (loss), net of tax	992	(1,325)	3,334	1,349
Comprehensive income	$26,699	$17,699	$52,303	$38,208

See accompanying notes to consolidated financial statements (unaudited).

Chemical Financial Corporation
Consolidated Statements of Changes in Shareholders' Equity (Unaudited)

	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total
	(In thousands, except per share data)				
Balances at December 31, 2014	$32,774	$565,166	$231,646	$ (32,453)	$797,133
Comprehensive income			36,859	1,349	38,208
Cash dividends declared and paid of $0.48 per share			(17,049)		(17,049)
Issuance of common stock in business acquisitions	5,183	154,721			159,904
Shares issued – stock options	88	1,058			1,146
Shares issued – directors' stock plans	11	305			316
Shares issued – restricted stock units	53	(381)			(328)
Share-based compensation	1	1,460			1,461
Balances at June 30, 2015	$38,110	$722,329	$251,456	$ (31,104)	$980,791
Balances at December 31, 2015	$38,168	$725,280	$281,558	$ (29,032)	$1,015,974
Comprehensive income			48,969	3,334	52,303
Cash dividends declared and paid of $0.52 per share			(19,942)		(19,942)
Shares issued – stock options	48	480			528
Shares issued – directors' stock plans	5	120			125
Shares issued – restricted stock units	45	(514)			(469)
Share-based compensation	1	1,779			1,780
Balances at June 30, 2016	$38,267	$727,145	$310,585	$ (25,698)	$1,050,299

See accompanying notes to consolidated financial statements (unaudited).

Chemical Financial Corporation
Consolidated Statements of Cash Flows (Unaudited)

	Six Months Ended June 30,	
	2016	2015
	(In thousands)	
Operating Activities		
Net income	$48,969	$36,859
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	4,500	3,000
Gains on sales of loans	(3,431)	(3,375)
Proceeds from sales of loans	119,845	119,683
Loans originated for sale	(120,077)	(111,903)
Net gains from sales/writedowns of other real estate and repossessed assets	(2,512)	(1,578)
Depreciation of premises and equipment	5,562	5,239
Amortization of intangible assets	4,751	3,787
Net gains on sale of investment securities	(37)	(607)
Net amortization of premiums and discounts on investment securities	2,891	2,759
Share-based compensation expense	1,780	1,461
Net increase in interest receivable and other assets	(13,642)	(11,695)
Net decrease in interest payable and other liabilities	(4,139)	(15,727)
Net cash provided by operating activities	44,460	27,903
Investing Activities		
Investment securities – available-for-sale:		
Proceeds from sales	—	13,173
Proceeds from maturities, calls and principal reductions	99,528	113,973
Investment securities – held-to-maturity:		
Proceeds from maturities, calls and principal reductions	57,518	54,481
Purchases	(101,295)	(205,286)
Net increase in loans	(385,814)	(250,997)
Proceeds from sales of other real estate and repossessed assets	7,377	7,934
Purchases of premises and equipment, net of disposals	(3,897)	(3,333)
Cash acquired, net of cash paid, in business combinations	—	16,551
Net cash used in investing activities	(326,583)	(253,504)
Financing Activities		
Net increase in interest- and noninterest-bearing demand deposits and savings accounts	95,263	217,719
Net decrease in time deposits	(87,384)	(72,795)
Net increase in securities sold under agreements to repurchase with customers and other short-term borrowings	159,014	103,824
Proceeds from long-term borrowings	150,000	25,000
Repayment of long-term borrowings	(20,558)	—
Cash dividends paid	(19,942)	(17,049)
Proceeds from directors’ stock plans and exercise of stock options, net of shares withheld	653	1,462
Cash paid for payroll taxes upon conversion of share-based awards	(752)	(546)
Net cash provided by financing activities	276,294	257,615
Net increase (decrease) in cash and cash equivalents	(5,829)	32,014
Cash and cash equivalents at beginning of period	238,789	183,020
Cash and cash equivalents at end of period	$232,960	$215,034
Supplemental Disclosure of Cash Flow Information:		
Interest paid	$10,764	$6,592

Loans transferred to other real estate and repossessed assets	3,370	5,908
Closed branch offices transferred to other real estate	1,863	359
Federal income taxes paid	11,700	20,800
Business combinations:		
Fair value of tangible assets acquired (non-cash)	—	1,284,552
Goodwill and identifiable intangible assets acquired	—	116,478
Liabilities assumed	—	1,257,917
Common stock issued	—	159,904

See accompanying notes to consolidated financial statements (unaudited).

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Chemical Financial Corporation
Notes to Consolidated Financial Statements (Unaudited)
June 30, 2016

Note 1: Significant Accounting Policies

Nature of Operations

Chemical Financial Corporation ("Corporation" or "Chemical") operates in a single operating segment — commercial banking. The Corporation is a financial holding company, headquartered in Midland, Michigan, that operates through one commercial bank, Chemical Bank. Chemical Bank operates within the State of Michigan as a state-chartered commercial bank. Chemical Bank operates through an internal organizational structure of four regional banking units and offers a full range of traditional banking and fiduciary products and services to the residents and business customers in the bank’s geographical market areas. The products and services offered by the regional banking units, through branch banking offices, are generally consistent throughout the Corporation, as is the pricing of those products and services. The marketing of products and services throughout the Corporation’s regional banking units is generally uniform, as many of the markets served by the regional banking units overlap. The distribution of products and services is uniform throughout the Corporation’s regional banking units and is achieved primarily through retail branch banking offices, automated teller machines and electronically accessed banking products.

The Corporation’s primary sources of revenue are interest from its loan products and investment securities, service charges and fees from customer deposit accounts and wealth management revenue.

Basis of Presentation

The accompanying unaudited consolidated financial statements of the Corporation and its subsidiaries have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information and the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, the interim consolidated financial statements do not include all of the information and footnotes required by GAAP for complete financial statements and should be read in conjunction with the Corporation’s consolidated financial statements and footnotes thereto included in the Corporation’s Annual Report on Form 10-K for the year ended December 31, 2015. In the opinion of management, the accompanying unaudited interim consolidated financial statements contain all adjustments believed necessary to present fairly the financial condition and results of operations of the Corporation for the periods presented. Operating results for the six months ended June 30, 2016 are not necessarily indicative of the results that may be expected for the year ending December 31, 2016.

Use of Estimates

Management makes estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying footnotes. Estimates that are particularly susceptible to significant change include the determination of the allowance for loan losses, expected cash flows from acquired loans, fair value amounts related to business combinations, pension expense, income taxes, goodwill impairment and those assets that require fair value measurement. Actual results could differ from these estimates.

Business Combinations

Pursuant to the guidance of Accounting Standards Codification ("ASC") Topic 805, Business Combinations ("ASC 805"), the Corporation recognizes assets acquired, including identified intangible assets, and the liabilities assumed in acquisitions at their fair values as of the acquisition date, with the acquisition-related transaction and restructuring costs expensed in the period incurred.

ASC 805 affords a measurement period beyond the acquisition date that allows the Corporation the opportunity to finalize the acquisition accounting in the event that new information is identified that existed as of the acquisition date but was not known by the Corporation at that time. The Corporation anticipates that measurement period adjustments may arise from adjustments to the fair values of assets and liabilities recognized at the acquisition date for its May 31, 2015 acquisition of Lake Michigan Financial Corporation ("Lake Michigan"), as additional information is obtained, such as appraisals of collateral securing loans and other borrower information. In the event that a measurement period

adjustment is identified, the Corporation will recognize the adjustment as part of its acquisition accounting, which may result in an adjustment to goodwill being recorded in the period the adjustment was identified.
See Note 2 for further information regarding the Corporation's mergers and acquisitions, including its pending merger with Talmer Bancorp, Inc. ("Talmer").

Chemical Financial Corporation
Notes to Consolidated Financial Statements (Unaudited)
June 30, 2016

Originated Loans
Originated loans include all of the Corporation's portfolio loans, excluding loans acquired in business combinations, as further discussed below. Originated loans are stated at their principal amount outstanding, net of unearned income, charge-offs and unamortized deferred fees and costs. Loan interest income is recognized on the accrual basis. Deferred loan fees and costs are amortized over the loan term based on the level-yield method. Net loan commitment fees are deferred and amortized into fee income on a straight-line basis over the commitment period.
The past due status of a loan is based on the loan’s contractual terms. A loan is placed in nonaccrual status (accrual of interest is discontinued) when principal or interest is past due 90 days or more (except for a loan that is secured by residential real estate, which is transferred to nonaccrual status at 120 days past due), unless the loan is both well-secured and in the process of collection, or earlier when, in the opinion of management, there is sufficient reason to doubt the collectibility of principal or interest. Interest previously accrued, but not collected, is reversed and charged against interest income at the time the loan is placed in nonaccrual status. Subsequent receipts of interest while a loan is in nonaccrual status are recorded as a reduction of principal. Loans are returned to accrual status when principal and interest payments are brought current, payments have been received consistently for a period of time (generally six months) and collectibility is no longer in doubt.
Loans Acquired in a Business Combination
Loans acquired in a business combination ("acquired loans") consist of loans acquired on May 31, 2015 in the acquisition of Lake Michigan, on April 1, 2015 in the acquisition of Monarch Community Bancorp, Inc. ("Monarch"), on October 31, 2014 in the acquisition of Northwestern Bancorp, Inc. ("Northwestern"), and on April 30, 2010 in the acquisition of O.A.K. Financial Corporation ("OAK"). Acquired loans were recorded at fair value at the date of acquisition, without a carryover of the associated allowance for loan losses related to these loans, through a fair value discount that was, in part, attributable to deterioration in credit quality. The estimate of expected credit losses was determined based on due diligence performed by executive and senior officers of the Corporation, with assistance from third-party consultants. The fair value discount was recorded as a reduction of the acquired loans’ outstanding principal balances in the consolidated statement of financial position at the acquisition date.
The Corporation accounts for acquired loans, which are recorded at fair value at acquisition, in accordance with ASC Topic 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality ("ASC 310-30"). ASC 310-30 allows investors to aggregate loans acquired into loan pools that have common risk characteristics and thereby use a composite interest rate and expectation of cash flows expected to be collected for the loan pools. Under the provisions of ASC 310-30, the Corporation aggregated acquired loans into 2 pools in the acquisition of Lake Michigan, 2 pools in the acquisition of Monarch, 4 pools in the acquisition of Northwestern and 14 pools in the acquisition of OAK based upon common risk characteristics, including types of loans, commercial type loans with similar risk grades and whether loans were performing or nonperforming. A pool is considered a single unit of accounting for the purposes of applying the guidance prescribed in ASC 310-30. A loan will be removed from a pool of acquired loans only if the loan is sold, foreclosed, paid off or written off, and will be removed from the pool at the carrying value. If an individual loan is removed from a pool of loans, the difference between its relative carrying amount and the cash, fair value of the collateral, or other assets received would not affect the effective yield used to recognize the accretable difference on the remaining pool. The Corporation estimated the cash flows expected to be collected over the life of the pools of loans at acquisition and estimates expected cash flows quarterly thereafter, based on a set of assumptions including expectations as to default rates, prepayment rates and loss severities. The Corporation must make numerous assumptions, interpretations and judgments using internal and third-party credit quality information to determine whether it is probable that the Corporation will be able to collect all contractually required payments. This is a point in time assessment and inherently subjective due to the nature of the available information and judgment involved.

The calculation of the fair value of the acquired loan pools entails estimating the amount and timing of cash flows attributable to both principal and interest expected to be collected on such loan pools and then discounting those cash flows at market interest rates. The excess of a loan pool's expected cash flows at the acquisition date over its estimated fair value is referred to as the "accretable yield," which is recognized into interest income over the estimated remaining life of the loan pool on a level-yield basis. The difference between a loan pool's contractually required principal and interest payments at the acquisition date and the cash flows expected to be collected at the acquisition date is referred to as the "nonaccretable difference," which includes an estimate of future credit losses expected to be incurred over the estimated life of the loan pool and interest payments that are not expected to be collected. Decreases to the expected cash flows in each loan pool in subsequent periods will require the Corporation to record a provision for loan losses. Improvements in expected cash flows in each loan pool in subsequent periods will result in reversing a portion of the nonaccretable difference, which is then classified as part of the accretable yield and subsequently recognized into interest income over the estimated remaining life of the loan pool.

Chemical Financial Corporation
Notes to Consolidated Financial Statements (Unaudited)
June 30, 2016

Loans Modified Under Troubled Debt Restructurings

Loans modified under troubled debt restructurings ("TDRs") involve granting a concession to a borrower who is experiencing financial difficulty. Concessions generally include modifications to original loan terms, including changes to a loan’s payment schedule or interest rate, which generally would not otherwise be considered. The Corporation’s TDRs include performing and nonperforming TDRs, which consist of originated loans that continue to accrue interest at the loan's original interest rate as the Corporation expects to collect the remaining principal and interest on the loan, and nonaccrual TDRs, which include originated loans that are in a nonaccrual status and are no longer accruing interest, as the Corporation does not expect to collect the full amount of principal and interest owed from the borrower on these loans. In accordance with ASC Topic 310-30, acquired loans are excluded from TDRs as these loans are accounted for in pools at net realizable value based on the principal and interest the Corporation expects to collect on such loans. At the time of modification (except for loans on nonaccrual status), a TDR is reported as a nonperforming TDR until a six-month payment history of principal and interest payments, in accordance with the terms of the loan modification, is sustained, at which time the Corporation moves the loan to a performing status ("performing TDR"). If the Corporation does not expect to collect all principal and interest on the loan, the modified loan is classified as a nonaccrual TDR. All TDRs are accounted for as impaired loans and are included in the Corporation’s analysis of the allowance for loan losses. A TDR that has been renewed by a borrower who is no longer experiencing financial difficulty and which yields a market rate of interest at the time of a renewal is no longer reported as a TDR.

Loans in the Corporation’s commercial loan portfolio (comprised of commercial, commercial real estate, real estate construction and land development loans) that meet the definition of a TDR generally consist of loans where the Corporation has allowed borrowers to defer scheduled principal payments and make interest-only payments for a specified period of time at the stated interest rate of the original loan agreement or reduced payments due to a moderate extension of the loan’s contractual term. If the Corporation does not expect to collect all principal and interest on the loan, the modified loan is classified as a nonaccrual TDR. If the Corporation does not expect to incur a loss on the loan based on its assessment of the borrowers’ expected cash flows, as the pre- and post-modification effective yields are approximately the same, the loan is classified as a nonperforming TDR until a six-month payment history is sustained, at which time the loan is classified as a performing TDR. Since no loss is expected to be incurred on nonperforming TDRs, no additional provision for loan losses has been recognized for these loans and they continue to accrue interest at their contractual interest rate. Nonperforming TDRs are individually evaluated for impairment and transferred to nonaccrual status if they become 90 days past due as to principal or interest payments or if it is probable that any remaining principal and interest payments due on the loan will not be collected in accordance with the modified terms of the loan.

Loans in the Corporation’s consumer loan portfolio (comprised of residential mortgage, consumer installment and home equity loans) that meet the definition of a performing or nonperforming TDR generally consist of residential mortgage loans that include a concession that reduces a borrower’s monthly payments by decreasing the interest rate charged on the loan for a specified period of time (generally 24 months) under a formal modification agreement. The Corporation recognizes an additional provision for loan losses related to impairment on these loans on an individual basis based on the present value of expected future cash flows discounted at the loan’s original effective interest rate. These loans continue to accrue interest at their effective interest rate, which consists of contractual interest under the terms of the modification agreement in addition to an adjustment for the accretion of computed impairment. These loans are moved to nonaccrual status if they become 90 days past due as to principal or interest payments, or sooner if conditions warrant.

Impaired Loans

A loan is defined to be impaired when it is probable that payment of principal and interest will not be paid in accordance with the original contractual terms of the loan agreement. Impaired loans include nonaccrual loans (including nonaccrual TDRs), performing and nonperforming TDRs and acquired loans that were not performing in accordance with original contractual terms. Impaired loans are accounted for at the lower of the present value of expected cash flows discounted at the loan's original effective interest rate or the estimated fair value of the collateral, if the loan is collateral dependent. When the present value of expected cash flows or the fair value of collateral of an impaired loan in the originated loan portfolio is less than the amount of unpaid principal outstanding on the loan, the principal balance of the loan is reduced to its carrying value through either an allocation of the allowance for loan losses or a partial charge-off of the loan balance.

Nonperforming Loans

Nonperforming loans are comprised of loans for which the accrual of interest has been discontinued (nonaccrual loans, including nonaccrual TDRs), accruing originated loans contractually past due 90 days or more as to interest or principal payments and nonperforming TDRs.

Acquired loans that were classified as nonperforming loans prior to being acquired and acquired loans that are not performing in accordance with contractual terms subsequent to acquisition are not classified as nonperforming loans subsequent to acquisition

because the loans are recorded in pools at net realizable value based on the principal and interest the Corporation expects to collect on such loans.

Allowance for Loan Losses

The allowance for loan losses ("allowance") is presented as a reserve against loans. The allowance represents management's assessment of probable loan losses inherent in the Corporation's loan portfolio.

Management's evaluation of the adequacy of the allowance is based on a continuing review of the loan portfolio, actual loan loss experience, the underlying value of the collateral, risk characteristics of the loan portfolio, the level and composition of nonperforming loans, the financial condition of the borrowers, the balance of the loan portfolio, loan growth, economic conditions, employment levels in the Corporation's local markets, and special factors affecting specific business sectors. The Corporation maintains formal policies and procedures to monitor and control credit risk. Management evaluates the allowance on a quarterly basis in an effort to ensure the level is appropriate to absorb probable losses inherent in the loan portfolio.

The allowance provides for probable losses that have been identified with specific customer relationships and for probable losses believed to be incurred in the remainder of the originated loan portfolio, but that have not been specifically identified. The Corporation utilizes its own loss experience to estimate inherent losses on loans. Internal risk ratings are assigned to each loan in the commercial loan portfolio (commercial, commercial real estate, real estate construction and land development loans) at the time of origination and are subject to subsequent periodic reviews by senior management. The Corporation performs a detailed credit quality review quarterly on all loans greater than $0.25 million that have deteriorated below certain levels of credit risk, and may allocate a specific portion of the allowance to such loans based upon this review. A portion of the allowance is allocated to the remaining loans by applying projected loss ratios, based on numerous factors. Projected loss ratios incorporate factors such as charge-off experience, trends with respect to adversely risk-rated loans in the commercial loan portfolio, trends with respect to past due and nonaccrual loans, changes in economic conditions and trends, changes in the value of underlying collateral and other credit risk factors. This evaluation involves a high degree of uncertainty.

In determining the allowance and the related provision for loan losses, the Corporation considers four principal elements: (i) valuation allowances based upon probable losses identified during the review of impaired loans in the commercial loan portfolio, (ii) reserves established for adversely-rated loans in the commercial loan portfolio and nonaccrual residential mortgage, consumer installment and home equity loans based on loan loss experience of other adversely-rated loans, (iii) reserves, by loan classes, on all other loans based principally on a five-year historical loan loss experience, with equal weighting placed on all of the years, loan loss trends and giving consideration to estimated loss emergence periods, and (iv) a reserve for qualitative factors that take into consideration risks inherent in the originated loan portfolio that differ from historical loan loss experience.

Although the Corporation allocates portions of the allowance to specific loans and loan types, the entire allowance attributable to originated loans is available for any loan losses that occur in the originated portfolio. Loans that are deemed not collectible are charged off and reduce the allowance. The provision for loan losses and recoveries on loans previously charged off increase the allowance. Collection efforts may continue and recoveries may occur after a loan is charged off.

Acquired loans are aggregated into pools based upon common risk characteristics. An allowance may be recorded related to an acquired loan pool if it experiences a decrease in expected cash flows, as compared to those projected at the acquisition date. On a quarterly basis, the expected future cash flow of each pool is estimated based on various factors, including changes in property values of collateral dependent loans, default rates, loss severities and prepayment speeds. Decreases in estimates of expected cash flows within a pool generally result in a charge to the provision for loan losses and a corresponding increase in the allowance allocated to acquired loans for the particular pool. Increases in estimates of expected cash flows within a pool generally result in a reduction in the allowance

allocated to acquired loans for the particular pool, if applicable, and then an adjustment to the accretable yield for the pool, which will increase amounts recognized in interest income in subsequent periods.

Various regulatory agencies, as an integral part of their examination process, periodically review the allowance. Such agencies may require additions to the allowance, based on their judgment, reflecting information available to them at the time of their examinations.

Fair Value Measurements

Fair value for assets and liabilities measured at fair value on a recurring or nonrecurring basis refers to the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants in the market in which the reporting entity transacts such sales or transfers based on the assumptions market participants would use when pricing an asset or liability. Assumptions are developed based on prioritizing information within a fair value hierarchy that gives the highest priority to quoted prices in active markets and the lowest priority to unobservable data, such as the reporting entity’s own data.

The Corporation may choose to measure eligible items at fair value at specified election dates. Unrealized gains and losses on items for which the fair value measurement option has been elected are reported in earnings at each subsequent reporting date. The fair value option (i) may be applied instrument by instrument, with certain exceptions, allowing the Corporation to record identical financial assets and liabilities at fair value or by another measurement basis permitted under GAAP, (ii) is irrevocable (unless a new election date occurs) and (iii) is applied only to entire instruments and not to portions of instruments. At June 30, 2016, December 31, 2015 and June 30, 2015, the Corporation had elected the fair value option on all of its residential mortgage loans held-for-sale. The Corporation has not elected the fair value option for any other financial assets or liabilities.

Share-Based Compensation

The Corporation grants stock options, stock awards, restricted stock performance units and restricted stock service-based units to certain executive and senior management employees. The Corporation accounts for share-based compensation expense using the modified-prospective transition method. Under that method, compensation expense is recognized for stock options based on the estimated grant date fair value as computed using the Black-Scholes option pricing model and the probability of issuance. The Corporation accounts for stock awards based on the closing stock price of the Corporation's common stock on the date of the award. The fair values of both stock options and stock awards are recognized as compensation expense on a straight-line basis over the requisite service period. The Corporation accounts for restricted stock performance units based on the closing stock price of the Corporation's common stock on the date of grant, discounted by the present value of estimated future dividends to be declared over the requisite performance or service period. The fair value of restricted stock performance units is recognized as compensation expense over the expected requisite performance period, or requisite service period for awards with multiple performance and service conditions. The Corporation accounts for restricted stock service-based units based on the closing stock price of the Corporation's common stock on the date of grant, as these awards accrue dividend equivalents equal to the amount of any cash dividends that would have been payable to a shareholder owning the number of shares of the Corporation's common stock represented by the restricted stock service-based units. The fair value of the restricted stock service-based units is recognized as compensation expense over the requisite service period.

Cash flows realized from the tax benefits of exercised stock option awards that result from actual tax deductions that are in excess of the recorded tax benefits related to the compensation expense recognized for those options (excess tax benefits) are classified as financing activities on the consolidated statements of cash flows.

Bank-Owned Life Insurance

The Corporation has life insurance policies on certain key officers of Chemical Bank. The majority of the bank-owned life insurance policies of the Corporation were obtained through its acquisition of Lake Michigan. Bank-owned life insurance is recorded at the cash surrender value, net of surrender charges, and is included within other assets on the consolidated statements of financial position and changes in the cash surrender values are recorded as other noninterest income on the consolidated statements of income.

Income and Other Taxes

The Corporation is subject to the income and other tax laws of the United States, the State of Michigan and any other states where nexus has been created. These laws are complex and are subject to different interpretations by the taxpayer and the various taxing authorities. In determining the provision for income and other taxes, management must make judgments and estimates about the application of these inherently complex laws, related regulations and case law. In the process of preparing the Corporation’s tax returns, management attempts to make reasonable interpretations of enacted tax laws. These interpretations are subject to challenge by the tax authorities upon audit or to reinterpretation based on management’s ongoing assessment of facts and evolving case law.

On a quarterly basis, management assesses the reasonableness of its effective federal tax rate based upon its estimate of taxable income and the applicable taxes expected for the full year. Deferred tax assets and liabilities are reassessed on a quarterly basis, including the need for a valuation allowance for deferred tax assets.

Uncertain income tax positions are evaluated to determine whether it is more-likely-than-not that a tax position will be sustained upon examination based on the technical merits of the tax position. If a tax position is more-likely-than-not to be sustained, a tax benefit is recognized for the amount that is greater than 50% likely to be realized. Reserves for contingent income tax liabilities attributable to unrecognized tax benefits associated with uncertain tax positions are reviewed quarterly for adequacy based upon developments in tax law and the status of audits or examinations. The Corporation had no contingent income tax liabilities recorded at June 30, 2016, December 31, 2015 or June 30, 2015.

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Investments in Qualified Affordable Housing Projects, Federal Historic Projects and New Market Tax Credits

The Corporation invests in qualified affordable housing projects, federal historic projects, and new market projects for the purpose of community reinvestment and obtaining tax credits. Return on the Corporation's investment in these projects comes in the form of the tax credits and tax losses that pass through to the Corporation. The carrying value of the investments are reflected in other assets on the consolidated statements of financial position. The Corporation utilizes the proportional amortization method to account for investments in qualified affordable housing projects and the equity method to account for investments in other tax credit projects.

Under the proportional amortization method, the Corporation amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits allocated. The Corporation recognized additional income tax expense attributable to the amortization of investments in qualified affordable housing projects of $0.6 million and $1.2 million during the three and six months ended June 30, 2016, respectively, and $0.2 million and $0.3 million during the three and six months ended June 30, 2015, respectively. The Corporation's remaining investment in qualified affordable housing projects accounted for under the proportional amortization method totaled $24.3 million at June 30, 2016, $21.7 million at December 31, 2015 and $21.4 million at June 30, 2015.

Under the equity method, the Corporation's share of the earnings or losses are included in other operating expenses on the consolidated statements of income. The Corporation's remaining investment in new market projects accounted for under the equity method totaled $7.5 million, $1.7 million and $3.3 million at June 30, 2016, December 31, 2015 and June 30, 2015, respectively.

The Corporation's unfunded equity contributions relating to investments in qualified affordable housing projects, federal historic tax projects and new market projects is recorded in other liabilities on the consolidated statements of financial position. The Corporation's remaining unfunded equity contributions totaled $11.5 million, $8.0 million and $9.7 million at June 30, 2016, December 31, 2015 and June 30, 2015.

Management analyzes these investments for potential impairment when events or changes in circumstances indicate that it is more-likely-than-not that the carrying amount of the investment will not be realized. An impairment loss is measured as the amount by which the carrying amount of an investment exceeds its fair value. There were no impairment losses recognized as of June 30, 2016, December 31, 2015 or June 30, 2015.

The Corporation consolidates variable interest entities ("VIEs") in which it is the primary beneficiary. In general, a VIE is an entity that either (i) has an insufficient amount of equity to carry out its principal activities without additional subordinated financial support, (ii) has a group of equity owners that are unable to make significant decisions about its activities or (iii) has a group of equity owners that do not have the obligation to absorb losses or the right to receive returns as generated by its operations. If any of these characteristics are present, the entity is subject to a variable interests consolidation model, and consolidation is based on variable interests, not on ownership of the entity's outstanding voting stock. Variable interests are defined as contractual, ownership, or other monetary interests in an entity that change with fluctuations in the entity's net asset value. The primary beneficiary consolidates the VIE. The primary beneficiary is defined as the enterprise that has the power to direct the activities and absorb losses or the right to receive benefits. The Corporation is a significant limited partner in the qualified affordable housing, federal historic and new market projects it has invested in. These projects meet the definition of VIEs. However, the Corporation is not the primary beneficiary of any of the VIEs in which it holds a limited partnership interest; therefore, the VIEs are not consolidated in the Corporation's consolidated financial statements.

Shareholders’ Equity

Common Stock Repurchase Programs

From time to time, the board of directors of the Corporation approves common stock repurchase programs allowing management to repurchase shares of the Corporation’s common stock in the open market. The repurchased shares are available for later reissuance in connection with potential future stock dividends, the Corporation’s dividend

reinvestment plan, employee benefit plans and other general corporate purposes. Under these programs, the timing and actual number of shares subject to repurchase are at the discretion of management and are contingent on a number of factors, including the projected parent company cash flow requirements and the Corporation's market price per share.

In January 2008, the board of directors of the Corporation authorized the repurchase of up to 500,000 shares of the Corporation's common stock under a stock repurchase program. In November 2011, the board of directors of the Corporation reaffirmed the stock buy-back authorization with the qualification that the shares may only be repurchased if the share price is below the tangible book value per share of the Corporation's common stock at the time of the repurchase. Since the January 2008 authorization, no shares have been repurchased. At June 30, 2016, there were 500,000 remaining shares available for repurchase under the Corporation's stock repurchase program.

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Shelf Registration
On June 12, 2014, the Corporation filed an automatic shelf registration statement on Form S-3 with the Securities and Exchange Commission ("SEC") for an indeterminate amount of securities, which became immediately effective. The shelf registration statement provides the Corporation with the ability to raise capital, subject to SEC rules and limitations, if the board of directors of the Corporation decides to do so.
Preferred Stock
On April 20, 2015, the shareholders of the Corporation approved an amendment to the restated articles of incorporation which eliminated and replaced the previous class of 200,000 shares of preferred stock, that had been approved by shareholders on April 20, 2009, with a new class of 2,000,000 shares of preferred stock. At June 30, 2016, no shares of preferred stock were issued and outstanding.
Common Stock
On July 19, 2016, the shareholders of the Corporation approved an amendment to the restated articles of incorporation to increase the number of authorized shares of common stock from 60,000,000 to 100,000,000 in connection with the pending merger with Talmer.
Legal Matters
On February 22, 2016, two putative class action and derivative complaints were filed in the Circuit Court for Oakland County, Michigan by individuals purporting to be a shareholder of Talmer. The actions are styled Regina Gertel Lee v. Chemical Financial Corporation, et. al., Case No. 2016-151642-CB and City of Livonia Employees’ Retirement System v. Chemical Financial Corporation et. al., Case No. 2016-151641-CB. These complaints purport to be brought derivatively on behalf of Talmer against the individual defendants, and individually and on behalf of all others similarly situated against Talmer and Chemical. The complaints allege, among other things, that the directors of Talmer breached their fiduciary duties to Talmer’s shareholders in connection with the merger by approving a transaction pursuant to an allegedly inadequate process that undervalues Talmer and includes preclusive deal protection provisions, and that Chemical allegedly aided and abetted the Talmer directors in breaching their duties to Talmer’s shareholders. The complaints also allege that the individual defendants have been unjustly enriched. Both complaints seek various remedies on behalf of the putative class (consisting of all shareholders of Talmer who are not related to or affiliated with any defendant). They request, among other things, that the Court enjoin the merger from being consummated in accordance with its agreed-upon terms, direct the Talmer directors to exercise their fiduciary duties, rescind the merger agreement to the extent that it is already implemented, award the plaintiff all costs and disbursements in each respective action (including reasonable attorneys’ and experts’ fees), and grant such further relief as the court deems just and proper. The City of Livonia plaintiff amended its complaint on April 21, 2016 to add additional factual allegations, including but not limited to allegations that Keefe Bruyette & Woods, Inc. served as a financial advisor for the proposed merger despite an alleged conflict of interest, that Talmer’s board acted under actual or potential conflicts of interest, and that the defendants omitted and/or misrepresented material information about the proposed merger in the Form S-4 Registration Statement relating to the proposed merger. Talmer, Chemical and the individual defendants all believe that the claims asserted against each of them in the above-described lawsuits are without merit and intend to vigorously defend against these lawsuits. These two cases ere consolidated as In re Talmer Bancorp Shareholder Litigation, case number 2016-151641-CB, per an order entered on May 12, 2016.
On March 22, 2016, an additional putative class action and derivative complaint was filed in the Circuit Court for Oakland County, Michigan, by an individual purporting to be a shareholder of Talmer, styled Stephen Bushansky v. Gary Torgow et. al. Case No. 2016-152112-CB. This action contained similar allegations, claims, and requests for relief as the complaints filed in the Lee and City of Livonia lawsuits discussed above. The Bushansky lawsuit was voluntarily dismissed by the plaintiff as to all defendants, without prejudice, on April 18, 2016. On April 27, 2016, Stephen Bushansky filed a new putative class action complaint in the United State District Court for Eastern District

of Michigan, styled Stephen Bushansky v. Talmer Bancorp In. et.al., Docket No. 1:16-cv-11511. This lawsuit alleged violations of Sections 14(a) and 20(a) of the Securities Exchange Act of 1934, and named Talmer, Chemical, and several individuals as defendants. The complaint alleged, among other things, that the Defendants issued materially incomplete and misleading disclosures in the preliminary Form S-4 Registration Statement relating to the proposed merger. The Federal Bushansky lawsuit was voluntarily dismissed by the plaintiff as to all defendants, without prejudice, on June 20, 2016.

On April 6, 2016, a complaint was filed in the United States District Court for the Eastern District of Michigan by another purported shareholder of Talmer, styled Matthew Sciabacucchi v. Chemical Financial Corporation et. al., Docket No. 1:16-cv-11261. Mr. Sciabacucchi purports to bring this action "on behalf of himself and all others similarly situated." This lawsuit alleges violations of Sections 14(a) and 20(a) of the Securities Exchange Act of 1934, naming Talmer, Chemical, and several individuals as defendants.

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The complaint alleges, among other things, that the Defendants issued materially incomplete and misleading disclosures in the Form S-4 Registration Statement relating to the proposed merger. The Complaint contains requests for relief that include, among other things, that the Court enjoin the proposed transaction, rescind the transaction if it is consummated or award rescissory damages, order the Talmer directors to file a revised Registration Statement, declare that the Defendants violated Sections 14(a) and/or Section 20(a) of the Securities Exchange Act, as well as Rule 14a-9 promulgated thereunder, award the plaintiff all costs associated with bringing the action (including reasonable attorneys' and experts' fees), and grant such further relief as the court deems just and proper. Talmer, Chemical and the individual defendants all believe that the claims asserted against each of them in this lawsuit are without merit and intend to vigorously defend against this lawsuit.

On April 25, 2016, a complaint was filed in the United States District Court for the Eastern District of Michigan by another purported shareholder of Talmer, styled Kevin Nicholl v. Chemical Financial Corporation et. al., Docket No. 1:16-cv-11482. The plaintiff names Talmer, Chemical, and several individuals as defendants. This lawsuit was styled as a class action and derivative action, and alleged breach of fiduciary duties as well as violations of Sections 14(a) and 20(a) of the Securities Exchange Act of 1934. The Nicholl lawsuit was voluntarily dismissed by the plaintiff as to all defendants, with prejudice, on June 20, 2016.

On June 16, 2016, a complaint was filed in the United States District Court for the Eastern District of Michigan by a purported Talmer shareholder, styled City of Livonia Employees' Retirement System v. Chemical Financial Corporation, et. al., Docket No. 2:16-cv-12229. The plaintiff purports to bring the action "individually and on behalf of all others similarly situated," and requests certification as a class action. This lawsuit alleges violations of Section 14(a) and 20(a) of the Securities Exchange Act of 1934. The Complaint alleges, among other things, that the Defendants issued materially incomplete and misleading disclosures in the Form S-4 Registration Statement relating to the proposed merger. The Complaint contains requests for relief that include, among other things, that the Court enjoin the proposed transaction unless and until additional information is provided to Talmer's shareholders, declare that the Defendants violated the securities laws in connection with the proposed merger, award compensatory damages, interest, attorneys' and experts' fees, and that the Court grant such other relief as it deems just and proper. Talmer, Chemical, and the individual defendants all believe that the claims asserted against each of them in this lawsuit are without merit and intend to vigorously defend against this lawsuit.

In addition, the Corporation and Chemical Bank are subject to certain legal actions arising in the ordinary course of business. In the opinion of management, after consultation with legal counsel, the ultimate disposition of these matters is not expected to have a material adverse effect on the consolidated financial condition or results of operations of the Corporation.

Reclassifications

Certain amounts appearing in the consolidated financial statements and notes thereto for prior periods have been reclassified to conform with the current presentation. The reclassification had no effect on net income or shareholders' equity as previously reported.

Adopted Accounting Pronouncements

Consolidation of Variable Interest Entities

In February 2015, the FASB issued ASU No. 2015-02, Consolidation (Topic 810): Amendments to the Consolidation Analysis ("ASU 2015-02"). ASU 2015-02 is applicable to reporting entities that are required to evaluate whether they should consolidate certain legal entities. Specifically, ASU 2015-02 (i) modifies the evaluation of whether limited partnerships and similar legal entities are VIEs, (ii) eliminates the presumption that a general partner should consolidate a limited partnership, (iii) affects the consolidation analysis of reporting entities that are involved with VIEs, particularly those that have fee arrangements and related party relationships and (iv) provides a scope exception from consolidation guidance for reporting entities with interests in legal entities that are required to comply with or

operate in accordance with requirements that are similar to those in Rule 2a-7 of the Investment Company Act of 1940 for registered money market funds. The adoption of ASU 2015-02 effective January 1, 2016 did not have a material impact on the Corporation's consolidated financial condition or results of operations.

Customer's Accounting for Cloud Computing Fees

In April 2015, the FASB issued ASU No. 2015-05, Intangibles - Goodwill and Other - Internal Use Software (Subtopic 350-40): Customer’s Accounting for Fees Paid in a Cloud Computing Arrangement ("ASU 2015-05"). ASU 2015-05 provides guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. ASU 2015-05 does not change the accounting for a customer’s accounting for service contracts. The purpose of ASU 2015-05 is to clarify which fees paid in a cloud computing arrangement should be capitalized and

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which fees should be expensed as incurred. The adoption of ASU 2015-05 prospectively effective January 1, 2016 did not have a material impact on the Corporation's consolidated financial condition or results of operations.

Pending Accounting Pronouncements

Recognition and Measurement

In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities ("ASU 2016-01"). ASU 2016-01 amends current guidance by: (i) requiring equity investments with readily determinable fair values to be measured at fair value with changes in fair value recognized in net income, (ii) allowing an entity to measure equity investments that do not have readily determinable fair values at either fair value or cost minus impairment, if any, plus or minus changes in observable prices, with changes in measurement recognized in net income, (iii) simplifying the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment, (iv) eliminating the requirement to disclose the methods and significant assumptions used to estimate the fair value for financial instruments measured at amortized cost on the balance sheet; (v) requiring use the of exit price notion when measuring the fair value of financial instruments for disclosure purposes; (vi) requiring recognition of changes in the fair value related to instrument-specific credit risk in other comprehensive income if the fair value option for financial liabilities is elected, (vii) requiring separate presentation in the financial statements of financial assets and financial liabilities by measurement category, and (8) clarifying that an entity should evaluate the need for a valuation allowance on deferred tax assets related to available-for-sale securities in combination with the entity’s other deferred tax assets. ASU 2016-01 is effective for interim and annual reporting periods beginning after December 15, 2017. Early application is permitted as of the beginning of the fiscal year of adoption only for items (iv) and (vi) above. Early adoption of the other items mentioned above is not permitted. The adoption of ASU 2016-01 is not expected to have a material impact on the Corporation's consolidated financial condition or results of operations.

Leases

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842) ("ASU 2016-02"). Under ASU 2016-02, the Corporation will be required to recognize the following for all leases (with the exception of short-term leases): (i) a right to use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term and (ii) a lease liability, which is a liability that represents lessee's obligation to make lease payments arising from a lease, measured on a discounted basis. ASU 2016-02 requires a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. ASU 2016-02 is effective for public companies for interim and annual periods beginning after December 15, 2018. The adoption of ASU 2016-02 is not expected to have a material impact on the Corporation's consolidated financial condition or results of operations.

Stock Compensation

In March 2016, the FASB issued ASU No. 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting ("ASU 2016-09"). ASU 2016-09 allows for simplification of several aspects of the accounting for share-based payment transactions including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. Under ASU 2016-09, all excess tax benefits and tax deficiencies (including tax benefits of dividends on share-based payment awards) should be recognized as income tax expense or benefit in the income statement. ASU 2016-09 also requires recognition of excess tax benefits regardless of whether the benefit reduces taxes payable in the current period. ASU 2016-09 further permits the withholding of an amount up to employees' maximum individual tax rate in the relevant jurisdiction without resulting in a liability classification. ASU 2016-09 also requires any excess tax benefits be classified along with other income tax cash flows as an operating activity and cash paid by an employer when directly withholding shares for tax-withholding purposes to be classified as a financing activity. ASU 2016-09 is effective for public

companies for interim and annual periods beginning after December 15, 2016. The Corporation is currently evaluating the impact of ASU 2016-09 on the Corporation's consolidated financial condition and results of operations.

Credit Losses

In June, the FASB issued ASU No. 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments ("ASU 2016-13"). ASU 2016-13 changes how entities will measure credit losses for most financial assets and certain other instruments that are not measured at fair value through net income. ASU 2016-13 requires an entity measure expected credit losses for financial assets over the estimated lifetime of expected credit loss and record an allowance that, when deducted from the amortized cost basis of the financial asset, presents the net amount expected to be collected on the financial asset. The standard includes the following core concepts in determining the expected credit loss estimate: (a) be based on an asset’s amortized cost (including premiums or discounts, net deferred fees and costs, foreign

exchange and fair value hedge accounting adjustments), (b) reflect losses expected over the remaining contractual life of an asset (considering the effect of voluntary prepayments), (c) consider available relevant information about the estimated collectability of cash flows (including information about past events, current conditions, and reasonable and supportable forecasts), and (d) reflect the risk of loss, even when that risk is remote.

ASU 2016-13 also amends the recording of purchased credit-deteriorated assets. Under the new guidance, an allowance will be recognized at acquisition through a gross-up approach whereby an entity will record as the initial amortized cost the sum of (a) the purchase price and (b) an estimate of credit losses as of the date of acquisition. In addition, the guidance also requires immediate recognition in earnings any subsequent changes, both favorable and unfavorable, in expected cash flows by adjusting this allowance.

ASU 2016-13 amends the impairment model for available-for-sale debt securities and requires entities to determine whether all or a portion of the unrealized loss on an available-for-sale debt security is a credit loss. Management may not use the length of time a security has been in an unrealized loss position as a factor in concluding whether a credit loss exists, as is currently permitted. In addition, an entity will recognize an allowance for credit losses on available-for-sale debt securities as a contra-account to the amortized cost basis rather than as a direct reduction of the amortized cost basis of the investment, as is currently required. As a result, entities will recognize improvements to credit losses on available-for-sale debt securities immediately in earnings rather than as interest income over time under current practice.

New disclosures required by ASU 2016-13 include: (a) for financial assets measured at amortized cost, an entity will be required to disclose information about how it developed its allowance, including changes in the factors that influenced management’s estimate of expected credit losses and the reasons for those changes, (b) for financial receivables and net investments in leases measured at amortized cost, an entity will be required to further disaggregate the information it currently discloses about the credit quality of these assets by year or the asset’s origination or vintage for as many as five annual periods, and (c) for available-for-sale debt securities, an entity will be required to provide a roll-forward of the allowance for credit losses and an aging analysis for securities that are past due.

Upon adoption of ASU 2016-13, a cumulative-effect adjustment to retained earnings will be recorded as of the beginning of the first reporting period in which the guidance is effective. ASU 2016-13 is effective for public companies for interim and annual periods beginning after December 15, 2019, with early adoption permitted for annual periods beginning after December 15, 2018. The Corporation is currently evaluating the provisions of ASU 2016-13 to determine the potential impact on the Corporation's consolidated financial condition and results of operations.

Note 2: Mergers and Acquisitions

Pending Merger with Talmer Bancorp, Inc.

On January 25, 2016, the Corporation entered into an Agreement and Plan of Merger with Talmer. Under the terms of the merger agreement, each Talmer shareholder will receive $1.61 in cash and 0.4725 shares of the Corporation's common stock for each share of Talmer common stock, subject to adjustment in limited circumstances. Based on the 30-day volume weighted price per share of the Corporation's common stock as of January 25, 2016, the merger had a transaction value of approximately $1.1 billion. Following the completion of the merger, the Corporation intends to consolidate Talmer's wholly-owned subsidiary bank, Talmer Bank and Trust, with and into Chemical Bank. At June 30, 2016, Talmer had total assets of $6.9 billion, total loans of $5.0 billion and total deposits of $5.3 billion, including brokered deposits of $389 million. Talmer Bank and Trust is a full service community bank offering a full suite of commercial banking, retail banking, mortgage banking, wealth management and trust services to small and medium-sized businesses and individuals through 80 full service banking offices located primarily within southeast Michigan and northeast Ohio, as well as in west Michigan, northeast Michigan, Chicago, Illinois, northern Indiana, and Las Vegas, Nevada. At a special meeting of Talmer shareholders, held on July 14, 2016, Talmer shareholders

approved the merger. And at a special meeting of Chemical shareholders, held on July 19, 2016, Chemical shareholders approved the merger. Completion of the merger is subject to regulatory approval, in addition to satisfaction of other customary closing conditions.

Acquisition of Lake Michigan Financial Corporation

On May 31, 2015, the Corporation acquired all the outstanding stock of Lake Michigan for total consideration of $187.4 million, which included stock consideration of $132.9 million and cash consideration of $54.5 million. As a result of the acquisition, the Corporation issued approximately 4.3 million shares of its common stock, based on an exchange ratio of 1.326 shares of its common stock, and paid $16.64 in cash, for each share of Lake Michigan common stock outstanding. Lake Michigan, a bank holding company which owned The Bank of Holland and The Bank of Northern Michigan, provided traditional banking services and products with five banking offices in Holland, Grand Haven, Grand Rapids, Petoskey and Traverse City, Michigan. The Bank of Holland and The Bank of Northern Michigan were consolidated with and into Chemical Bank on November 13, 2015.

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At the acquisition date, Lake Michigan added total assets of $1.24 billion, including total loans of $986 million, and total deposits of $925 million to the Corporation's consolidated statement of financial position. The Corporation recorded $101 million of goodwill, which was primarily attributable to the synergies and economies of scale expected from combining the operations of the Corporation and Lake Michigan. In addition, the Corporation recorded $8.6 million of core deposit and other intangible assets in conjunction with the acquisition. During the first quarter 2016, the Corporation obtained additional information regarding the valuation of deferred tax assets, which resulted in a decrease to goodwill recognized in the transaction of $0.5 million. In accordance with ASU 2015-16, no amounts were recorded in the consolidated statements of income during 2016 for these adjustments that would have been recorded in a previous reporting period had these adjustments been recognized as of the acquisition date.
Upon acquisition, the Lake Michigan loan portfolio had contractually required principal and interest payments receivable of $1.01 billion and $190.2 million, respectively, expected principal and interest cash flows of $986.1 million and $189.6 million, respectively, and a fair value of $985.5 million. The difference between the contractually required payments receivable and the expected cash flows represents the nonaccretable difference, which totaled $22.6 million at the acquisition date, with $22.0 million attributable to expected credit losses. The difference between the expected cash flows and fair value represents the accretable yield, which totaled $190.2 million at the date of acquisition. The outstanding contractual principal balance and the carrying amount of the Lake Michigan acquired loan portfolio were $756 million and $734 million, respectively, at June 30, 2016, compared to $864 million and $842 million, respectively, at December 31, 2015 and $990 million and $967 million, respectively, at June 30, 2015. There was no related allowance for loan losses at those dates.
Acquisition of Monarch Community Bancorp, Inc.
On April 1, 2015, the Corporation acquired all of the outstanding stock of Monarch in an all-stock transaction valued at $27.2 million. As a result of the acquisition, the Corporation issued 860,575 shares of its common stock based on an exchange ratio of 0.0982 shares of its common stock for each share of Monarch common stock outstanding. Monarch, a bank holding company, owned Monarch Community Bank, which operated five full service branch offices in Coldwater, Marshall, Hillsdale and Union City, Michigan. Monarch Community Bank was consolidated with and into Chemical Bank on May 8, 2015.
As of the April 1, 2015 acquisition date, Monarch added total assets of $183 million, including total loans of $122 million, and total deposits of $144 million to the Corporation's consolidated statement of financial position. In connection with the acquisition of Monarch, the Corporation recorded $5.3 million of goodwill, which was primarily attributable to the synergies and economies of scale expected from combining the operations of the Corporation and Monarch. In addition, the Corporation recorded $1.9 million of core deposit intangible assets in conjunction with the acquisition.
Upon acquisition, the Monarch loan portfolio had contractually required principal and interest payments receivable of $128.9 million and $37.8 million, respectively, expected principal and interest cash flows of $122.6 million and $37.1 million, respectively, and a fair value of $121.8 million. The difference between the contractually required payments receivable and the expected cash flows represents the nonaccretable difference, which totaled $7.1 million at the acquisition date, with $6.3 million attributable to expected credit losses. The difference between the expected cash flows and fair value represents the accretable yield, which totaled $37.9 million at the date of acquisition. The outstanding contractual principal balance and the carrying amount of the Monarch acquired loan portfolio were $101 million and $94 million, respectively, at June 30, 2016, compared to $115 million and $108 million, respectively, at December 31, 2015 and $126 million and $119 million, respectively, at June 30, 2015. There was no related allowance for loan losses at those dates.
Acquisition of Northwestern Bancorp, Inc.

On October 31, 2014, the Corporation acquired all of the outstanding stock of Northwestern Bancorp, Inc. (Northwestern) for total cash consideration of $121 million. Northwestern, a bank holding company which owned Northwestern Bank, provided traditional banking services and products through 25 banking offices serving communities in the northwestern lower peninsula of Michigan. At the acquisition date, Northwestern added total assets of $815 million, including total loans of $475 million, and total deposits of $794 million to the Corporation. Northwestern Bank was consolidated with and into Chemical Bank as of the acquisition date. In connection with the acquisition of Northwestern, the Corporation recorded $60.3 million of goodwill, which was primarily attributable to the synergies and economies of scale expected from combining the operations of the Corporation and Northwestern. In addition, the Corporation recorded $12.9 million of core deposit intangible assets in conjunction with the acquisition.

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Upon acquisition, the Northwestern loan portfolio had contractually required principal and interest payments receivable of $507 million and $112 million, respectively, expected principal and interest cash flows of $481 million and $104 million, respectively, and a fair value of $475 million. The difference between the contractually required payments receivable and the expected cash flows represents the nonaccretable difference, which totaled $34 million at the acquisition date, with $26 million attributable to expected credit losses. The difference between the expected cash flows and fair value represents the accretable yield, which totaled $110 million at the acquisition date. The outstanding contractual principal balance and the carrying amount of the Northwestern acquired loan portfolio were $305 million and $275 million, respectively, at June 30, 2016, compared to $361 million and $330 million, respectively, at December 31, 2015 and $415 million and $382 million, respectively, at June 30, 2015.

Acquisition of 21 Branches

On December 7, 2012, Chemical Bank acquired 21 branches from Independent Bank, a subsidiary of Independent Bank Corporation, located in the Northeast and Battle Creek regions of Michigan, including $404 million in deposits and $44 million in loans (branch acquisition transaction). The purchase price of the branch offices, including equipment, was $8.1 million and the Corporation paid a premium on deposits of $11.5 million, or approximately 2.85% of total deposits. The loans were purchased at a discount of 1.75%. In connection with the branch acquisition transaction, the Corporation recorded goodwill of $6.8 million and other intangible assets attributable to customer core deposits of $5.6 million.

Acquisition of O.A.K. Financial Corporation

On April 30, 2010, the Corporation acquired OAK in an all-stock transaction for total consideration of $83.7 million. OAK provided traditional banking services and products through 14 banking offices serving communities in Ottawa, Allegan and Kent counties in west Michigan. At the acquisition date, OAK added total assets of $820 million, including total loans of $627 million, and total deposits of $693 million, including brokered deposits of $193 million. Upon acquisition, the OAK loan portfolio had contractually required principal payments receivable of $683 million and a fair value of $627 million. The outstanding contractual principal balance and the carrying amount of the OAK acquired loan portfolio were $182 million and $166 million, respectively, at June 30, 2016, compared to $204 million and $183 million, respectively, at December 31, 2015 and $236 million and $215 million, respectively, at June 30, 2015.

Accretable Yield

Activity for the accretable yield, which includes contractually due interest for acquired loans that have been renewed or extended since the date of acquisition and continue to be accounted for in loan pools in accordance with ASC 310-30, follows:

	Lake Michigan	Monarch	North-western	OAK	Total
Six Months Ended June 30, 2016	(In thousands)				
Balance at beginning of period	$152,999	$34,558	$ 82,623	$28,077	$298,257
Additions (reductions)*	(10,365)	(863)	(5,848)	(201)	(17,277)
Accretion recognized in interest income	(17,291)	(2,836)	(8,029)	(6,284)	(34,440)
Reclassification from nonaccretable difference	—	—	5,000	5,000	10,000
Balance at end of period	$125,343	$30,859	$ 73,746	$26,592	$256,540
Six Months Ended June 30, 2015					
Balance at beginning of period	$—	$—	$ 104,675	$33,286	$137,961
Additions attributable to acquisitions	190,246	37,914	—	—	228,160
Additions (reductions)*	1,550	(1,141)	(2,859)	5,215	2,765

Accretion recognized in interest income	(3,486)	(968)	(10,058)	(6,326)	(20,838)
Balance at end of period	$188,310	$35,805	$ 91,758	$32,175	$348,048

*Represents additions of estimated contractual interest expected to be collected from acquired loans being renewed or extended, less reductions in contractual interest resulting from the early payoff of acquired loans.

As part of its ongoing assessment of the acquired loan portfolios, management has determined that the overall credit quality of the Northwestern and OAK acquired loan portfolios has improved, which has resulted in an improvement in expected cash flows of certain loan pools in these acquired loan portfolios. Accordingly, management reclassified $5.0 million during the three months ended June 30, 2016 from the nonaccretable difference to the accretable yield for each of these acquired loan portfolios, which will increase amounts recognized into interest income over the estimated remaining lives of the loan pools within these portfolios.

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Note 3: Investment Securities

The following is a summary of the amortized cost and fair value of investment securities available-for-sale and investment securities held-to-maturity at June 30, 2016, December 31, 2015 and June 30, 2015:

	Investment Securities Available-for-Sale			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
	(In thousands)			
June 30, 2016				
U.S. Treasury securities	$5,781	$ 29	$ —	$5,810
Government sponsored agencies	156,843	715	536	157,022
State and political subdivisions	12,901	319	—	13,220
Residential mortgage-backed securities	166,582	2,034	—	168,616
Collateralized mortgage obligations	100,433	611	195	100,849
Corporate bonds	9,746	30	64	9,712
Preferred stock and trust preferred securities	2,888	436	1	3,323
Total	$455,174	$ 4,174	$ 796	$458,552
December 31, 2015				
U.S. Treasury securities	$5,773	$ —	$ 8	$5,765
Government sponsored agencies	195,711	78	800	194,989
State and political subdivisions	14,731	395	6	15,120
Residential mortgage-backed securities	189,452	538	2,222	187,768
Collateralized mortgage obligations	133,256	111	1,137	132,230
Corporate bonds	14,825	2	200	14,627
Preferred stock and trust preferred securities	2,888	344	—	3,232
Total	$556,636	$ 1,468	$ 4,373	$553,731
June 30, 2015				
U.S. Treasury securities	$8,270	$ 24	$ —	$8,294
Government sponsored agencies	227,424	683	200	227,907
State and political subdivisions	26,476	503	14	26,965
Residential mortgage-backed securities	213,621	742	1,694	212,669
Collateralized mortgage obligations	167,768	245	981	167,032
Corporate bonds	39,680	76	78	39,678
Preferred stock and trust preferred securities	2,889	272	—	3,161
Total	$686,128	$ 2,545	$ 2,967	$685,706

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	Investment Securities Held-to-Maturity			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
	(In thousands)			
June 30, 2016				
State and political subdivisions	$552,328	$ 16,123	$ 321	$568,130
Trust preferred securities	500	—	215	285
Total	$552,828	$ 16,123	$ 536	$568,415
December 31, 2015				
State and political subdivisions	$509,471	$ 7,446	$ 4,512	$512,405
Trust preferred securities	500	—	200	300
Total	$509,971	$ 7,446	$ 4,712	$512,705
June 30, 2015				
State and political subdivisions	$469,337	$ 4,853	$ 7,912	$466,278
Trust preferred securities	500	—	200	300
Total	$469,837	$ 4,853	$ 8,112	$466,578

The majority of the Corporation's residential mortgage-backed securities and collateralized mortgage obligations are backed by a U.S. government agency (Government National Mortgage Association) or a government sponsored enterprise (Federal Home Loan Mortgage Corporation or Federal National Mortgage Association).

The following is a summary of the amortized cost and fair value of investment securities at June 30, 2016, by maturity, for both available-for-sale and held-to-maturity investment securities. The maturities of residential mortgage-backed securities and collateralized mortgage obligations are based on scheduled principal payments. The maturities of all other debt securities are based on final contractual maturity.

	June 30, 2016	
	Amortized Cost	Fair Value
	(In thousands)	
Investment Securities Available-for-Sale:		
Due in one year or less	$154,820	$155,386
Due after one year through five years	257,040	258,856
Due after five years through ten years	37,877	38,374
Due after ten years	4,049	4,112
Preferred stock	1,388	1,824
Total	$455,174	$458,552
Investment Securities Held-to-Maturity:		
Due in one year or less	$59,330	$59,633
Due after one year through five years	275,988	280,491
Due after five years through ten years	130,304	136,879
Due after ten years	87,206	91,412
Total	$552,828	$568,415

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The following schedule summarizes information for both available-for-sale and held-to-maturity investment securities with gross unrealized losses at June 30, 2016, December 31, 2015 and June 30, 2015, aggregated by category and length of time that individual securities have been in a continuous unrealized loss position.

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	(In thousands)					
June 30, 2016						
Government sponsored agencies	$14,110	$ 19	$18,787	$ 517	$32,897	$ 536
State and political subdivisions	73,532	237	25,713	84	99,245	321
Collateralized mortgage obligations	8,461	13	22,955	182	31,416	195
Corporate bonds	—	—	4,936	64	4,936	64
Preferred stock and trust preferred securities	1,499	1	285	215	1,784	216
Total	$97,602	$ 270	$72,676	$ 1,062	$170,278	$ 1,332
December 31, 2015						
U.S. Treasury securities	$5,765	$ 8	$—	$ —	$5,765	$ 8
Government sponsored agencies	114,640	292	21,681	508	136,321	800
State and political subdivisions	195,285	2,891	68,361	1,627	263,646	4,518
Residential mortgage-backed securities	169,226	2,146	3,435	76	172,661	2,222
Collateralized mortgage obligations	60,459	408	39,382	729	99,841	1,137
Corporate bonds	9,532	200	—	—	9,532	200
Trust preferred securities	—	—	300	200	300	200
Total	$554,907	$ 5,945	$133,159	$ 3,140	$688,066	$ 9,085
June 30, 2015						
Government sponsored agencies	$24,789	$ 163	$14,715	$ 37	$39,504	$ 200
State and political subdivisions	258,503	5,433	63,584	2,493	322,087	7,926
Residential mortgage-backed securities	187,858	1,592	3,643	102	191,501	1,694
Collateralized mortgage obligations	49,845	155	48,881	826	98,726	981
Corporate bonds	9,670	49	14,971	29	24,641	78
Trust preferred securities	—	—	300	200	300	200
Total	$530,665	$ 7,392	$146,094	$ 3,687	$676,759	$ 11,079

An assessment is performed quarterly by the Corporation to determine whether unrealized losses in its investment securities portfolio are temporary or other-than-temporary by carefully considering all reasonably available information. The Corporation reviews factors such as financial statements, credit ratings, news releases and other pertinent information of the underlying issuer or company to make its determination. Management did not believe any individual unrealized loss on any investment security, as of June 30, 2016, represented an other-than-temporary impairment (OTTI). Management believed that the unrealized losses on investment securities at June 30, 2016 were temporary in nature and due primarily to changes in interest rates and reduced market liquidity and not as a result of credit-related issues.

At June 30, 2016, the Corporation did not have the intent to sell any of its impaired investment securities and believed that it was more-likely-than-not that the Corporation will not have to sell any such investment securities before a full recovery of amortized cost. Accordingly, at June 30, 2016, the Corporation believed the impairments in its investment securities portfolio were temporary in nature. However, there is no assurance that OTTI may not occur in the future.

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Note 4: Loans

Loan portfolio segments are defined as the level at which an entity develops and documents a systematic methodology to determine its allowance. The Corporation has two loan portfolio segments (commercial loans and consumer loans) that it uses in determining the allowance. Both quantitative and qualitative factors are used by management at the loan portfolio segment level in determining the adequacy of the allowance for the Corporation. Classes of loans are a disaggregation of an entity's loan portfolio segments. Classes of loans are defined as a group of loans which share similar initial measurement attributes, risk characteristics, and methods for monitoring and assessing credit risk. The Corporation has six classes of loans, which are set forth below.

Commercial — Loans and lines of credit to varying types of businesses, including municipalities, school districts and nonprofit organizations, for the purpose of supporting working capital, operational needs and term financing of equipment. Repayment of such loans is generally provided through operating cash flows of the business. Commercial loans are predominately secured by equipment, inventory, accounts receivable, personal guarantees of the owner and other sources of repayment, although the Corporation may also secure commercial loans with real estate.

Commercial real estate — Loans secured by real estate occupied by the borrower for ongoing operations, non-owner occupied real estate leased to one or more tenants and vacant land that has been acquired for investment or future land development.

Real estate construction and land development — Real estate construction loans represent secured loans for the construction of business properties. Real estate construction loans often convert to a commercial real estate loan at the completion of the construction period. Land development loans represent secured development loans made to borrowers for the purpose of infrastructure improvements to vacant land to create finished marketable residential and commercial lots/land. Most land development loans are originated with the intention that the loans will be paid through the sale of developed lots/land by the developers within twelve months of the completion date. Land development loans are primarily comprised of loans to develop residential properties.

Residential mortgage — Loans secured by one- to four-family residential properties, generally with fixed interest rates for periods of fifteen years or less. The loan-to-value ratio at the time of origination is generally 80% or less. Residential mortgage loans with a loan-to-value ratio of more than 80% generally require private mortgage insurance.

Consumer installment — Loans to consumers primarily for the purpose of acquiring automobiles, recreational vehicles and personal watercraft and comprised primarily of indirect loans purchased from dealers. These loans consist of relatively small amounts that are spread across many individual borrowers.

Home equity — Loans and lines of credit whereby consumers utilize equity in their personal residence, generally through a second mortgage, as collateral to secure the loan.

Commercial, commercial real estate, real estate construction and land development loans are referred to as the Corporation's commercial loan portfolio, while residential mortgage, consumer installment and home equity loans are referred to as the Corporation's consumer loan portfolio. A summary of loans follows:

	June 30, 2016	December 31, 2015	June 30, 2015
	(In thousands)		
Commercial loan portfolio:			
Commercial	$1,953,301	$ 1,905,879	$1,754,873
Commercial real estate	2,157,733	2,112,162	2,243,513
Real estate construction and land development	285,848	232,076	112,312
Subtotal	4,396,882	4,250,117	4,110,698
Consumer loan portfolio:			
Residential mortgage	1,494,192	1,429,636	1,310,167

Consumer installment	1,048,622	877,457	887,907
Home equity	707,573	713,937	725,971
Subtotal	3,250,387	3,021,030	2,924,045
Total loans	$7,647,269	$ 7,271,147	$7,034,743

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Credit Quality Monitoring

The Corporation maintains loan policies and credit underwriting standards as part of the process of managing credit risk. These standards include making loans generally only within the Corporation's market areas. The Corporation's lending markets generally consist of communities across the lower peninsula of Michigan, except for the southeastern portion of Michigan. The Corporation has no foreign loans.

The Corporation, through Chemical Bank, has a commercial loan portfolio approval process involving underwriting and individual and group loan approval authorities to consider credit quality and loss exposure at loan origination. The loans in the Corporation's commercial loan portfolio are risk rated at origination based on the grading system set forth below. The approval authority of relationship managers is established based on experience levels, with credit decisions greater than $1.0 million requiring group loan authority approval, except for six executive and senior officers who have varying loan limits exceeding $1.5 million and up to $3.5 million. With respect to the group loan authorities, Chemical Bank has a loan committee, consisting of certain executive and senior officers, that meets weekly to consider loans ranging in amounts from $1.0 million to $10.0 million, depending on risk rating and credit action required. A directors' loan committee of Chemical Bank, consisting of eight independent members of the board of directors of Chemical Bank, the chief executive officer of Chemical Bank and the senior credit officer of Chemical Bank, meets bi-weekly to consider loans in amounts over $10.0 million, and certain loans under $10.0 million depending on a loan's risk rating and credit action required. Loans over $15.0 million require the approval of the board of directors of Chemical Bank.

The majority of the Corporation's consumer loan portfolio is comprised of secured loans that are relatively small. The Corporation's consumer loan portfolio has a centralized approval process which utilizes standardized underwriting criteria. The ongoing measurement of credit quality of the consumer loan portfolio is largely done on an exception basis. If payments are made on schedule, as agreed, then no further monitoring is performed. However, if delinquency occurs, the delinquent loans are turned over to the Corporation's collection department for resolution, resulting in repossession or foreclosure if payments are not brought current. Credit quality for the entire consumer loan portfolio is measured by the periodic delinquency rate, nonaccrual amounts and actual losses incurred.

Loans in the commercial loan portfolio tend to be larger and more complex than those in the consumer loan portfolio, and therefore, are subject to more intensive monitoring. All loans in the commercial loan portfolio have an assigned relationship manager, and most borrowers provide periodic financial and operating information that allows the relationship managers to stay abreast of credit quality during the life of the loans. The risk ratings of loans in the commercial loan portfolio are reassessed at least annually, with loans below an acceptable risk rating reassessed more frequently and reviewed by various loan committees within the Corporation at least quarterly.

The Corporation maintains a centralized independent loan review function that monitors the approval process and ongoing asset quality of the loan portfolio, including the accuracy of loan grades. The Corporation also maintains an independent appraisal review function that participates in the review of all appraisals obtained by the Corporation for loans in the commercial loan portfolio.

Credit Quality Indicators

Commercial Loan Portfolio

The Corporation uses a nine grade risk rating system to monitor the ongoing credit quality of its commercial loan portfolio. These loan grades rank the credit quality of a borrower by measuring liquidity, debt capacity, coverage and payment behavior as shown in the borrower's financial statements. The loan grades also measure the quality of the borrower's management and the repayment support offered by any guarantors. A summary of the Corporation's loan grades (or characteristics of the loans within each grade) follows:

Risk Grades 1-5 (Acceptable Credit Quality) — All loans in risk grades 1 through 5 are considered to be acceptable credit risks by the Corporation and are grouped for purposes of allowance for loan loss considerations and financial

reporting. The five grades essentially represent a ranking of loans that are all viewed to be of acceptable credit quality, taking into consideration the various factors mentioned above, but with varying degrees of financial strength, debt coverage, management and factors that could impact credit quality. Business credits within risk grades 1 through 5 range from Risk Grade 1: Prime Quality (factors include: excellent business credit; excellent debt capacity and coverage; outstanding management; strong guarantors; superior liquidity and net worth; favorable loan-to-value ratios; debt secured by cash or equivalents, or backed by the full faith and credit of the U.S. Government) to Risk Grade 5: Acceptable Quality With Care (factors include: acceptable business credit, but with added risk due to specific industry or internal situations).

Risk Grade 6 (Watch) — A business credit that is not acceptable within the Corporation's loan origination criteria; cash flow may not be adequate or is continually inconsistent to service current debt; financial condition has deteriorated as company trends/management have become inconsistent; the company is slow in furnishing quality financial information; working capital needs of the company are reliant on short-term borrowings; personal guarantees are weak and/or with little or no liquidity; the net worth of the company has deteriorated after recent or continued losses; the loan requires constant monitoring and attention from the Corporation; payment delinquencies becoming more serious; if left uncorrected, these potential weaknesses may, at some future date, result in deterioration of repayment prospects.
Risk Grade 7 (Substandard — Accrual) — A business credit that is inadequately protected by the current financial net worth and paying capacity of the obligor or of the collateral pledged, if any; management has deteriorated or has become non-existent; quality financial information is not available; a high level of maintenance is required by the Corporation; cash flow can no longer support debt requirements; loan payments are continually and/or severely delinquent; negative net worth; personal guaranty has become insignificant; a credit that has a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. The Corporation still expects a full recovery of all contractual principal and interest payments; however, a possibility exists that the Corporation will sustain some loss if deficiencies are not corrected.
Risk Grade 8 (Substandard — Nonaccrual) — A business credit accounted for on a nonaccrual basis that has all the weaknesses inherent in a loan classified as risk grade 7 with the added characteristic that the weaknesses are so pronounced that, on the basis of current financial information, conditions and values, collection in full is highly questionable; a partial loss is possible and interest is no longer being accrued. This loan meets the definition of an impaired loan. The risk of loss requires analysis to determine whether a valuation allowance needs to be established.
Risk Grade 9 (Substandard — Doubtful) — A business credit that has all the weaknesses inherent in a loan classified as risk grade 8 and interest is no longer being accrued, but additional deficiencies make it highly probable that liquidation will not satisfy the majority of the obligation; the primary source of repayment is nonexistent and there is doubt as to the value of the secondary source of repayment; the possibility of loss is likely, but current pending factors could strengthen the credit. This loan meets the definition of an impaired loan. A loan charge-off is recorded when management deems an amount uncollectible; however, the Corporation will establish a valuation allowance for probable losses, if required.
The Corporation considers all loans graded 1 through 5 as acceptable credit risks and structures and manages such relationships accordingly. Periodic financial and operating data combined with regular loan officer interactions are deemed adequate to monitor borrower performance. Loans graded 6 and 7 are considered higher-risk credits than loans graded 1 through 5 and the frequency of loan officer contact and receipt of financial data is increased to stay abreast of borrower performance. Loans graded 8 and 9 are considered problematic and require special care. Further, loans graded 6 through 9 are managed and monitored regularly through a number of processes, procedures and committees, including oversight by a loan administration committee comprised of executive and senior management of the Corporation, and include highly structured reporting of financial and operating data, intensive loan officer intervention and strategies to exit, as well as potential management by the Corporation's special assets group.
The following schedule presents the recorded investment of loans in the commercial loan portfolio by risk rating categories at June 30, 2016, December 31, 2015 and June 30, 2015:

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	Commercial	Commercial Real Estate	Real Estate Construction and Land Development	Total
	(In thousands)			
June 30, 2016				
Originated Portfolio:				
Risk Grades 1-5	$1,537,612	$1,479,365	$ 239,194	$3,256,171
Risk Grade 6	46,202	36,814	843	83,859
Risk Grade 7	35,602	15,434	517	51,553
Risk Grade 8	14,577	21,324	496	36,397
Risk Grade 9	—	1	—	1
Subtotal	1,633,993	1,552,938	241,050	3,427,981
Acquired Portfolio:				
Risk Grades 1-5	292,492	554,352	40,671	887,515
Risk Grade 6	15,352	20,746	1,500	37,598
Risk Grade 7	8,448	23,879	1,229	33,556
Risk Grade 8	3,016	5,818	1,398	10,232
Risk Grade 9	—	—	—	—
Subtotal	319,308	604,795	44,798	968,901
Total	$1,953,301	$2,157,733	$ 285,848	$4,396,882
December 31, 2015				
Originated Portfolio:				
Risk Grades 1-5	$1,418,301	$1,341,202	$ 183,323	$2,942,826
Risk Grade 6	34,727	31,036	180	65,943
Risk Grade 7	39,933	26,658	1,123	67,714
Risk Grade 8	26,459	25,163	521	52,143
Risk Grade 9	2,095	—	—	2,095
Subtotal	1,521,515	1,424,059	185,147	3,130,721
Acquired Portfolio:				
Risk Grades 1-5	340,782	629,430	41,683	1,011,895
Risk Grade 6	28,321	23,926	2,556	54,803
Risk Grade 7	11,607	29,975	1,537	43,119
Risk Grade 8	3,654	4,772	1,153	9,579
Risk Grade 9	—	—	—	—
Subtotal	384,364	688,103	46,929	1,119,396
Total	$1,905,879	$2,112,162	$ 232,076	$4,250,117
June 30, 2015				
Originated Portfolio:				
Risk Grades 1-5	$1,269,091	$1,273,725	$ 97,364	$2,640,180
Risk Grade 6	32,189	34,677	433	67,299
Risk Grade 7	41,316	29,737	2,127	73,180
Risk Grade 8	17,260	25,283	502	43,045
Risk Grade 9	—	4	—	4

Subtotal	1,359,856	1,363,426	100,426	2,823,708
Acquired Portfolio:				
Risk Grades 1-5	347,914	820,400	10,139	1,178,453
Risk Grade 6	29,412	22,796	71	52,279
Risk Grade 7	13,910	30,288	119	44,317
Risk Grade 8	3,781	6,603	1,557	11,941
Risk Grade 9	—	—	—	—
Subtotal	395,017	880,087	11,886	1,286,990
Total	$1,754,873	$2,243,513	$ 112,312	$4,110,698

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Consumer Loan Portfolio

The Corporation evaluates the credit quality of loans in the consumer loan portfolio based on the performing or nonperforming status of the loan. Loans in the consumer loan portfolio that are performing in accordance with original contractual terms and are less than 90 days past due and accruing interest are considered to be in a performing status, while those that are in nonaccrual status, contractually past due 90 days or more as to interest or principal payments or classified as a nonperforming TDR are considered to be in a nonperforming status. Nonaccrual TDRs in the consumer loan portfolio are included with nonaccrual loans, while other TDRs in the consumer loan portfolio are considered to be in a nonperforming status until they meet the Corporation's definition of a performing TDR, at which time they are considered to be in a performing status.

The following schedule presents the recorded investment of loans in the consumer loan portfolio based on loans in a performing status and loans in a nonperforming status at June 30, 2016, December 31, 2015 and June 30, 2015:

	Residential Mortgage	Consumer Installment	Home Equity	Total Consumer
	(In thousands)			
June 30, 2016				
Originated Loans:				
Performing	$1,299,382	$1,041,978	$ 598,283	$2,939,643
Nonperforming	7,983	285	3,042	11,310
Subtotal	1,307,365	1,042,263	601,325	2,950,953
Acquired Loans:				
Performing	185,492	6,298	105,360	297,150
Nonperforming	1,335	61	888	2,284
Subtotal	186,827	6,359	106,248	299,434
Total	$1,494,192	$1,048,622	$ 707,573	$3,250,387
December 31, 2015				
Originated Loans:				
Performing	$1,207,945	$868,975	$ 587,566	$2,664,486
Nonperforming	9,030	451	3,246	12,727
Subtotal	1,216,975	869,426	590,812	2,677,213
Acquired Loans:				
Performing	210,580	7,984	122,118	340,682
Nonperforming	2,081	47	1,007	3,135
Subtotal	212,661	8,031	123,125	343,817
Total	$1,429,636	$877,457	$ 713,937	$3,021,030
June 30, 2015				
Originated Loans:				