PROASSURANCE CORP
Form 10-Q
May 03, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)
ýQuarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended March 31, 2018 or
¨Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from to
Commission file number 0-16533
ProAssurance Corporation
(Exact Name of Registrant as Specified in Its Charter)

| | |
|---|---|
| Delaware | 63-1261433 |
| (State or Other Jurisdiction of Incorporation or Organization) | (IRS Employer Identification No.) |
| 100 Brookwood Place, Birmingham, AL | 35209 |
| (Address of Principal Executive Offices) | (Zip Code) |
| (205) 877-4400 | |
| (Registrant's Telephone Number, Including Area Code) | (Former Name, Former Address, and Former Fiscal Year, if Changed Since Last Report) |

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§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 ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

| | | | |
|---|---|---|---|
| Large accelerated filer | ý | Accelerated filer | ¨ |
| Non-accelerated filer | ¨ (Do not check if a smaller reporting company) | Smaller reporting company | ¨ |
| Emerging growth company | ¨ | | |

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No ý
As of April 30, 2018, there were 53,593,712 shares of the registrant's common stock outstanding.

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Glossary of Terms and Acronyms

When the following terms and acronyms appear in the text of this report, they have the meanings indicated below.

| Term | Meaning |
|---|---|
| AOCI | Accumulated other comprehensive income (loss) |
| ASU | Accounting Standards Update |
| BEAT | Base erosion anti-abuse tax |
| Board | Board of Directors of ProAssurance Corporation |
| BOLI | Business owned life insurance |
| Council of Lloyd's | The governing body for Lloyd's of London |
| DPAC | Deferred policy acquisition costs |
| Eastern Re | Eastern Re, LTD, S.P.C. |
| EBUB | Earned but unbilled premium |
| FAL | Funds at Lloyd's |
| FASB | Financial Accounting Standards Board |
| FHLB | Federal Home Loan Bank |
| FHLMC | Federal Home Loan Mortgage Corporation |
| FNMA | Federal National Mortgage Association |
| GAAP | Generally accepted accounting principles in the United States of America |
| GNMA | Government National Mortgage Association |
| HCPL | Healthcare professional liability |
| IBNR | Incurred but not reported |
| Inova Re | Inova Re, LTD, S.P.C. |
| IRS | Internal Revenue Service |
| LIBOR | London Interbank Offered Rate |
| LLC | Limited liability company |
| Lloyd's | Lloyd's of London market |
| LP | Limited partnership |
| Medical technology liability | Medical technology and life sciences products liability |
| NAV | Net asset value |
| NOL | Net operating loss |
| NRSRO | Nationally recognized statistical rating organization |
| NYSE | New York Stock Exchange |
| OCI | Other comprehensive income (loss) |
| OTTI | Other-than-temporary impairment |
| PCAOB | Public Company Accounting Oversight Board |
| Revolving Credit Agreement | ProAssurance's $250 million revolving credit agreement |
| ROE | Return on equity |
| SEC | Securities and Exchange Commission |
| SPA | Special Purpose Arrangement |
| SPC | Segregated portfolio cell |
| Specialty P&C | Specialty Property and Casualty |
| Syndicate 1729 | Lloyd's of London Syndicate 1729 |
| Syndicate 6131 | Lloyd's of London Syndicate 6131, a Special Purpose Arrangement with Lloyd's of London Syndicate 1729 |
| Syndicate Credit Agreement | Unconditional revolving credit agreement with the Premium Trust Fund of Syndicate 1729 |

| | |
|---|---|
| TCJA | Tax Cuts and Jobs Act H.R.1 of 2017 |

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| Term | Meaning |
|---|---|
| U.K. | United Kingdom of Great Britain and Northern Ireland |
| VIE | Variable interest entity |

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Caution Regarding Forward-Looking Statements

Any statements in this Form 10-Q that are not historical facts are specifically identified as forward-looking statements. These statements are based upon our estimates and anticipation of future events and are subject to significant risks, assumptions and uncertainties that could cause actual results to vary materially from the expected results described in the forward-looking statements. Forward-looking statements are identified by words such as, but not limited to, "anticipate," "believe," "estimate," "expect," "hope," "hopeful," "intend," "likely," "may," "optimistic," "possible," "potential," "preliminary," "project," "should," "will" and other analogous expressions. There are numerous factors that could cause our actual results to differ materially from those in the forward-looking statements. Thus, sentences and phrases that we use to convey our view of future events and trends are expressly designated as forward-looking statements as are sections of this Form 10-Q that are identified as giving our outlook on future business.

Forward-looking statements relating to our business include among other things: statements concerning future liquidity and capital requirements, investment valuation and performance, return on equity, financial ratios, net income, premiums, losses and loss reserve, premium rates and retention of current business, competition and market conditions, the expansion of product lines, the development or acquisition of business in new geographical areas, the availability of acceptable reinsurance, actions by regulators and rating agencies, court actions, legislative actions, payment or performance of obligations under indebtedness, payment of dividends and other matters.

These forward-looking statements are subject to significant risks, assumptions and uncertainties, including, among other things, the following factors that could affect the actual outcome of future events:

changes in general economic conditions, including the impact of inflation or deflation and unemployment;

our ability to maintain our dividend payments;

regulatory, legislative and judicial actions or decisions that could affect our business plans or operations;

the enactment or repeal of tort reforms;

formation or dissolution of state-sponsored insurance entities providing coverages now offered by ProAssurance which could remove or add sizable numbers of insureds from or to the private insurance market;

changes in the interest and tax rate environment;

resolution of uncertain tax matters and changes in tax laws, including the impact of the TCJA;

changes in U.S. laws or government regulations regarding financial markets or market activity that may affect the U.S. economy and our business;

changes in the ability of the U.S. government to meet its obligations that may affect the U.S. economy and our business;

performance of financial markets affecting the fair value of our investments or making it difficult to determine the value of our investments;

changes in requirements or accounting policies and practices that may be adopted by our regulatory agencies, the FASB, the SEC, the PCAOB or the NYSE that may affect our business;

changes in laws or government regulations affecting the financial services industry, the property and casualty insurance industry or particular insurance lines underwritten by our subsidiaries;

the effect on our insureds, particularly the insurance needs of our insureds, and our loss costs, of changes in the healthcare delivery system and/or changes in the U.S. political climate that may affect healthcare policy or our business;

consolidation of our insureds into or under larger entities which may be insured by competitors, or may not have a risk profile that meets our underwriting criteria or which may not use external providers for insuring or otherwise managing substantial portions of their liability risk;

uncertainties inherent in the estimate of our loss and loss adjustment expense reserve and reinsurance recoverable;

changes in the availability, cost, quality or collectability of insurance/reinsurance;

the results of litigation, including pre- or post-trial motions, trials and/or appeals we undertake;

effects on our claims costs from mass tort litigation that are different from that anticipated by us;

allegations of bad faith which may arise from our handling of any particular claim, including failure to settle;

loss or consolidation of independent agents, agencies, brokers or brokerage firms;

changes in our organization, compensation and benefit plans;

changes in the business or competitive environment may limit the effectiveness of our business strategy and impact our revenues;

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our ability to retain and recruit senior management;
the availability, integrity and security of our technology infrastructure or that of our third-party providers of technology infrastructure, including any susceptibility to cyber-attacks which might result in a loss of information or operating capability;
the impact of a catastrophic event, as it relates to both our operations and our insured risks;
the impact of acts of terrorism and acts of war;
the effects of terrorism-related insurance legislation and laws;
guaranty funds and other state assessments;
our ability to achieve continued growth through expansion into new markets or through acquisitions or business combinations;
changes to the ratings assigned by rating agencies to our insurance subsidiaries, individually or as a group;
provisions in our charter documents, Delaware law and state insurance laws may impede attempts to replace or remove management or may impede a takeover;
state insurance restrictions may prohibit assets held by our insurance subsidiaries, including cash and investment securities, from being used for general corporate purposes;
taxing authorities can take exception to our tax positions and cause us to incur significant amounts of legal and accounting costs and, if our defense is not successful, additional tax costs, including interest and penalties; and
expected benefits from completed and proposed acquisitions may not be achieved or may be delayed longer than expected due to business disruption; loss of customers, employees or key agents; increased operating costs or inability to achieve cost savings; and assumption of greater than expected liabilities, among other reasons.

Additional risks, assumptions and uncertainties that could arise from our membership in the Lloyd's market and our participation in Lloyd's Syndicates include, but are not limited to, the following:

members of Lloyd's are subject to levies by the Council of Lloyd's based on a percentage of the member's underwriting capacity, currently a maximum of 3%, but can be increased by Lloyd's;
Syndicate operating results can be affected by decisions made by the Council of Lloyd's which the management of Syndicate 1729 and Syndicate 6131 have little ability to control, such as a decision to not approve the business plan of Syndicate 1729 or Syndicate 6131, or a decision to increase the capital required to continue operations, and by our obligation to pay levies to Lloyd's;
Lloyd's insurance and reinsurance relationships and distribution channels could be disrupted or Lloyd's trading licenses could be revoked making it more difficult for a Lloyd's Syndicate to distribute and market its products;
rating agencies could downgrade their ratings of Lloyd's as a whole; and
Syndicate 1729 and Syndicate 6131 operations are dependent on a small, specialized management team and the loss of their services could adversely affect the Syndicate’s business. The inability to identify, hire and retain other highly qualified personnel in the future, could adversely affect the quality and profitability of Syndicate 1729’s or Syndicate 6131's business.

Our results may differ materially from those we expect and discuss in any forward-looking statements. The principal risk factors that may cause these differences are described in "Item 1A, Risk Factors" in our Form 10-K and other documents we file with the SEC, such as our current reports on Form 8-K and our regular reports on Form 10-Q.

We caution readers not to place undue reliance on any such forward-looking statements, which are based upon conditions existing only as of the date made, and advise readers that these factors could affect our financial performance and could cause actual results for future periods to differ materially from any opinions or statements expressed with respect to future periods in any current statements. Except as required by law or regulations, we do not undertake and specifically decline any obligation to publicly release the result of any revisions that may be made to any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

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ProAssurance Corporation and Subsidiaries
Condensed Consolidated Balance Sheets (Unaudited)
(In thousands, except share data)

| | March 31, 2018 | December 31, 2017 |
|---|---|---|
| Assets | | |
| Investments | | |
| Fixed maturities, at fair value; cost or amortized cost, $2,169,546 and $2,257,188, respectively | $2,157,831 | $2,280,242 |
| Equity investments, at fair value; cost, $471,337 and $425,942, respectively | 492,159 | 470,609 |
| Short-term investments | 349,119 | 432,126 |
| Business owned life insurance | 62,562 | 62,113 |
| Investment in unconsolidated subsidiaries | 401,030 | 330,591 |
| Other investments, $33,042 and $52,301 at fair value, respectively, otherwise at cost or amortized cost | 35,944 | 110,847 |
| Total Investments | 3,498,645 | 3,686,528 |
| Cash and cash equivalents | 43,247 | 134,495 |
| Premiums receivable | 247,644 | 238,085 |
| Receivable from reinsurers on paid losses and loss adjustment expenses | 12,935 | 7,317 |
| Receivable from reinsurers on unpaid losses and loss adjustment expenses | 329,540 | 335,585 |
| Prepaid reinsurance premiums | 39,899 | 39,916 |
| Deferred policy acquisition costs | 50,765 | 50,261 |
| Deferred tax asset, net | 16,874 | 9,930 |
| Real estate, net | 31,646 | 31,975 |
| Intangible assets, net | 81,408 | 82,952 |
| Goodwill | 210,725 | 210,725 |
| Other assets | 115,596 | 101,428 |
| Total Assets | $4,678,924 | $4,929,197 |
| Liabilities and Shareholders' Equity | | |
| Liabilities | | |
| Policy liabilities and accruals | | |
| Reserve for losses and loss adjustment expenses | $2,056,801 | $2,048,381 |
| Unearned premiums | 426,627 | 398,884 |
| Reinsurance premiums payable | 46,933 | 37,726 |
| Total Policy Liabilities | 2,530,361 | 2,484,991 |
| Other liabilities | 207,866 | 437,600 |
| Debt less debt issuance costs | 371,528 | 411,811 |
| Total Liabilities | 3,109,755 | 3,334,402 |
| Shareholders' Equity | | |
| Common shares, par value $0.01 per share, 100,000,000 shares authorized, 62,960,615 and 62,824,523 shares issued, respectively | 630 | 628 |
| Additional paid-in capital | 380,250 | 383,077 |
| Accumulated other comprehensive income (loss), net of deferred tax expense (benefit) of ($1,842) and $5,218, respectively | (8,046) | 14,911 |
| Retained earnings | 1,614,344 | 1,614,186 |
| Treasury shares, at cost, 9,367,545 shares and 9,367,502 shares, respectively | (418,009) | (418,007) |
| Total Shareholders' Equity | 1,569,169 | 1,594,795 |
| Total Liabilities and Shareholders' Equity | $4,678,924 | $4,929,197 |

See accompanying notes.

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ProAssurance Corporation and Subsidiaries
Condensed Consolidated Statements of Changes in Capital (Unaudited)
(In thousands)

| | Common Stock | Additional Paid-in Capital | Accumulated Other Comprehensive Income (Loss) | Retained Earnings | Treasury Stock | Total |
|---|---|---|---|---|---|---|
| Balance at December 31, 2017 | $ 628 | $383,077 | $ 14,911 | $1,614,186 | $(418,007) | $1,594,795 |
| Cumulative-effect adjustment- ASU 2016-01 adoption* | — | — | — | 8,334 | — | 8,334 |
| Cumulative-effect adjustment- ASU 2018-02 adoption* | — | — | 3,416 | (3,416) | — | — |
| Common shares issued for compensation and effect of shares reissued to stock purchase plan | — | 122 | — | — | (2) | 120 |
| Share-based compensation | — | 902 | — | — | — | 902 |
| Net effect of restricted and performance shares issued | 2 | (3,851) | — | — | — | (3,849) |
| Dividends to shareholders | — | — | — | (16,616) | — | (16,616) |
| Other comprehensive income (loss) | — | — | (26,373) | — | — | (26,373) |
| Net income | — | — | — | 11,856 | — | 11,856 |
| Balance at March 31, 2018 | $ 630 | $380,250 | $ (8,046) | $1,614,344 | $(418,009) | $1,569,169 |

| | Common Stock | Additional Paid-in Capital | Accumulated Other Comprehensive Income (Loss) | Retained Earnings | Treasury Stock | Total |
|---|---|---|---|---|---|---|
| Balance at December 31, 2016 | $ 627 | $376,518 | $ 17,399 | $1,824,088 | $(419,930) | $1,798,702 |
| Cumulative-effect adjustment- ASU 2016-09 adoption | — | 425 | — | (276) | — | 149 |
| Common shares issued for compensation and effect of shares reissued to stock purchase plan | — | 938 | — | — | 2 | 940 |
| Share-based compensation | — | 3,346 | — | — | — | 3,346 |
| Net effect of restricted and performance shares issued | 1 | (5,315) | — | — | — | (5,314) |
| Dividends to shareholders | — | — | — | (16,516) | — | (16,516) |
| Other comprehensive income (loss) | — | — | 2,924 | — | — | 2,924 |
| Net income | — | — | — | 41,455 | — | 41,455 |
| Balance at March 31, 2017 | $ 628 | $375,912 | $ 20,323 | $1,848,751 | $(419,928) | $1,825,686 |

* See Note 1 for discussion of accounting guidance adopted during the period.
See accompanying notes.

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ProAssurance Corporation and Subsidiaries
Condensed Consolidated Statements of Income and Comprehensive Income (Unaudited)
(In thousands, except per share data)

| | Three Months Ended March 31 | |
|---|---|---|
| | 2018 | 2017 |
| Revenues | | |
| Net premiums earned | $187,159 | $182,903 |
| Net investment income | 22,027 | 23,186 |
| Equity in earnings (loss) of unconsolidated subsidiaries | 1,640 | 1,808 |
| Net realized investment gains (losses): | | |
| OTTI losses | — | (419) |
| Portion of OTTI losses recognized in other comprehensive income before taxes | — | 248 |
| Net impairment losses recognized in earnings | — | (171) |
| Other net realized investment gains (losses) | (12,517) | 13,451 |
| Total net realized investment gains (losses) | (12,517) | 13,280 |
| Other income | 2,723 | 1,821 |
| Total revenues | 201,032 | 222,998 |
| Expenses | | |
| Net losses and loss adjustment expenses | 129,786 | 119,151 |
| Underwriting, policy acquisition and operating expenses | | |
| Operating expense | 32,467 | 34,482 |
| DPAC amortization | 24,893 | 22,626 |
| Segregated portfolio cells dividend expense (income) | 1,747 | 2,375 |
| Interest expense | 3,705 | 4,133 |
| Total expenses | 192,598 | 182,767 |
| Income before income taxes | 8,434 | 40,231 |
| Provision for income taxes | | |
| Current expense (benefit) | (1,328) | (8,278) |
| Deferred expense (benefit) | (2,094) | 7,054 |
| Total income tax expense (benefit) | (3,422) | (1,224) |
| Net income | 11,856 | 41,455 |
| Other comprehensive income (loss), after tax, net of reclassification adjustments | (26,373) | 2,924 |
| Comprehensive income (loss) | $(14,517) | $44,379 |
| Earnings per share | | |
| Basic | $0.22 | $0.78 |
| Diluted | $0.22 | $0.77 |
| Weighted average number of common shares outstanding: | | |
| Basic | 53,515 | 53,315 |
| Diluted | 53,682 | 53,535 |
| Cash dividends declared per common share | $0.31 | $0.31 |

See accompanying notes.

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ProAssurance Corporation and Subsidiaries
Condensed Consolidated Statements of Cash Flows (Unaudited)
(In thousands)

| | Three Months Ended March 31 | |
|---|---|---|
| | 2018 | 2017 |
| Operating Activities | | |
| Net income | $11,856 | $41,455 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization, net of accretion | 6,079 | 7,803 |
| (Increase) decrease in cash surrender value of BOLI | (449) | (455) |
| Net realized investment (gains) losses | 12,517 | (13,280) |
| Share-based compensation | 902 | 3,346 |
| Deferred income taxes | (2,094) | 7,054 |
| Policy acquisition costs, net of amortization (net deferral) | (504) | (2,376) |
| Equity in (earnings) loss of unconsolidated subsidiaries | (1,640) | (1,808) |
| Distributed earnings from unconsolidated subsidiaries | 7,018 | 10,893 |
| Other | 752 | (167) |
| Other changes in assets and liabilities: | | |
| Premiums receivable | (9,559) | (1,238) |
| Reinsurance related assets and liabilities | 9,651 | 2,428 |
| Other assets | 6,254 | (5,027) |
| Reserve for losses and loss adjustment expenses | 8,420 | 3,561 |
| Unearned premiums | 27,743 | 24,576 |
| Other liabilities | (3,592) | (7,393) |
| Net cash provided (used) by operating activities | 73,354 | 69,372 |
| Investing Activities | | |
| Purchases of: | | |
| Fixed maturities, available for sale | (367,872) | (160,364) |
| Fixed maturities, trading | (4,162) | — |
| Equity investments | (67,129) | (35,400) |
| Other investments | (7,108) | (3,930) |
| Funding of qualified affordable housing project tax credit partnerships | — | (37) |
| Investment in unconsolidated subsidiaries | (21,985) | (5,613) |
| Proceeds from sales or maturities of: | | |
| Fixed maturities, available for sale | 459,822 | 171,986 |
| Equity investments | 51,085 | 41,584 |
| Other investments | 6,092 | 6,788 |
| Return of invested capital from unconsolidated subsidiaries | 11,783 | 6,955 |
| Net sales or maturities (purchases) of short-term investments | 82,976 | 160,792 |
| Unsettled security transactions, net change | 22,421 | 6,296 |
| Purchases of capital assets | (1,836) | (4,535) |
| Repayments (advances) under Syndicate Credit Agreement | (17,980) | 1,159 |
| Net cash provided (used) by investing activities | 146,107 | 185,681 |

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| | Three Months Ended March 31 | |
|---|---|---|
| | 2018 | 2017 |
| Continued from the previous page. | | |
| Financing Activities | | |
| Borrowings (repayments) under Revolving Credit Agreement | (40,000 ) | — |
| Repayments of Mortgage Loans | (349 ) | — |
| Dividends to shareholders | (266,734) | (265,664 ) |
| External capital contribution received for segregated portfolio cells | 251 | 114 |
| Other | (3,877 ) | (4,932 ) |
| Net cash provided (used) by financing activities | (310,709) | (270,482 ) |
| Increase (decrease) in cash and cash equivalents | (91,248 ) | (15,429 ) |
| Cash and cash equivalents at beginning of period | 134,495 | 117,347 |
| Cash and cash equivalents at end of period | $43,247 | $101,918 |
| Significant Non-Cash Transactions | | |
| Dividends declared and not yet paid | $16,616 | $16,516 |

See accompanying notes.

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ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
March 31, 2018

1. Basis of Presentation

The accompanying unaudited Condensed Consolidated Financial Statements include the accounts of ProAssurance Corporation and its consolidated subsidiaries (ProAssurance, PRA or the Company). The financial statements have been prepared in accordance with GAAP for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation, consisting of normal recurring adjustments, have been included. ProAssurance’s results for the three months ended March 31, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018. The accompanying Condensed Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and Notes contained in ProAssurance’s December 31, 2017 report on Form 10-K. In connection with its preparation of the Condensed Consolidated Financial Statements, ProAssurance evaluated events that occurred subsequent to March 31, 2018 for recognition or disclosure in its financial statements and notes to financial statements.

ProAssurance operates in four reportable segments as follows: Specialty P&C, Workers' Compensation, Lloyd's Syndicate and Corporate. For more information on the nature of products and services provided and for financial information by segment, refer to Note 12.

Reclassifications

In the second quarter of 2017, ProAssurance began presenting separately the components of underwriting, policy acquisition and operating expense as operating expense and DPAC amortization on the Condensed Consolidated Statements of Income and Comprehensive Income in order to provide additional details for investors. The Condensed Consolidated Statements of Income and Comprehensive Income for the three months ended March 31, 2017 have been reclassified to conform to the current period presentation. Total underwriting, policy acquisition and operating expense as well as net income for the three months ended March 31, 2017 was not affected by the change in presentation.

Certain other insignificant prior period amounts have been reclassified to conform to the current period presentation.

Other Liabilities

Other liabilities consisted of the following:

| (In thousands) | March 31, 2018 | December 31, 2017 |
|---|---|---|
| SPC dividends payable | $47,122 | $ 46,925 |
| Unpaid dividends | 16,616 | 267,292 |
| All other | 144,128 | 123,383 |
| Total other liabilities | $207,866 | $ 437,600 |

SPC dividends payable are the cumulative undistributed earnings contractually payable to the external preferred shareholders of the SPCs operated by Eastern Re and Inova Re, ProAssurance's Cayman Islands reinsurance subsidiaries.

Unpaid dividends represent common stock dividends declared by ProAssurance's Board that had not yet been paid as of March 31, 2018. Unpaid dividends at December 31, 2017 reflected a special dividend declared in the fourth quarter of 2017 that was paid in January 2018.

Accounting Changes Adopted

Restricted Cash (ASU 2016-18)

Effective for fiscal years beginning after December 15, 2017 and interim periods within those fiscal years, the FASB issued guidance related to the classification of restricted cash presented in the statement of cash flows with the objective of reducing diversity in practice. Under the new guidance, entities are required to include restricted cash and restricted cash equivalents with cash and cash equivalents when reconciling beginning-of-period and end-of-period total amounts as presented on the statement of cash flows. ProAssurance adopted the guidance as of January 1, 2018. Adoption of the guidance had no material effect on ProAssurance’s results of operations, financial position or cash flows.

Intra-Entity Transfers of Assets Other than Inventory (ASU 2016-16)
Effective for fiscal years beginning after December 15, 2017 and interim periods within those fiscal years, the FASB issued guidance which reduces the complexity in accounting standards related to the income tax consequences of intra-entity transfers of assets other than inventory between tax-paying components. A tax-paying component is an individual entity or group of entities that is consolidated for tax purposes. Under the new guidance, entities are required to recognize income tax consequences of an intra-entity transfer of assets other than inventory when the transfer occurs instead of delaying recognition until the asset has been sold to an outside party. ProAssurance adopted the guidance as of January 1, 2018. Adoption of the guidance had no material effect on ProAssurance’s results of operations, financial position or cash flows.

Classification of Certain Cash Receipts and Cash Payments (ASU 2016-15)
Effective for fiscal years beginning after December 15, 2017 and interim periods within those fiscal years, the FASB issued guidance related to the classification of certain cash receipts and cash payments presented in the statement of cash flows with the objective of reducing diversity in practice. ProAssurance adopted the guidance as of January 1, 2018 and elected to use the cumulative earnings approach for presenting distributions from equity method investees. Adoption of the guidance had no material effect on ProAssurance’s results of operations or financial position; however, ProAssurance reclassified approximately $10.9 million in distributions from unconsolidated subsidiaries from investing activities to operating activities in the Condensed Consolidated Statement of Cash Flows for the three months ended March 31, 2017.

Revenue from Contracts with Customers (ASU 2014-09)
Effective for fiscal years beginning after December 15, 2017 the FASB issued guidance related to revenue from contracts with customers. The core principle of the new guidance is that revenue is recognized to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ProAssurance adopted the guidance as of January 1, 2018 under the modified retrospective method. Adoption of the guidance had no material effect on ProAssurance’s results of operations, financial position or cash flows.

Recognition and Measurement of Financial Assets and Financial Liabilities (ASU 2016-01)
Effective for fiscal years beginning after December 15, 2017 and interim periods within those fiscal years, the FASB issued guidance that requires equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. The new guidance also specifies that an entity use the exit price notion when measuring the fair value of financial instruments for disclosure purposes and present financial assets and liabilities by measurement category and form of financial asset. Other provisions of the new guidance include: revised disclosure requirements related to the presentation in comprehensive income of changes in the fair value of liabilities; elimination, for public companies, of disclosure requirements relative to the methods and significant assumptions underlying fair values disclosed for financial instruments measured at amortized cost; and simplified impairment assessments for equity investments without readily determinable fair values. ProAssurance adopted the guidance as of January 1, 2018 using a modified retrospective application and recorded a cumulative-effect after-tax adjustment of approximately $8.3 million to beginning retained earnings in the Condensed Consolidated Statement of Changes in Capital for the three months ended March 31, 2018. Adoption of the guidance had no material effect on ProAssurance’s results of operations, financial position or cash flows.

Modification Accounting for Employee Share-Based Payment Awards (ASU 2017-09)
Effective for fiscal years beginning after December 15, 2017 and interim periods within those fiscal years, the FASB issued guidance which reduces the complexity in accounting standards when there is a change in the terms or conditions of a share-based payment award. The new guidance clarifies that an entity should apply the modification accounting guidance if the value, vesting conditions or classification of the award changes. ProAssurance adopted the guidance as of January 1, 2018. Adoption of the guidance had no material effect on ProAssurance’s results of

operations, financial position or cash flows.
Reclassification of Certain Tax Effects from AOCI (ASU 2018-02)
Effective for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years, with early adoption permitted, the FASB issued guidance which permits a reclassification from AOCI to retained earnings for stranded tax effects resulting from the newly enacted federal corporate tax rate from the TCJA. The amount of the reclassification from AOCI to retained earnings will be the difference between the historical corporate tax rate and the newly enacted 21% corporate tax rate on deferred tax items originally established through OCI and not net income. The guidance allows entities to adopt in any interim or annual period for which financial statements have not yet been issued and apply the guidance either (1) in the period of adoption or (2) retrospectively to each period in which the effect of the change in the tax rate is recognized. ProAssurance adopted this guidance as of January 1, 2018 and elected to apply this guidance in the period of adoption using the specific identification method. Using a modified retrospective application, ProAssurance recorded a cumulative-effect

adjustment which increased beginning AOCI by approximately $3.4 million and decreased beginning retained earnings by the same amount in the Condensed Consolidated Statement of Changes in Capital for the three months ended March 31, 2018. Adoption of this guidance had no material effect on ProAssurance's financial position, results of operations or cash flows.

Accounting Changes Not Yet Adopted

Technical Corrections and Improvements to Financial Instruments - Overall (ASU 2018-03)

Effective for fiscal years beginning after December 15, 2017 and interim periods within those fiscal years beginning after June 15, 2018, the FASB amended the new standard on recognizing and measuring financial assets and financial liabilities to clarify certain aspects of the guidance. Under the amended guidance, an entity that uses the measurement alternative for equity investments without readily determinable fair values can change its measurement approach to a fair value method through an irrevocable election that would apply to that security and all identical or similar investments of the same issuer. Also, entities are required to use the prospective transition approach only for equity investments they elect to measure using the new measurement alternative. Additionally, the guidance clarifies how to apply the measurement alternative and presentation requirements for financial liabilities measured under the fair value option. ProAssurance plans to adopt the guidance beginning July 1, 2018. As of March 31, 2018, ProAssurance does not have any equity investments without readily determinable fair values or financial liabilities measured under the fair value option; therefore, adoption of the guidance is not expected to have a material effect on ProAssurance’s financial position, results of operations or cash flows.

Leases (ASU 2016-02)

Effective for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years, the FASB issued guidance that requires a lessee to recognize for all leases (with the exception of short-term leases) a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis, and a right-of-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. ProAssurance plans to adopt the guidance beginning January 1, 2019 and is currently in the process of evaluating all of its leases. As the majority of ProAssurance's leases are real estate operating leases and are not considered to be material, adoption of the guidance is not expected to have a material effect on ProAssurance’s results of operations, financial position or cash flows.

Premium Amortization on Purchased Callable Debt Securities (ASU 2017-08)

Effective for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years, the FASB issued guidance that will require the premium for certain callable debt securities to be amortized over a shorter period than is currently required. Currently amortization is permitted over the contractual life of the instrument and the guidance shortens the amortization to the earliest call date. The purpose of the guidance is to more closely align the amortization period of premiums to expectations incorporated in market pricing on the underlying securities. ProAssurance plans to adopt the guidance beginning January 1, 2019. As ProAssurance amortizes premium on callable debt securities to the earliest call date, adoption of the guidance is not expected to have a material effect on ProAssurance’s results of operations, financial position or cash flows.

Derivatives and Hedging (ASU 2017-12)

Effective for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years, the FASB issued guidance to improve financial reporting of hedging relationships to better portray the entity's risk management activities in the consolidated financial statements. The new guidance eliminates the requirement to separately measure and report hedge ineffectiveness and requires the entire change in the fair value of a hedging instrument to be presented in the same income statement line as the hedged item. ProAssurance plans to adopt the guidance beginning January 1, 2019. ProAssurance's derivative instrument at March 31, 2018 is not designated as a hedging instrument; therefore, adoption is not expected to have a material effect on ProAssurance's results of operations, financial position or cash flows.

Improvements to Financial Instruments - Credit Losses (ASU 2016-13)

Effective for fiscal years beginning after December 15, 2019 and interim periods within those fiscal years, the FASB issued guidance that replaces the incurred loss impairment methodology, which delays recognition of credit losses until a probable loss has been incurred, with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. Under the new guidance, credit losses are required to be recorded through an allowance for credit losses account and the income statement reflects the measurement for newly recognized financial assets, as well as increases or decreases of expected credit losses that have taken place during the period. ProAssurance is in the process of evaluating the effect the new guidance would have on its results of operations and financial position and plans to adopt the guidance beginning January 1, 2020.

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Simplifying the Test for Goodwill Impairment (ASU 2017-04)

Effective for the fiscal years beginning after December 15, 2019 and interim periods within those fiscal years, the FASB issued guidance that simplifies the requirements to test goodwill for impairment for business entities that have goodwill reported in their financial statements. The guidance eliminates the second step of the impairment test which measures a goodwill impairment loss by comparing the implied fair value of a reporting unit's goodwill with the carrying amount. In addition, the guidance also eliminates the requirements for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment. ProAssurance plans to adopt the guidance beginning January 1, 2020. Adoption is not expected to have a material effect on ProAssurance’s results of operations, financial position or cash flows.

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2. Fair Value Measurement

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. A three level hierarchy has been established for valuing assets and liabilities based on how transparent (observable) the inputs are that are used to determine fair value, with the inputs considered most observable categorized as Level 1 and those that are the least observable categorized as Level 3. Hierarchy levels are defined as follows:

| | |
|---|---|
| Level 1: | quoted (unadjusted) market prices in active markets for identical assets and liabilities. For ProAssurance, Level 1 inputs are generally quotes for debt or equity securities actively traded in exchange or over-the-counter markets. |
| Level 2: | market data obtained from sources independent of the reporting entity (observable inputs). For ProAssurance, Level 2 inputs generally include quoted prices in markets that are not active, quoted prices for similar assets or liabilities, and results from pricing models that use observable inputs such as interest rates and yield curves that are generally available at commonly quoted intervals. |
| Level 3: | the reporting entity's own assumptions about market participant assumptions based on the best information available in the circumstances (non-observable inputs). For ProAssurance, Level 3 inputs are used in situations where little or no Level 1 or 2 inputs are available or are inappropriate given the particular circumstances. Level 3 inputs include results from pricing models for which some or all of the inputs are not observable, discounted cash flow methodologies, single non-binding broker quotes and adjustments to externally quoted prices that are based on management judgment or estimation. |

Fair values of assets measured at fair value on a recurring basis as of March 31, 2018 and December 31, 2017 are shown in the following tables. Where applicable, the tables also indicate the fair value hierarchy of the valuation techniques utilized to determine those fair values. For some assets, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. When this is the case, the asset is categorized based on the level of the most significant input to the fair value measurement. Assessments of the significance of a particular input to the fair value measurement require judgment and consideration of factors specific to the assets being valued.

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March 31, 2018

| | March 31, 2018 Fair Value Measurements Using | | | Total | | | | |
|---|---|---|---|---|---|---|---|---|
| (In thousands) | Level 1 | Level 2 | Level 3 | Fair Value | | | | |
| Assets: | | | | | | | | |
| Fixed maturities, available for sale | | | | | | | | |
| U.S. Treasury obligations | $— | $129,751 | $— | $129,751 | | | | |
| U.S. Government-sponsored enterprise obligations | — | 29,959 | — | 29,959 | | | | |
| State and municipal bonds | — | 329,995 | — | 329,995 | | | | |
| Corporate debt, multiple observable inputs | 2,334 | 1,230,832 | — | 1,233,166 | | | | |
| Corporate debt, limited observable inputs | — | — | 15,097 | 15,097 | | | | |
| Residential mortgage-backed securities | — | 215,420 | — | 215,420 | | | | |
| Agency commercial mortgage-backed securities | — | 14,887 | — | 14,887 | | | | |
| Other commercial mortgage-backed securities | — | 29,195 | — | 29,195 | | | | |
| Other asset-backed securities | — | 138,890 | 17,323 | 156,213 | | | | |
| Fixed maturities, trading | | | | | | | | |
| Corporate debt | — | 4,148 | — | 4,148 | | | | |
| Equity investments | | | | | | | | |
| Financial | 74,556 | — | — | 74,556 | | | | |
| Utilities/Energy | 46,637 | — | — | 46,637 | | | | |
| Consumer oriented | 54,789 | — | — | 54,789 | | | | |
| Industrial | 48,859 | — | — | 48,859 | | | | |
| Bond funds | 153,256 | — | — | 1,448 | $918 | $8,100 | $33,159 | $46,103 |
| William J. Deutsch, Jr. | $6,000 | $ 1,351 | $857 | $ 6,750 | $ 33,494 | $ 48,452 | | |
| James J. Brennan | $14,259 | $ 1,577 | $994 | $ 4,445 | $ 34,257 | $ 55,532 | | |

(i) Includes use of an automobile or an automobile allowance, and in the case of Messrs. Gasior, Cloutier and Brennan, club dues.

(ii) Consists of premiums paid by the Company during the fiscal year with respect to additional short- and long-term disability insurance for each named executive officer. Certain amounts were paid by the executive and reimbursed by the Company under employment agreement provisions that reduce, on a dollar-for-dollar basis, the Bank's obligations under such executive's employment agreement in the event of the executive's death or disability by the amount of insurance proceeds received by the executive's named beneficiary.

(iii) Reflects reimbursement for income and employment taxes incurred by the executive as a result of the insurance premiums paid by the executive and reimbursed by the Company. See note (ii) above and discussion below for additional information.

(iv) Includes the Bank's contribution to the executive's ESOP account plus any amounts reallocated as a result of forfeitures by terminated ESOP participants. The ESOP was terminated on March 29, 2017.

Grants of Plan-Based Awards

The following table sets forth for the year ended December 31, 2017 certain information as to grants of plan-based awards for the Chief Executive Officer and the other Named Executive Officers under the terms of any applicable cash incentive compensation plans or the 2006 EIP. For the year ended December 31, 2017, cash payments were paid in April 2018 in the amounts listed in the "Summary Compensation Table."

| Name | | Estimated Future/Possible Payouts Under Non-Equity Incentive Plan Awards | | |
|---|---|---|---|---|
| | | Threshold ($) | Target ($) | Maximum ($) |
| F. Morgan Gasior | (1) | $ — | $ 206,352 | $ 206,352 |
| Paul A. Cloutier | (1) | $ — | $ 56,997 | $ 56,997 |
| John G. Manos | (2) | $ — | $ 123,110 | $ 123,110 |
| William J. Deutsch, Jr. | (3) | $ — | $ 165,000 | $ 165,000 |
| James J. Brennan | (4) | $ — | $ — | $ — |

(1) Messrs. Gasior and Cloutier are eligible to receive a cash incentive plan payment of up to 50% and 20% of base salary, respectively, based on the achievement of weighted performance goals. See "Conclusions for Year Ended December 31, 2017 - Review of the Chief Executive Officer" and "Conclusions for Year Ended December 31, 2017 - Review of the Chief Financial Officer" in the Compensation Discussion and Analysis above for additional detail.

(2) Mr. Manos is eligible to receive a cash incentive plan payment of up to 50% of base salary based on the achievement of Business Plan objectives for 2017. Final incentive earned is subject to asset quality adjustments. The target amount provided for Mr. Manos is a representative amount that would be earned under the 2017 plan if fiscal 2017 budgets were achieved with no discretionary adjustment.

(3) Mr. Deutsch is eligible to receive a cash incentive plan payment up to a maximum of $165,000 based on the achievement of Business Plan objectives for 2017. Final incentive earned is subject to risk-based deferrals and asset quality adjustments. The target amount provided for Mr. Deutsch is a representative amount that would be earned under the plan if fiscal budgets were achieved with no discretionary adjustment.

(4) Mr. Brennan was not eligible for and did not participate in any cash incentive plans during fiscal 2017.

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Outstanding Equity Awards at Fiscal Year-End

The following table sets forth information concerning unvested shares of restricted stock at December 31, 2017 held by the individuals named in the summary compensation table:

| | Stock Awards | | | |
|---|---|---|---|---|
| Name | # of Shares or Units of Stock That Have Not Vested | Market Value of Shares or Units of Stock That Have Not Vested ($) | Equity Incentive Plan Awards: # of Unearned Shares, Units or Other Rights That Have Not Vested[1] | Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units, or Other Rights That Have Not Vested ($)[2] |
| F. Morgan Gasior | — | $ — | — | $ — |
| Paul A. Cloutier | — | $ — | — | $ — |
| John G. Manos | — | $ — | — | $ — |
| William J. Deutsch, Jr. | — | $ — | 940 | $ 14,420 |
| James J. Brennan | — | $ — | — | $ — |

(1) The amount for Mr. Deutsch reflects the remaining unearned shares of a performance-based equity award granted on May 14, 2013, which was eligible to be earned if predefined annual performance goals were achieved prior to a March 31, 2016 final performance determination date. On the final performance determination date, the Human Resources Committee approved the extension of the performance period for this award through December 31, 2017. In April 2018, the Human Resources Committee approved the achievement of performance that resulted in 694 shares being vested and 246 shares being forfeited.

(2) The market value of shares is based on a closing stock price of $15.34 on December 31, 2017.

Option Exercises and Stock Vested During 2017

The following table reflects option awards exercised by the named executive officers during 2017. No stock awards vested during 2017.

| | Option Awards | |
|---|---|---|
| Name | # of Shares Acquired on Exercise | Value Realized Upon Exercise ($) [1] |
| F. Morgan Gasior | 300,000 | $718,600 |
| Paul A. Cloutier | 151,000 | $372,630 |
| John G. Manos | 95,834 | $223,293 |
| William J. Deutsch, Jr. | 10,000 | $20,300 |
| James J. Brennan | 165,668 | $337,963 |

(1) For options, the value realized on exercise is equal to the difference between the market price of the underlying shares at exercise and the exercise price of the options.

Potential Payments upon Termination or Change of Control

The following table sets forth information concerning potential payments and benefits under the Company's compensation programs and benefit plans to which the Named Executive Officers would be entitled upon a termination of employment as of December 31, 2017. As is more fully described on the following page, the named executive officers entered into employment agreements with the Company and/or the Bank, as applicable (each, an "Employment Agreement"), which provide for payments and benefits to a terminating executive officer following a termination other than for "cause" or by resignation. Except for the payments and benefits provided by the Employment Agreements, all other payments and benefits provided to any Named Executive Officer upon termination of his employment are the same as the payments and benefits provided to other eligible executives of the Bank.

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| Executive | Potential Payments Upon Termination or Change of Control | Termination by the Bank | | | Other Types of Termination | | | Change of Control (3) |
|---|---|---|---|---|---|---|---|---|
| | | For Cause | For Disability (1) | Without Cause (2) | By Resignation | For Good Reason (2) | Upon Death (1) | |
| F. Morgan Gasior | Cash payments | $— | $1,073,330 | $1,466,345 | $— | $1,466,345 | $1,073,330 | $1,466,345 |
| | Continued Benefits | — | 17,276 | 21,446 | — | 21,446 | 17,276 | 21,446 |
| Paul A. Cloutier | Cash payments | $— | $730,576 | $1,014,548 | $— | $1,014,548 | $730,576 | $1,014,548 |
| | Continued Benefits | — | 28,678 | 35,600 | — | 35,600 | 28,678 | 35,600 |
| John G. Manos | Cash payments | $— | $692,853 | $1,101,020 | $— | $1,101,020 | $692,853 | $704,725 |
| | Continued Benefits | — | 29,251 | 36,312 | — | 36,312 | 29,251 | 36,312 |
| William J. Deutsch, Jr. | Cash payments | $— | $663,024 | $663,024 | $— | $663,024 | $663,024 | $663,024 |
| | Accelerated Equity Awards | — | 14,420 | 14,420 | — | 14,420 | 14,420 | 14,420 |
| | Continued Benefits | — | 14,752 | 14,752 | — | 14,752 | 14,752 | 14,752 |
| James J. Brennan | Cash payments | $— | $456,611 | $1,109,383 | $— | $1,109,383 | $456,611 | $1,109,383 |
| | Continued Benefits | — | — | — | — | — | — | — |

(1) For each Named Executive Officer, except Mr. Deutsch, cash payments include an amount equal to the average cash incentive compensation paid during the preceding two years prorated for the year of termination, prorated employer matching 401(k) contribution for the year of termination, and the base salary the executive would have received from the date of termination through the end of his employment period. The cash payments for Mr. Deutsch include a prorated annual cash incentive compensation for the year of termination, prorated employer matching 401(k) contribution for the year of termination, and the base salary the executive would have received from the date of termination through the end of the executive's employment period. The intrinsic value of accelerated equity awards for Mr. Deutsch is based on the closing stock price on December 31, 2017 of $15.34. Continued benefits reflect the incremental cost of core benefits to the Company during the executive's remaining employment period based on actual cost for 2017, except for Mr. Brennan, whose agreement was amended on July 27, 2017 to exclude continued benefits post-termination. Excludes any reduction in benefits as a result of disability insurance or federal social security disability payments.

(2) For each Named Executive Officer, except Mr. Deutsch, cash payments include an amount equal to the average cash incentive compensation paid during the preceding two years prorated for the year of termination, prorated employer matching 401(k) contribution, and three times the executive’s three-year average cash compensation. The cash payments for Mr. Deutsch include a prorated annual cash incentive compensation for the year of termination, prorated employer matching 401(k) contribution for the year of termination, and the base salary the executive would have received from the date of termination through the end of the executive's employment period. The intrinsic value of accelerated equity awards for Mr. Deutsch is based on the closing stock price on December 31, 2017 of $15.34. Continued benefits reflect the incremental cost of core benefits to the Company for 36 months based on the actual cost for 2017, except for Mr. Deutsch, whose continued benefits reflect the incremental cost of core benefits to the Company during the executive's remaining employment period, and Mr. Brennan, whose agreement was amended on July 27, 2017 to exclude continued benefits post-termination.

(3) The payments reflected in this column assume the executive terminated for good reason in connection solely with a change of control, if applicable. For each Named Executive Officer, except Mr. Deutsch, cash payments include an amount equal to the average cash incentive compensation paid during the preceding two years prorated for the year of termination, prorated employer matching 401(k) contribution, and three times the executive’s three-year average cash compensation. The cash payments for Mr. Deutsch include a prorated annual cash incentive compensation for the year of termination, prorated employer matching 401(k) contribution for the year of termination, and the base salary the executive would have received from the date of termination through the end of the executive's employment period. The intrinsic value of accelerated equity awards for Mr. Deutsch is based on the closing stock price on December 31, 2017 of $15.34. Continued benefits reflect the incremental cost of core benefits to the

Company for 36 months based on the actual cost for 2017, except for Mr. Deutsch, whose continued benefits reflect the incremental cost of core benefits to the Company during the executive's remaining employment period, and Mr. Brennan, whose agreement was amended on July 27, 2017 to exclude continued benefits post-termination. Executive severance benefits for Messrs. Manos and Deutsch are reduced to avoid constituting an “excess parachute payment” under Section 280G of the Internal Revenue Code. Assuming a December 31, 2017 good reason termination upon a change in control, the cash payments reflected above for Mr. Manos has been reduced by $396,295 to comply with this requirement.

Accrued Pay and Regular Retirement Benefits. The amounts shown in the table above do not include payments and benefits to the extent they are provided on a non-discriminatory basis to salaried employees generally upon termination of employment. These include:

- Accrued but unpaid salary and vacation pay.
- Distributions of plan balances under the Bank’s 401(k) plan and its ESOP. See “401(k) Plan” and “Employee Stock Ownership Plan and Trust” for an overview of the 401(k) and the ESOP.

Employment Agreements. The Bank’s employment agreements with Messrs. Gasior, Cloutier, Manos, Deutsch and Brennan were amended and restated in May 2008, and were amended again in December 2012 principally to ensure compliance with Section 409A of the Internal Revenue Code. In May 2013, the Bank entered into an amended and restated employment agreement with Mr. Deutsch, which was substantially similar to his prior agreement with the exception of a change in term from 24 months to 36 months and a limit on perquisites and post-employment health insurance. In June 2017, the Bank approved amendments to the Bank’s existing employment agreements for Messrs. Gasior, Cloutier, Manos, Deutsch and Brennan which included, in part, changing the annual review process completion date from March 31st to May 31st each calendar year; removing disability and life insurance from the definition of “Core Plans,” and making disability and life insurance unavailable as post termination

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benefits; clarifying the term “Average Annual Compensation” as used in the employment agreements for Messrs. Gasior, Cloutier, Manos and Brennan; memorializing the cap that has been historically imposed on the dues reimbursement provided to Messrs. Gasior, Cloutier, and Brennan; revising Mr. Gasior’s employment agreement to provide that he will have access to health insurance until he qualifies for Medicare provided that he pays the annual premiums at his expense at the COBRA-rate; revising the agreements for Messrs. Cloutier, Manos, and Deutsch to provide for a cash insurance stipend if the Bank’s insurer will not allow them to remain in the Bank’s health insurance plan after their employment ends or until they become eligible for other group health insurance or Medicare; revising Mr. Brennan’s agreement to remove the post-terminated health insurance provision, to permit reductions in Mr. Brennan’s base salary with his prior written consent and defining the term “Full-time Employment” and revising the indemnification provision in the employment agreements to provide that indemnification will be made by the Bank under the laws of the State of Maryland, which also govern indemnification by the Company. Each employment agreement has an initial term of 36 months that can be extended each year for an additional year, at the discretion of the Board of Directors.

Under the employment agreements, the Bank will pay the executive officers the base salary as reflected in the Bank’s payroll records, subject to discretionary increases by the Board of Directors. The 2018 base salaries for Messrs. Gasior, Cloutier, Manos, Deutsch and Brennan are $450,000, $290,682, $251,143, $232,943 and $173,913, respectively. The employment agreements provide that the base salary may be increased but may not be decreased without the executive officer’s prior written consent. The employment agreements also provide that the executive officer will receive the use of an automobile or an automobile allowance and in the case of Messrs. Gasior, Cloutier and Brennan, the payment of designated club dues, provided that, in a given year, these payments may not, in the aggregate, exceed 10% of the executive officer’s cash compensation. The employment agreements further provide that the executive officer is entitled to participate with other executive officers in cash incentive compensation plans and discretionary cash bonuses, if approved or awarded by the Board, respectively. In addition to base salary, cash incentive compensation plans or discretionary cash bonuses as may be approved by the Board, the employment agreements provide for, among other things, participation in a Section 125 cafeteria plan, group medical, dental, and vision (referred to as the “Core Plans”), disability, and life insurance plans, the 401(k) plan, and other employee and fringe benefits applicable to executive personnel.

During the employment period, each executive officer is provided with a supplemental disability insurance policy that pays 60% of base salary for the remaining term of the agreement in the event the executive officer is terminated due to disability. If an executive officer becomes disabled, his or her base salary will be reduced proportionately by the disability payments made under the disability policy and under the federal social security system. Each executive officer is responsible for paying the premiums but receives an annual allowance in an amount sufficient, on an after-tax basis, to equal the premium payments. In the event of termination of employment due to disability, the executive officer will be entitled to his earned salary, an amount equal to the annual average of any cash incentive compensation and bonus that the executive officer received during the preceding two fiscal years, except for Mr. Deutsch who would receive an amount equal to the cash incentive compensation he would receive during the current year. The executive officer will receive the prorated employer matching 401(k) plan contribution that the executive officer would be entitled to receive for the current year. In addition, the executive officer will be entitled to the base salary the executive officer would have been paid through the date the employment period would have expired if the executive officer’s employment had not been sooner terminated due to disability, which will be reduced on a dollar-for-dollar basis by the disability insurance and federal social security disability payments referenced above, and continued coverage under the Core Plans through the date the employment period would have expired, subject to the executive officer’s continued payment of the costs and contributions for which he is responsible. After their continued coverage under the core plans expires, Messrs. Cloutier, Manos, and Deutsch will be provided with a cash insurance expense stipend if the Bank’s insurer will not allow them to remain in the Bank’s health insurance plan after their employment ends or until they become eligible for Medicare coverage or for coverage under another employer’s group health plan. Mr. Gasior will have access to health insurance until he qualifies for Medicare provided that he pays the annual insurance premiums at COBRA rates. Mr. Brennan is eligible for Medicare and thus will not be provided with any post-termination health insurance.

In the event the executive officer’s employment is terminated due to death, his surviving spouse and minor children, if any, will be entitled to the same coverage under the core plans that the executive officer would have been provided if his employment had terminated due to disability. In addition, the executive officer’s estate or trust, as applicable, will be entitled to the base salary the executive officer would have been paid through the date the employment period would have expired if the executive officer’s employment had not been sooner terminated due to death. The Bank will generally have no obligation to pay or provide an executive officer’s estate, surviving spouse, or minor children with any other compensation or benefits on account of the executive officer’s death.

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In the event the executive officer’s employment is terminated without cause by the Bank, the executive officer will receive his earned salary, prorated incentive compensation, accrued plan contribution, and continued coverage under the Core Plans for 36 months, except for Mr. Deutsch, whose continued coverage would be during the remaining employment period, and Mr. Brennan, who would have no continued coverage due to his eligibility for Medicare. Continued coverage under the Core Plans is subject to the executive officer’s payment of costs and contributions for which he or she is responsible. After their continued coverage under the Core Plans expires, Messrs. Cloutier, Manos, and Deutsch will be provided with a cash insurance expense stipend; Mr. Gasior will have access to health insurance until he qualifies for Medicare provided that he pays the annual insurance premiums at COBRA rates. In the event of a termination without cause, the executive would be paid an amount equal to three times the average annual compensation, with the exception of Mr. Deutsch who would be paid his base salary from the effective date of termination through the date the employment period would have expired. Payment of benefits would be made in a single lump sum (except for Mr. Deutsch, for whom the payment would be made in equal installments), except for payments upon death and payments that exceed certain “safe harbor” provisions of the Internal Revenue Code.

Under the employment agreements, the executive officer may terminate his employment for “Good Reason” by giving notice within 60 days after the event giving rise to the right to terminate employment. Good Reason generally includes (i) the Bank’s decision not to re-elect or failure to re-elect the executive officer to his present position; (ii) with the exception of Mr. Deutsch, the Bank’s failure to extend the executive officer’s employment period on the anniversary date for an additional year; (iii) the relocation of the executive officer’s principal place of employment by more than a specified distance; (iv) the reduction in the executive officer’s base salary or a material reduction in benefits to which the executive officer is entitled; (v) the liquidation or dissolution of the Bank or the Company; (vi) the Bank’s material uncured breach of the employment agreement; and (vii) with the exception of Mr. Deutsch, the occurrence of a “Change of Control” as such term is defined in the 2006 EIP. With respect to Mr. Gasior’s employment agreement, “Good Reason” also includes the failure to elect or re-elect him as Chairman of the Board of Directors of the Bank, a change in the composition of the Board of Directors of the Bank such that the current directors no longer constitute a majority of the board other than in certain circumstances where the new board is nominated or appointed by the existing board, or a significant reduction in the scope of his duties, powers, privileges, authority or responsibilities. In the event an executive officer’s employment is terminated for Good Reason, he will receive the same amounts, the same coverage under the Core Plans and the same health insurance coverage continuation rights that he would have received if his employment had been terminated without cause. An executive officer who terminates his employment by resignation other than due to Good Reason will only be entitled to his earned salary and vacation through the date of termination.

The executive officer is required under the employment agreement to execute a general release in consideration for any severance amounts. The executive officer also agrees not to compete with the Bank or its affiliates for six months after termination or during the period that severance amounts are paid, if longer. In addition, the executive officer agrees not to solicit the Bank’s customers, their business or the Bank’s employees for eighteen months, which may be reduced in certain circumstances. Payment of amounts due the executive officers under the employment agreements will generally be made in a single lump sum, or in the case of Mr. Deutsch, in equal installments as described above.

The Board of Directors of the Bank last reviewed the Bank’s employment agreements with Messrs. Gasior, Cloutier, Manos, Deutsch and Brennan in 2017 and approved the extension of their terms through May 31, 2020. The reviews are conducted annually and the next review is scheduled to occur in the second quarter of 2018.

In October 2008, the Company entered into employment agreements with Messrs. Gasior, Cloutier and Brennan and amended them in December 2012, principally to ensure compliance with Section 409A of the Internal Revenue Code. In July 2017, the Company further amended their employment agreements. The employment agreements have three-year terms and, except as discussed below, are otherwise substantially similar to the respective employment agreements that these individuals have with the Bank. The Board of Directors of the Company last reviewed the Company’s employment agreements with Messrs. Gasior, Cloutier and Brennan in 2017 and approved the extension of their terms through May 31, 2020. The reviews are conducted annually and the next review is scheduled to occur in the second quarter of 2018.

The Company does not separately compensate Messrs. Gasior, Cloutier or Brennan for their services to the Company. Instead, the Bank pays and provides their cash compensation and benefits, and allocates a portion of this expense to the Company pursuant to an intercompany expense sharing arrangement in proportion to the time and services that they provide to the Company. The employment agreements between the Company and Messrs. Gasior, Cloutier and Brennan thus provide that any cash compensation and benefits that become simultaneously due under both their employment agreements with the Company and their employment agreements with the Bank will be subtracted from those due Messrs. Gasior, Cloutier and Brennan under their respective employment agreements with the Company. The payments and benefits that each of Messrs. Gasior, Cloutier and Brennan will receive under his employment agreement with the Company if his employment is terminated without cause, for

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Good Reason or due to death or disability are the same as those provided for in their respective employment agreements with the Bank.

The primary material differences between the Company's employment agreements with Messrs. Gasior, Cloutier and Brennan and their respective employment agreements with the Bank are that their employment agreements with the Company provide that, upon the termination of employment based on the occurrence of a Change of Control as that term is defined in the 2006 EIP, (i) the restricted periods applicable to the non-competition and non-solicitation covenants set forth in their respective employment agreements with the Company and their employment agreements with the Bank will be reduced to six months and the scope of the competitive restrictions will be limited to those that existed immediately prior to the Change of Control; and (ii) all obligations that may become due simultaneously under both the Company's employment agreements with Messrs. Gasior, Cloutier and Brennan and their respective employment agreements with the Bank will first be provided under their employment agreements with the Company. The Company employment agreements do not impose a limit on the compensation that would be payable to Messrs. Gasior, Cloutier or Brennan upon the occurrence of a Change of Control to avoid an "excess parachute payment" under Section 280G of the Internal Revenue Code.

Compensation of Directors

Directors' Fees. All directors of the Company, other than Messrs. O'Neill and Palmer, are also directors of the Bank. Except for Mr. Gasior, who receives no fees for serving as a director, committee chairperson or committee member, the directors of the Bank received a Board fee of $2,000 per month for preparing for and attending meetings of the Board of Directors of the Bank during 2017. Except for the Audit Committee, the Bank did not pay its directors a separate fee during 2017 for serving on board committees. The members of the Audit Committee were paid an Audit Committee fee during 2017 because the Audit Committee is a required entity with separate responsibilities established by applicable laws and regulations. During 2017, the Bank paid an Audit Committee fee of $1,000 per quarter to Mr. Hausmann (the Chairman of the Audit Committee), and $800 per quarter to Messrs. Wells and Wherfel (members of the Audit Committee). The Company did not compensate the other members of the Audit Committee due to the Audit Committee fee that they received from the Bank.

The Company did not separately compensate the members of its Board of Directors other than Messrs. O'Neill and Palmer during 2017 for preparing for and attending meetings of the Board of Directors of the Company. Messrs. O'Neill and Palmer were separately compensated for their service as directors of the Company because they are not directors of the Bank. The Company paid Messrs. O'Neill and Palmer a Board fee of $1,000 per month and also reimbursed Mr. O'Neill for his travel expenses for attending meetings of the Board of Directors of the Company.

The table below provides information on 2017 compensation for directors who served in 2017. Directors receive no perquisites in addition to the scheduled fees paid to each member, except as noted below:

| Name | Fees Earned or Paid in Cash ($) | All Other Compensation [1] | Total ($) |
|---|---|---|---|
| Cassandra J. Francis | $24,000 | $ — | $24,000 |
| John M. Hausmann, C.P.A. | $28,000 | $ — | $28,000 |
| Thomas F. O'Neill | $12,000 | $ 12,360 | $24,360 |
| John W. Palmer | $12,000 | $ — | $12,000 |
| Terry R. Wells | $27,200 | $ — | $27,200 |
| Glen R. Wherfel, C.P.A. | $27,200 | $ — | $27,200 |

(1) The amount for Mr. O'Neill represents the cost of Board-approved chartered air travel for meeting attendance due to a temporary medical condition that limited his mobility.

The Holding Company's and Bank's standard Board and Committee fees remained constant from 2006 until 2018. In 2018, it was determined to re-evaluate the fees given the significant changes in business, market and regulatory conditions and expectations since the last review. Accordingly, management obtained updated industry comparison data from Cook & Co. to evaluate market conditions for the purpose of the 2018 Board and Committee fee review.

Based on the roles and responsibilities of the directors, the most recent market information and the overall industry comparative data, it was proposed and approved to increase the Board and Committee fees in April 2018.

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Below is a table reflecting the annualized Board and Committee fees.

| Name | Current Fee | Fee Effective April 2018 |
|---|---|---|
| Holding Company Director | $12,000 | $ 18,000 |
| Bank Director (1) | $24,000 | $ 36,000 |
| Audit Committee Chair | $4,000 | $ 6,000 |
| Audit Committee Member | $3,200 | $ 4,800 |

(1) Historically, the directors of the Bank did not receive a separate fee for serving as a director of the Holding Company. Effective April 2018, a director will receive separate fees for serving as a director for the Holding Company and the Bank.

Outstanding Non-Employee Director Equity Awards at Fiscal Year-End

Non-employee directors had no outstanding equity awards as of December 31, 2017.

ADVISORY VOTE ON EXECUTIVE COMPENSATION

Pursuant to the rules and regulations of the SEC, the compensation of the Chief Executive Officer, Chief Financial Officer and the three other most highly compensated executive officers of the Company and Bank (collectively, the "Named Executive Officers") is described in detail in the "Compensation Discussion and Analysis" and "Executive Compensation" sections of this Proxy Statement, including the compensation tables and the accompanying narrative discussions.

At our 2017 Annual Meeting, we provided stockholders with the opportunity to vote on an advisory, non-binding basis as to the frequency that stockholders would vote on a "say-on-pay" proposal, which gives stockholders the opportunity to endorse or not endorse, on an advisory, non-binding basis, the compensation paid to our Named Executive Officers. In light of the advisory vote of stockholders at our 2017 Annual Meeting, we determined to hold the "say-on-pay" advisory vote on an annual basis until the next frequency vote, which is occurring at the 2023 Annual Meeting. Accordingly, stockholders have the opportunity to vote on an advisory, non-binding resolution at the Annual Meeting to approve the compensation of our Named Executive Officers, as described in this Proxy Statement under "Compensation Discussion and Analysis" and the compensation tables and narrative disclosure.

We are asking you to indicate your support for the compensation of our Named Executive Officers as described in this Proxy Statement. This vote is not intended to address any specific item of executive compensation, but rather the overall compensation of our Named Executive Officers and the compensation policies and practices described in this Proxy Statement.

The "say-on-pay" proposal will be presented at the Annual Meeting in the form of the following resolution:

"RESOLVED, that the compensation paid to the Company's Named Executive Officers, as disclosed in this Proxy Statement pursuant to Item 402 of Securities and Exchange Commission Regulation S-K, including the Compensation Discussion and Analysis, compensation tables and narrative discussion, is hereby APPROVED."

The Board of Directors recommends that the stockholders of the Company vote "FOR" this resolution.

The Board of Directors believes that the Company's compensation policies and procedures appropriately encourage a culture of pay for performance, serve to attract and retain experienced, highly qualified executives who are critical to the Company's long term success, and align the compensation of the Named Executive Officers with the long term interests of the Company and its stockholders. Consistent with these objectives, and as discussed more fully in the "Compensation Discussion and Analysis" section of this Proxy Statement:

- The Chief Executive Officer, Chief Financial Officer, Commercial Real Estate Lending President, National Commercial Leasing President, and Executive Vice President received cash incentive plan payments, and the Corporate Secretary and General Counsel received a discretionary bonus payment for the year ended December 31, 2017.
- Base compensation increased 2.0% for all Named Executive Officers in 2018, except the base salary for Chief Executive Officer Gasior increased by 9.0% from 2017.
- 

Base compensation increased 1.5% for all Named Executive Officers in 2017, except the base salary for Chief Executive Officer Gasior remained unchanged from 2016.

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The approval of this resolution requires the affirmative vote of a majority of the votes cast at the Annual Meeting, without regard to either broker non-votes or shares as to which the “ABSTAIN” box has been selected on the proxy card. At our 2017 Annual Meeting of Stockholders, over 72% of the advisory votes cast were for the approval of the compensation paid to the Company’s Named Executive Officers. The Company received no communications from shareholders concerning our “Say-On-Pay” resolution in 2017. During 2017 and 2018, the Human Resources Committee of the Bank updated and monitored the industry comparative data used for benchmarking the Bank’s financial and operating performance, established specific Business Plan performance targets for the named executive officers (other than Mr. Brennan) and measured the actual performance achieved in 2017 compared to the established Business Plan performance targets. For those named executive officers with established Business Plan performance targets, the Human Resources Committee of the Bank did not alter the original Business Plan targets nor approve discretionary bonus payments if the original Business Plan targets were not achieved. In addition, the Boards of Directors of the Company and of the Bank adopted revisions to the Code of Business Conduct and the Insider Trading Policy to include recovery of performance-based compensation related to restatements of financial reports under certain circumstances, and expanded the existing prohibitions on transactions involving shares issued by the Company (known as “anti-hedging” restrictions) to include the holding of shares in margin accounts or the pledging of shares as collateral for loan (known as “anti-pledging” restrictions) as disclosed above.

Where no instructions are indicated, validly executed proxies will be voted “FOR” this resolution.

The advisory vote on this resolution will not be binding on the Board of Directors or the Compensation Committee, and will not overrule their prior decisions with respect to the compensation that was paid or awarded to any Named Executive Officer or create or imply any additional fiduciary duty on the Board of Directors or the Human Resources Committee. The Board of Directors and the Human Resource Committee will review the voting results and take them into account when making future decisions on the compensation of the Named Executive Officers, and will periodically review all material elements of the Company’s executive compensation program and procedures to ensure that they continue to fulfill their objectives. Stockholders have an opportunity to vote annually on the compensation of the Company’s Named Executive Officers.

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## COMMUNICATIONS WITH THE BOARD OF DIRECTORS

Any stockholder who wishes to contact the Board of Directors or an individual director may do so by writing to the Board of Directors or the individual director care of, BankFinancial Corporation, 15W060 North Frontage Road, Burr Ridge, Illinois 60527, Attention: James J. Brennan, Secretary. Each communication received will be reviewed by the Secretary and distributed to the Board of Directors or the individual director, as appropriate, depending on the facts and circumstances outlined in the communication. The Secretary may attempt to handle an inquiry directly or forward a communication to another employee of the Company for response. The Secretary also has the authority not to forward a communication to the Board of Directors or an individual director if it is primarily commercial in nature, relates to an improper or irrelevant topic, or is unduly hostile, threatening, illegal or otherwise inappropriate.

## TRANSACTIONS WITH CERTAIN RELATED PERSONS

Neither the Bank nor the Company had any outstanding extensions of credit as of December 31, 2017 to any executive officer or directors or to a related interest of a director or executive officer other than Ms. Francis. The Bank made certain secured real estate loans to Ms. Francis and her spouse prior to Ms. Francis' appointment as a director in 2006, and these loans were considered to be grandfathered from the Bank's practice of not making loans to directors or executive officers. Only one of these loans, a loan secured by a single family residence, is still outstanding. These extensions of credit, including the one outstanding loan, were made in the ordinary course of business on substantially the same terms, including interest rate and collateral, as those prevailing at the time for comparable transactions with persons not related to the Bank, do not involve more than normal risk of collectability or present other unfavorable features, and have not been past due or classified as nonaccrual, restructured or a potential problem loan. The Bank's Professional Responsibility Policy provides that no director or executive officer (as defined by the Bank's Board of Directors) may provide goods or services to the Bank or an affiliate (which includes the Company) unless approved by the disinterested majority of the Board of Directors after full disclosure and it is determined that the arrangement is fair and appropriate. In addition, all transactions between the Bank or its affiliates and a director or executive officer must be conducted on an arm's length basis, comply with all applicable laws and regulations and be on terms that are no more favorable to the director or executive officer than those afforded to similarly situated customers and vendors.

## STOCKHOLDER PROPOSALS

In order to be eligible for inclusion in the proxy materials for next year's annual meeting of stockholders, any stockholder proposal to take action at such meeting must be received at BankFinancial Corporation's executive office, 15W060 North Frontage Road, Burr Ridge, Illinois 60527, no later than 5:00 P.M., Chicago, Illinois Time, on December 28, 2018. Any such proposals shall be subject to the requirements of the proxy rules adopted under the Securities Exchange Act of 1934, as amended, and the Company's bylaws.

## ADVANCE NOTICE OF BUSINESS TO BE CONDUCTED AT AN ANNUAL MEETING

The Company's bylaws provide an advance notice procedure for certain business, or nominations to the Board of Directors, to be brought before an annual meeting of stockholders. In order for a stockholder to properly bring business before an annual meeting, or to propose a nominee for election to the Board of Directors, the stockholder must give written notice to the Secretary of the Company not earlier than the 150th day nor later than 5:00 P.M., Chicago, Illinois Time, on the 120th day prior to the first anniversary of the date of mailing of the notice for the preceding year's annual meeting; provided, however, that in the event that the date of the annual meeting is advanced or delayed by more than 30 days from the first anniversary of the date of the preceding year's annual meeting, notice by the stockholder to be timely must be so delivered not earlier than the 150th day prior to the date of such annual meeting and not later than 5:00 P.M., Chicago, Illinois Time, on the later of the 120th day prior to the date of such annual meeting or the tenth day following the day on which public announcement of the date of such meeting is first made. The notice must include:

- As to each individual whom the stockholder proposes to nominate for election or re-election as a director,
  - the name, age, business address and residence address of such individual;
  - the class, series and number of any shares of stock of BankFinancial Corporation that are beneficially owned by such individual;
  - the date such shares were acquired and the investment intent of such acquisition; and

all other information relating to such individual that is required to be disclosed in solicitations of proxies for election of directors in an election contest (even if an election contest is not involved), or is otherwise required, in each case pursuant to Regulation 14A (or any successor provision) under the Securities Exchange Act of 1934,

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as amended, and the rules thereunder (including such individual's written consent to being named in the Proxy Statement as a nominee and to serving as a director if elected);

- As to any other business that the stockholder proposes to bring before the meeting, a description of such business, the reasons for proposing such business at the meeting and any material interest in such business of such stockholder and any "Stockholder Associated Person" (as defined in the Company's bylaws), individually or in the aggregate, including any anticipated benefit to the stockholder and the Stockholder Associated Person therefrom;
- As to the stockholder giving the notice and any Stockholder Associated Person, the class, series and number of all shares of stock of the Company which are owned by such stockholder and by such Stockholder Associated Person, if any, and the nominee holder for, and number of shares owned beneficially but not of record by such stockholder and by any such Stockholder Associated Person;
- As to the stockholder giving the notice and any Stockholder Associated Person described above, the name and address of such stockholder, as they appear on the Company's stock ledger and current name and address, if different, and of such Stockholder Associated Person; and
- To the extent known by the stockholder giving the notice, the name and address of any other stockholder supporting the nominee for election or re-election as a director or the proposal of other business on the date of such stockholder's notice.

Nothing in this Proxy Statement shall be deemed to require the Company to include in its Proxy Statement and proxy relating to an annual meeting any stockholder proposal that does not meet all of the requirements for inclusion established by the SEC in effect at the time such proposal is received.

Advance written notice for certain business, or nominations to the Board of Directors, to be brought before the 2019 Annual Meeting of Stockholders must be given to the Company no earlier than November 28, 2018 and no later than 5:00 P.M., Chicago, Illinois Time, on December 28, 2018. If notice is received before November 29, 2018 or after 5:00 P.M., Chicago, Illinois Time, on December 28, 2018, it will not be considered timely, and the Company will not be required to present the matter at the next Annual Meeting of Stockholders.

OTHER MATTERS

The Board of Directors is not aware of any business to come before the Annual Meeting other than the matters described above in the Proxy Statement. However, if any other matters should properly come before the Annual Meeting, it is intended that the holders of the proxies will act as determined by a majority vote of those present and voting.

A COPY OF THE COMPANY'S ANNUAL REPORT ON FORM 10-K FOR THE YEAR ENDED DECEMBER 31, 2017 WILL BE FURNISHED WITHOUT CHARGE TO STOCKHOLDERS AS OF THE RECORD DATE UPON WRITTEN REQUEST TO BANKFINANCIAL CORPORATION, 15W060 NORTH FRONTAGE ROAD, BURR RIDGE, ILLINOIS 60527, ATTN: JAMES J. BRENNAN, SECRETARY.

BY ORDER OF THE BOARD OF DIRECTORS

James J. Brennan

Secretary

Burr Ridge, Illinois

April 27, 2018

APPENDIX A
BANKFINANCIAL CORPORATION
CORPORATE GOVERNANCE AND NOMINATING COMMITTEE
OF THE BOARD OF DIRECTORS
COMMITTEE CHARTER
(Adopted by the Board of Directors on February 24, 2010)

I. PURPOSE OF THE COMMITTEE

The Corporate Governance and Nominating Committee shall be directly responsible for recruitment and evaluation of incumbent and new candidates for election to the Board of Directors.

II. MEMBERSHIP

The Board shall appoint the members of the Corporate Governance and Nominating Committee annually. All members of the Committee shall be independent of the Company's management and free of any relationship that would compromise their exercise of independent judgment as Committee members. Directors eligible for re-nomination during the current calendar year are not eligible for appointment as members of the Committee for the current year. Each member of the Committee must satisfy all applicable qualification and independence requirements set forth in the rules and regulations of applicable regulatory organizations.

III. FREQUENCY OF MEETINGS

The Committee shall meet as frequently as necessary but no less than annually. The Committee shall also meet at the request of the Chief Executive Officer or a majority of the Board of Directors. The Board of Directors shall designate a Chairperson of the Committee. The Committee Chairperson shall approve an agenda in advance of each meeting. A majority of the members of the Committee shall constitute a quorum. The Committee shall maintain minutes or other records of its meetings and activities.

The Committee shall, through its Chairperson, report regularly to the Board following the meetings of the Committee, addressing the matters designated by this Charter and such other related matters as the Committee may deem appropriate.

IV. AUTHORITY

The Committee may conduct or authorize investigations into any matters within its scope of this Charter. The Committee may also take any other action permitted by applicable laws, rules and regulations necessary to accomplish any action authorized by this charter.

The Committee may conduct meetings in executive session with members of the Board of Directors or new candidates (in each case, either individually or jointly) to effect the appropriate environment of communication and coordination for the Company's control environment.

The Committee may request reports from the Chief Executive Officer or General Counsel. The Committee may also retain (and determine the funding for) experts to advise or assist it, including outside counsel, search firms or other advisors, and the Company must provide sufficient funding for any such assistance.

V. SCOPE OF COMMITTEE RESPONSIBILITIES

The scope of Corporate Governance and Nominating Committee responsibilities is as follows:

A. Board of Directors Candidate Evaluation

- Determine whether candidates meet the minimum qualifications for election pursuant to the Company's Charter, Section 1.09 of the Company's Bylaws and all applicable laws and regulations to which the Company is subject, including the determination whether an existing or proposed Board member meets all standards of independence established by applicable regulatory organizations;
- Determine whether the background, experience and expertise of any candidate to the Board of Directors is in the long-term interests of stockholders. In its sole discretion, the Committee may consider the current composition of the Board of Directors and its Committees, the number of directors meeting all "independence" standards imposed by applicable regulatory organizations, present and future business activities and plans,

the representation of the diverse communities and geographies served by the Company and any other factors the Committee deems appropriate.

B. Corporate Governance Compliance

- Facilitate and coordinate all meetings of independent directors required by all regulatory organizations. The Committee may appoint one or more independent directors as liaisons to non-independent directors, management or stockholders as it deems appropriate;
- Coordinate and report to the Board of Directors an annual evaluation of the Board's performance;
- Review director compensation and recommend any changes to the Board of Directors;
- Review the suitability of this Charter and the Company's corporate governance practices and recommend any changes to the Board of Directors;
- At least annually, assess any emerging legal or regulatory issues that may have a material effect on the Company's corporate governance policies, practices or reports in the future.

VI. LEAD DIRECTOR

The Chairperson of the Committee shall serve as the Lead Director of the Board of Directors. The Lead Director will call and preside at all executive sessions or special meetings of the Board's outside, independent directors and provide feedback to the Chief Executive Officer regarding the same; work with the Chairpersons of the other Committees of the Board to ensure coordinated coverage of Board's duties and responsibilities; serve as a supplemental point of contact for Board members and stockholders; serve as a liaison between the Board's outside, independent Directors who are not considered independent under applicable legal standards; coordinate the implementation of this Charter, including the annual Board performance evaluation for herein; and execute such other duties and responsibilities as the Board may establish.

VII. UNIVERSAL AGENDA ACCESS

Any member of the Board of Directors may place an item on the Agenda for any regular or special meeting of the Board of Directors by notifying the Chief Executive Officer or the Secretary of the same at least three business days before the scheduled date of the meeting.

VIII. CONCLUSION

The Committee is to serve as an independent and objective party to monitor the Company's corporate governance practices and facilitate the effective governance of the Company based on its evaluation of the composition and conduct of the Board of Directors.