

EAST WEST BANCORP INC
Form 10-Q
May 09, 2013
[Table of Contents](#)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

Mark One

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

For the quarterly period ended March 31, 2013

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 000-24939

EAST WEST BANCORP, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

95-4703316
(I.R.S. Employer
Identification No.)

135 N. Los Robles Ave, 7th Floor, Pasadena, California 91101

(Address of principal executive offices) (Zip Code)

(626) 768-6000

(Registrant's telephone number, including area code)

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

Number of shares outstanding of the issuer's common stock on the latest practicable date: 136,174,881 shares of common stock as of April 30, 2013.

Table of Contents

TABLE OF CONTENTS

<u>PART I - FINANCIAL INFORMATION</u>		4
<u>Item 1.</u>	<u>Condensed Consolidated Financial Statements (Unaudited)</u>	4
	<u>Notes to Condensed Consolidated Financial Statements (Unaudited)</u>	9
<u>Item 2.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	56
<u>Item 3.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	80
<u>Item 4.</u>	<u>Controls and Procedures</u>	80
<u>PART II - OTHER INFORMATION</u>		81
<u>Item 1.</u>	<u>Legal Proceedings</u>	81
<u>Item 1A.</u>	<u>Risk Factors</u>	81
<u>Item 2.</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	81
<u>Item 3.</u>	<u>Defaults Upon Senior Securities</u>	81
<u>Item 4.</u>	<u>Mine Safety Disclosures</u>	81
<u>Item 5.</u>	<u>Other Information</u>	82
<u>Item 6.</u>	<u>Exhibits</u>	82
<u>SIGNATURE</u>		82

Table of Contents

Forward-Looking Statements

Certain matters discussed in this Quarterly Report contain or incorporate statements that we believe are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the Exchange Act), and Rule 175 promulgated thereunder, and Section 21E of the Securities Exchange Act of 1934, as amended, and Rule 3b-6 promulgated thereunder. These statements relate to our financial condition, results of operations, plans, objectives, future performance or business. They usually can be identified by the use of forward-looking language, such as will likely result, may, are expected to, is anticipated, estimate, forecast, projected, intends to, or may include other similar phrases, such as believes, plans, trend, objective, continue, remain, or similar expressions, or future or conditional verbs, such as will, should, could, might, can, or similar verbs. You should not place undue reliance on these statements, as they are subject to risks and uncertainties, including, but not limited to, those described in the documents incorporated by reference. When considering these forward-looking statements, you should keep in mind these risks and uncertainties, as well as any cautionary statements we make. Moreover, you should treat these statements as speaking only as of the date they are made and based only on information then actually known to us.

There are a number of important factors that could cause future results to differ materially from historical performance and these forward-looking statements. Factors that might cause such a difference include, but are not limited to:

- our ability to manage the loan portfolio acquired from FDIC-assisted acquisitions within the limits of the loss protection provided by the FDIC;
- changes in our borrowers' performance on loans;
- changes in the commercial and consumer real estate markets;
- changes in our costs of operation, compliance and expansion;
- changes in the U.S. economy, including inflation;
- changes in government interest rate policies;
- changes in laws or the regulatory environment;
- changes in the economy of and monetary policy in the People's Republic of China;
- changes in critical accounting policies and judgments;
- changes in accounting policies or procedures as may be required by the Financial Accounting Standards Board or other regulatory agencies;
- changes in the equity and debt securities markets;
- changes in competitive pressures on financial institutions;
- effect of additional provision for loan losses;

Edgar Filing: EAST WEST BANCORP INC - Form 10-Q

- fluctuations of our stock price;
- success and timing of our business strategies;
- impact of reputational risk created by these developments on such matters as business generation and retention, funding and liquidity;
- impact of the European debt crisis;
- impact of potential federal tax increases and spending cuts;
- impact of adverse judgments or settlements in litigation against the Company;
- changes in our ability to receive dividends from our subsidiaries; and
- political developments, wars or other hostilities may disrupt or increase volatility in securities or otherwise affect economic conditions.

For a more detailed discussion of some of the factors that might cause such differences, see the Company's 2012 Form 10-K under the heading "ITEM 1A. RISK FACTORS" and the information set forth under "RISK FACTORS" in this Form 10-Q. The Company does not undertake, and specifically disclaims any obligation to update any forward-looking statements to reflect the occurrence of events or circumstances after the date of such statements except as required by law.

Table of Contents**PART I FINANCIAL INFORMATION****EAST WEST BANCORP, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS***(In thousands, except share data)**(Unaudited)*

	March 31, 2013	December 31, 2012
ASSETS		
Cash and cash equivalents	\$ 1,736,865	\$ 1,323,106
Short-term investments	379,029	366,378
Securities purchased under resale agreements	1,400,000	1,450,000
Investment securities available-for-sale, at fair value (with amortized cost of \$2,578,384 at March 31, 2013 and \$2,599,018 at December 31, 2012)	2,588,993	2,607,029
Loans held for sale	226,635	174,317
Loans receivable, excluding covered loans (net of allowance for loan losses of \$228,796 at March 31, 2013 and \$229,382 at December 31, 2012)	12,119,903	11,710,190
Covered loans (net of allowance for loan losses of \$10,110 at March 31, 2013 and \$5,153 at December 31, 2012)	2,752,269	2,935,595
Total loans receivable, net	14,872,172	14,645,785
FDIC indemnification asset	276,834	316,313
Other real estate owned, net	32,324	32,911
Other real estate owned covered, net	28,567	26,808
Total other real estate owned	60,891	59,719
Investment in Federal Home Loan Bank stock, at cost	96,795	107,275
Investment in Federal Reserve Bank stock, at cost	48,036	48,003
Investment in affordable housing partnerships	181,928	185,645
Premises and equipment, net	109,485	107,517
Accrued interest receivable	103,392	94,837
Due from customers on acceptances	22,662	28,612
Premiums on deposits acquired, net	53,875	56,285
Goodwill	337,438	337,438
Cash surrender value of life insurance policies	110,860	110,133
Other assets	496,065	517,718
TOTAL	\$ 23,101,955	\$ 22,536,110
LIABILITIES AND STOCKHOLDERS EQUITY		
Customer deposit accounts:		
Noninterest-bearing	\$ 4,838,523	\$ 4,535,877
Interest-bearing	14,097,179	13,773,477
Total deposits	18,935,702	18,309,354
Federal Home Loan Bank advances	313,494	312,975
Securities sold under repurchase agreements	995,000	995,000
Other borrowings		20,000
Bank acceptances outstanding	22,662	28,612
Long-term debt	137,178	137,178

Edgar Filing: EAST WEST BANCORP INC - Form 10-Q

Accrued expenses and other liabilities	354,800	350,869
Total liabilities	20,758,836	20,153,988

COMMITMENTS AND CONTINGENCIES (Note 12)

STOCKHOLDERS' EQUITY

Preferred stock, \$0.001 par value, 5,000,000 shares authorized; Series A, non-cumulative convertible, 200,000 shares issued and 85,710 shares outstanding in 2013 and 2012	83,027	83,027
Common stock, \$0.001 par value, 200,000,000 shares authorized; 157,354,024 and 157,160,193 shares issued in 2013 and 2012, respectively; 136,578,350 and 140,294,092 shares outstanding in 2013 and 2012, respectively	157	157
Additional paid in capital	1,470,674	1,464,739
Retained earnings	1,201,126	1,151,828
Treasury stock, at cost 20,775,674 shares in 2013 and 16,866,101 shares in 2012	(418,050)	(322,298)
Accumulated other comprehensive income, net of tax	6,185	4,669
Total stockholders' equity	2,343,119	2,382,122
TOTAL	\$ 23,101,955	\$ 22,536,110

See accompanying notes to condensed consolidated financial statements.

Table of Contents**EAST WEST BANCORP, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF INCOME***(In thousands, except per share data)**(Unaudited)*

	Three Months Ended	
	2013	March 31,
		2012
INTEREST AND DIVIDEND INCOME		
Loans receivable, including fees	\$ 217,159	\$ 221,039
Investment securities	10,210	21,232
Securities purchased under resale agreements	5,529	4,314
Investment in Federal Home Loan Bank stock	529	220
Investment in Federal Reserve Bank stock	720	713
Due from banks and short-term investments	4,276	6,532
Total interest and dividend income	238,423	254,050
INTEREST EXPENSE		
Customer deposit accounts	16,854	20,164
Federal funds purchased		2
Federal Home Loan Bank advances	1,039	2,142
Securities sold under repurchase agreements	10,529	11,722
Long-term debt	710	1,102
Total interest expense	29,132	35,132
Net interest income before provision for loan losses	209,291	218,918
(Reversal of) provision for loan losses, excluding covered loans	(762)	16,479
Provision for loan losses on covered loans	5,089	1,621
Net interest income after provision for loan losses	204,964	200,818
NONINTEREST (LOSS) INCOME		
Impairment loss on investment securities		(5,165)
Less: Noncredit-related impairment loss recorded in other comprehensive income		5,066
Net impairment loss on investment securities recognized in earnings		(99)
Decrease in FDIC indemnification asset and receivable	(31,899)	(5,418)
Branch fees	7,654	7,662
Net gain on sales of investment securities	5,577	483
Letters of credit fees and commissions	5,062	4,275
Foreign exchange income	2,336	1,796
Ancillary loan fees	2,052	2,008
Income from life insurance policies	968	990
Net gain on sales of loans	94	5,179
Other operating income	6,057	4,864
Total noninterest (loss) income	(2,099)	21,740
NONINTEREST EXPENSE		

Edgar Filing: EAST WEST BANCORP INC - Form 10-Q

Compensation and employee benefits	45,731	46,409
Occupancy and equipment expense	13,808	13,518
Amortization of investments in affordable housing partnerships and other investments	4,283	4,466
Amortization of premiums on deposits acquired	2,409	2,873
Deposit insurance premiums and regulatory assessments	3,782	3,992
Loan related expenses	3,584	4,481
Other real estate owned (gain on sale) expense	(984)	10,865
Legal expense	4,444	7,173
Prepayment penalty for FHLB advances		1,321
Data processing	2,437	2,464
Deposit related expenses	1,574	1,427
Consulting expense	454	1,467
Other operating expenses	14,833	14,307
Total noninterest expense	96,355	114,763
INCOME BEFORE PROVISION FOR INCOME TAXES	106,510	107,795
PROVISION FOR INCOME TAXES	34,419	39,712
NET INCOME	72,091	68,083
PREFERRED STOCK DIVIDENDS	1,714	1,714
NET INCOME AVAILABLE TO COMMON STOCKHOLDERS	\$ 70,377	\$ 66,369
EARNINGS PER SHARE AVAILABLE TO COMMON STOCKHOLDERS		
BASIC	\$ 0.51	\$ 0.46
DILUTED	\$ 0.50	\$ 0.45
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING		
BASIC	137,648	145,347
DILUTED	143,519	151,996
DIVIDENDS DECLARED PER COMMON SHARE	\$ 0.15	\$ 0.10

See accompanying notes to condensed consolidated financial statements.

Table of Contents**EAST WEST BANCORP, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME***(In thousands)**(Unaudited)*

	Three Months Ended	
	March 31,	
	2013	2012
Net income	\$ 72,091	\$ 68,083
Other comprehensive income, net of tax:		
Unrealized gain on investment securities available-for-sale:		
Unrealized holding gains arising during period	4,741	20,270
Reclassification adjustment for net gains included in net income	(3,235)	(280)
Noncredit-related impairment loss on securities		(2,938)
Unrealized gains on other investments	10	10
Reclassification adjustment for net gains included in net income		
Other comprehensive income	1,516	17,062
COMPREHENSIVE INCOME	\$ 73,607	\$ 85,145

See accompanying notes to condensed consolidated financial statements.

Table of Contents

EAST WEST BANCORP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY

*(In thousands, except share data)**(Unaudited)*

	Preferred Stock	Additional Paid In Capital Preferred Stock	Common Stock	Additional Paid In Capital Common Stock	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss), Net of Tax	Total Stockholders Equity
BALANCE, JANAUARY 1, 2012	\$	\$ 83,027	\$ 157	\$ 1,443,883	\$ 934,617	\$ (116,001)	\$ (33,940)	\$ 2,311,743
Net income					68,083			68,083
Other comprehensive income							17,062	17,062
Stock compensation costs				3,637				3,637
Tax benefit from stock compensation plans, net				29				29
Issuance of 205,103 shares of common stock pursuant to various stock compensation plans and agreements				1,539				1,539
Cancellation of 47,489 shares of common stock due to forfeitures of issued restricted stock				883		(883)		
60,073 shares of restricted stock surrendered due to employee tax liability						(1,313)		(1,313)
Preferred stock dividends					(1,714)			(1,714)
Common stock dividends					(14,791)			(14,791)
Purchase of 4,554,827 shares of treasury stock pursuant to the Stock Repurchase Program						(100,978)		(100,978)
BALANCE, MARCH 31, 2012	\$	\$ 83,027	\$ 157	\$ 1,449,971	\$ 986,195	\$ (219,175)	\$ (16,878)	\$ 2,283,297
BALANCE, JANAUARY 1, 2013	\$	\$ 83,027	\$ 157	\$ 1,464,739	\$ 1,151,828	\$ (322,298)	\$ 4,669	\$ 2,382,122
Net income					72,091			72,091
Other comprehensive income							1,516	1,516
Stock compensation costs				2,504				2,504
Tax benefit from stock compensation plans, net				2,602				2,602
Issuance of 193,831 shares of common stock pursuant to various stock compensation plans and agreements				442				442
Cancellation of 22,050 shares of common stock due to forfeitures of issued restricted stock				387		(387)		
344,423 shares of restricted stock surrendered due to employee tax liability						(8,365)		(8,365)
Preferred stock dividends					(1,714)			(1,714)

Edgar Filing: EAST WEST BANCORP INC - Form 10-Q

Common stock dividends					(21,079)				(21,079)						
Purchase of 3,543,100 shares of treasury stock pursuant to the Stock Repurchase Program					(87,000)				(87,000)						
BALANCE, MARCH 31, 2013	\$	\$	83,027	\$	157	\$	1,470,674	\$	1,201,126	\$	(418,050)	\$	6,185	\$	2,343,119

See accompanying notes to condensed consolidated financial statements.

Table of Contents**EAST WEST BANCORP, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS***(In thousands)**(Unaudited)*

	Three Months Ended March 31,	
	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 72,091	\$ 68,083
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	23,908	19,459
(Accretion) of discount and amortization of premiums, net	(48,390)	(34,660)
Decrease in FDIC indemnification asset and receivable	31,899	5,418
Stock compensation costs	2,504	3,637
Deferred tax expense (benefit)	312	(20,159)
Provision for loan losses	4,327	18,100
Impairment on other real estate owned	1,321	7,389
Net gain on sales of investment securities, loans and other assets	(8,592)	(7,014)
Prepayment penalty for Federal Home Loan Bank advances, net		1,321
Originations and purchases of loans held for sale	(43,604)	(15,782)
Proceeds from sales of loans held for sale	6,272	
Net proceeds from FDIC shared-loss agreements	33,890	39,358
Net change in accrued interest receivable and other assets	(12,525)	(27,165)
Net change in accrued expenses and other liabilities	20,557	40,427
Other net operating activities	(3,570)	(713)
Total adjustments	8,309	29,616
Net cash provided by operating activities	80,400	97,699
CASH FLOWS FROM INVESTING ACTIVITIES		
Net (increase) decrease in:		
Loans	(147,933)	68,532
Short-term investments	(12,651)	(115,742)
Federal funds sold		(30,000)
Purchases of:		
Securities purchased under resale agreements	(250,000)	
Investment securities available-for-sale	(267,882)	(8,018)
Loans receivable	(106,206)	(116,486)
Investments in affordable housing partnerships	(8,386)	(17,850)
Proceeds from sale of:		
Investment securities available-for-sale	196,853	260,261
Loans receivable	22,566	27,639
Loans held for sale originated for investment		52,559
Other real estate owned	22,313	22,791
Repayments, maturities and redemptions of investment securities available-for-sale	87,889	138,650
Paydowns, maturities and termination of securities purchased under resale agreements	300,000	136,434
Redemption of Federal Home Loan Bank stock	10,480	6,391
Other net investing activities	(4,929)	(832)

Edgar Filing: EAST WEST BANCORP INC - Form 10-Q

Net cash (used in) provided by investing activities	(157,886)	424,329
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase (decrease) in:		
Deposits	626,348	(113,801)
Short-term borrowings	(20,000)	(25,208)
Proceeds from:		
Issuance of common stock pursuant to various stock plans and agreements	442	1,539
Payment for:		
Repayment of FHLB advances		(23,003)
Modification of Federal Home Loan Bank advances		(37,678)
Repurchase of shares of treasury stock pursuant to the Stock Repurchase Plan	(87,000)	(100,978)
Cash dividends	(22,782)	(16,495)
Other net financing activities	(5,763)	(1,284)
Net cash provided by (used in) financing activities	491,245	(316,908)
Effect of exchange rate changes on cash and cash equivalents		(451)
NET INCREASE IN CASH AND CASH EQUIVALENTS	413,759	204,669
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	1,323,106	1,431,185
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 1,736,865	\$ 1,635,854
SUPPLEMENTAL CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest	\$ 28,885	\$ 34,140
Income tax payments, net of refunds	1,716	23,422
Noncash investing and financing activities:		
Loans transferred to loans held for sale, net	21,855	40,800
Transfers to other real estate owned	23,230	39,572
Loans to facilitate sales of other real estate owned and short sales		400

See accompanying notes to condensed consolidated financial statements.

Table of Contents

EAST WEST BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1 BASIS OF PRESENTATION

The condensed consolidated financial statements include the accounts of East West Bancorp, Inc. (referred to herein on an unconsolidated basis as "East West" and on a consolidated basis as the "Company") and its wholly-owned subsidiaries, East West Bank and subsidiaries ("East West Bank" or the "Bank") and East West Insurance Services, Inc. Intercompany transactions and accounts have been eliminated in consolidation. East West also has seven wholly-owned subsidiaries that are statutory business trusts (the "Trusts"). In accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 810, the Trusts are not consolidated into the accounts of East West Bancorp, Inc.

The interim condensed consolidated financial statements, presented in accordance with accounting principles generally accepted in the United States of America ("GAAP"), are unaudited and reflect all adjustments that, in the opinion of management, are necessary for a fair statement of financial condition and results of operations for the interim periods. All adjustments are of a normal and recurring nature. Results for the three months ended March 31, 2013 are not necessarily indicative of results that may be expected for any other interim period or for the year as a whole. Certain information and note disclosures normally included in annual financial statements prepared in accordance with GAAP have been condensed or omitted. Events subsequent to the condensed consolidated balance sheet date have been evaluated through the date the financial statements are issued for inclusion in the accompanying financial statements. The unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2012.

Certain prior year balances have been reclassified to conform to current year presentation.

NOTE 2 SIGNIFICANT ACCOUNTING POLICIES

Recent Accounting Standards

In October 2012, the FASB issued ASU 2012-06, *Business Combinations (Topic 805): Subsequent Accounting for an Indemnification Asset Recognized at the Acquisition Date as a Result of a Government-Assisted Acquisition of a Financial Institution*. ASU 2012-06 clarifies the applicable guidance for subsequently measuring an indemnification asset recognized as a result of a government-assisted acquisition of a financial institution. The standard instructs that when a reporting entity recognizes an indemnification asset, it should subsequently account for the change in the measurement of the indemnification asset on the same basis as the change in the assets subject to indemnification. Any amortization of changes in value should be limited to the contractual term of the indemnification agreement. The amended guidance is effective

Edgar Filing: EAST WEST BANCORP INC - Form 10-Q

for interim and annual periods beginning on or after December 15, 2012. The adoption of this guidance did not have a material effect on the Company's condensed consolidated financial statements, as the Company had applied this methodology prior to the issuance of this ASU.

In January 2013, the FASB issued ASU 2013-01, *Balance Sheet (Topic 210): Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities*. ASU 2013-01 clarifies that the scope of ASU 2011-01 applies to derivatives, repurchase agreements, and securities lending transactions to the extent that they are (1) offset in the financial statements or (2) subject to an enforceable master netting arrangement or similar agreement. The amended guidance is effective for interim and annual periods beginning on or after January 1, 2013. The adoption of this guidance did not have a material effect on the Company's condensed consolidated financial statements.

Table of Contents

In February 2013, the FASB issued ASU 2013-02, *Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*. ASU 2013-02 enhances the reporting of reclassifications out of accumulated other comprehensive income by requiring entities to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under GAAP to be reclassified in its entirety to net income. For other amounts that are not required under GAAP to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures required under GAAP that provide additional detail about those amounts. The amendments do not change the current requirements for reporting net income or other comprehensive income in financial statements. The amendments are effective for interim and annual periods beginning on or after December 15, 2012. The adoption of this guidance did not have a material effect on the Company's condensed consolidated financial statements.

NOTE 3 FAIR VALUE

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

- Level 1 Quoted prices for identical instruments that are highly liquid, observable and actively traded in over-the-counter markets. Level 1 financial instruments typically include U.S. Treasury securities.

- Level 2 Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs are observable and can be corroborated by market data. Level 2 financial instruments typically include U.S. Government debt and agency mortgage-backed securities, municipal securities, corporate debt securities, single issuer trust preferred securities, equity swap agreements, foreign exchange options, interest rate swaps, impaired loans and other real estate owned (OREO).

- Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. This category typically includes pooled trust preferred securities, impaired loans and derivatives payable.

Table of Contents

The Company records investment securities available-for-sale, equity swap agreements, derivative liabilities, foreign exchange options, interest rate swaps and short-term foreign exchange contracts at fair value on a recurring basis. Certain other assets such as impaired loans, other real estate owned, loans held for sale, goodwill, premiums on acquired deposits and other investments are recorded at fair value on a nonrecurring basis. Nonrecurring fair value measurements typically involve assets that are periodically evaluated for impairment and for which any impairment is recorded in the period in which the remeasurement is performed.

In determining the appropriate hierarchy levels, the Company performs a detailed analysis of assets and liabilities that are subject to fair value disclosure. The following tables present both financial and nonfinancial assets and liabilities that are measured at fair value on a recurring and nonrecurring basis. These assets and liabilities are reported on the condensed consolidated balance sheets at their fair values as of March 31, 2013 and December 31, 2012. Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to their fair value measurement. There were no transfers in and out of Levels 1 and 3 or Levels 2 and 3 during the first three months of 2013 and 2012.

Table of ContentsAssets (Liabilities) Measured at Fair Value on a Recurring Basis
as of March 31, 2013

	Fair Value Measurements March 31, 2013	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(In thousands)				
Investment securities available-for-sale:				
U.S. Treasury securities	\$ 470,764	\$ 470,764	\$	\$
U.S. Government agency and U.S. Government sponsored enterprise debt securities	197,537		197,537	
U.S. Government agency and U.S. Government sponsored enterprise mortgage-backed securities:				
Commercial mortgage-backed securities	145,044		145,044	
Residential mortgage-backed securities	1,035,415		1,035,415	
Municipal securities	206,758		206,758	
Other commercial mortgage-backed securities:				
Investment grade	51,359		51,359	
Corporate debt securities:				
Investment grade	453,323		453,323	
Non-investment grade	18,000		12,716	5,284
Other securities	10,793		10,793	
Total investment securities available-for-sale	\$ 2,588,993	\$ 470,764	\$ 2,112,945	\$ 5,284
Foreign exchange options	\$ 5,340	\$	\$ 5,340	\$
Interest rate swaps	34,192		34,192	
Short-term foreign exchange contracts	1,303		1,303	
Derivative liabilities	(41,024)		(37,791)	(3,233)

Assets (Liabilities) Measured at Fair Value on a Recurring Basis
as of December 31, 2012

	Fair Value Measurements December 31, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(In thousands)				
Investment securities available-for-sale:				
U.S. Treasury securities	\$ 460,677	\$ 460,677	\$	\$
U.S. Government agency and U.S. Government sponsored enterprise debt securities	197,855		197,855	
U.S. Government agency and U.S. Government sponsored enterprise mortgage-backed securities:				
Commercial mortgage-backed securities	180,665		180,665	
Residential mortgage-backed securities	1,144,085		1,144,085	
Municipal securities	167,093		167,093	
Other commercial mortgage-backed securities:				
Investment grade	17,084		17,084	
Corporate debt securities:				
Investment grade	411,983		411,983	
Non-investment grade	17,417		12,617	4,800

Edgar Filing: EAST WEST BANCORP INC - Form 10-Q

Other securities		10,170			10,170			
Total investment securities available-for-sale	\$	2,607,029	\$	460,677	\$	2,141,552	\$	4,800
Foreign exchange options	\$	5,011	\$		\$	5,011	\$	
Interest rate swaps		36,943				36,943		
Short-term foreign exchange contracts		896				896		
Derivative liabilities		(42,060)				(39,008)		(3,052)

Table of Contents

	Assets Measured at Fair Value on a Non-Recurring Basis as of and for the Three Months Ended March 31, 2013				Total Gains (Losses) for the Three Months Ended March 31, 2013
	Fair Value Measurements March 31, 2013	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2) (In thousands)	Significant Unobservable Inputs (Level 3)	
Non-covered impaired loans:					
Total residential	\$ 12,969	\$	\$ 12,969	\$	\$ (440)
Total commercial real estate	23,382		23,382		(2,115)
Total commercial and industrial	2,566		1,432	1,134	(2,258)
Total consumer	665		665		(116)
Total non-covered impaired loans	\$ 39,582	\$	\$ 38,448	\$ 1,134	\$ (4,929)
Non-covered OREO	\$ 13,227	\$	\$ 13,227	\$	\$ (1,385)
Covered OREO (1)	\$ 3,720	\$	\$ 3,720	\$	\$ (126)

	Assets Measured at Fair Value on a Non-Recurring Basis as of and for the Three Months Ended March 31, 2012				Total Gains (Losses) for the Three Months Ended March 31, 2012
	Fair Value Measurements March 31, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2) (In thousands)	Significant Unobservable Inputs (Level 3)	
Non-covered impaired loans:					
Total residential	\$ 5,564	\$	\$ 5,564	\$	\$ (1,903)
Total commercial real estate	21,073		21,073		(1,343)
Total commercial and industrial	3,316			3,316	(984)
Total consumer	7		7		(57)
Total non-covered impaired loans	\$ 29,960	\$	\$ 26,644	\$ 3,316	\$ (4,287)
Non-covered OREO	\$ 8,195	\$	\$ 8,195	\$	\$ (855)
Covered OREO (1)	\$ 25,585	\$	\$ 25,585	\$	\$ (6,449)
Loans held for sale	\$ 4,600	\$	\$ 4,600	\$	\$ (4,730)

(1) Covered OREO results from the WFIB and UCB FDIC-assisted acquisitions for which the Company entered into shared-loss agreements with the FDIC whereby the FDIC will reimburse the Company for 80% of eligible losses. As such, the Company's liability for losses is 20% of the \$126 thousand in losses, or \$25 thousand, and 20% of the \$6.4 million in losses, or \$1.3 million, for the three months ended March 31, 2013 and 2012, respectively.

Table of Contents

At each reporting period, all assets and liabilities for which the fair value measurement is based on significant unobservable inputs are classified as Level 3. The following tables provide a reconciliation of the beginning and ending balances for major asset and liability categories measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three months ended March 31, 2013 and 2012:

	Investment Securities Available-for-Sale Corporate Debt Securities Non-Investment Grade		Derivatives Payable
	(In thousands)		
Opening balance, January 1, 2013	\$	4,800	\$ (3,052)
Total gains or (losses) for the period: (1)			
Included in earnings			(181)
Included in other comprehensive income (unrealized) (2)		549	
Purchases, issues, sales, settlements (3)			
Purchases			
Issues			
Sales			
Settlements		(65)	
Transfer from investment grade to non-investment grade			
Transfers in and/or out of Level 3			
Closing balance, March 31, 2013	\$	5,284	\$ (3,233)
Changes in unrealized losses included in earnings relating to assets and liabilities held at the end of March 31, 2013	\$		\$ 181

	Investment Securities Available-for-Sale Corporate Debt Securities Non-Investment Grade		Derivatives Payable
	(In thousands)		
Opening balance, January 1, 2012	\$	2,235	\$ (2,634)
Total gains or (losses) for the period: (1)			
Included in earnings		(99)	(488)
Included in other comprehensive loss (unrealized) (2)		225	
Purchases, issues, sales, settlements (3)			
Purchases			
Issues			
Sales			
Settlements		(114)	
Transfer from investment grade to non-investment grade			
Transfers in and/or out of Level 3			
Closing balance, March 31, 2012	\$	2,247	\$ (3,122)
Changes in unrealized losses included in earnings relating to assets and liabilities held at the end of March 31, 2012	\$	99	\$ 488

(1) Total gains or losses represent the total realized and unrealized gains and losses recorded for Level 3 assets and liabilities. Realized gains or losses are reported in the condensed consolidated statements of income.

Edgar Filing: EAST WEST BANCORP INC - Form 10-Q

(2) Unrealized gains or losses on investment securities are reported in accumulated other comprehensive income (loss), net of tax, in the condensed consolidated statements of comprehensive income.

(3) Purchases, issuances, sales, and settlements represent Level 3 assets and liabilities that were either purchased, issued, sold, or settled during the period. The amounts are recorded at their end of period fair values.

Table of Contents

Valuation Methodologies

Investment Securities Available-for-Sale The fair values of available-for-sale investment securities are generally determined by prices obtained from independent external pricing service providers who have experience in valuing these securities or by comparison to the average of at least two quoted market prices obtained from independent external brokers. In obtaining such valuation information from third parties, the Company has reviewed the methodologies used to develop the resulting fair values.

The Company's Level 3 available-for-sale securities include four pooled trust preferred securities. The fair values of these investment securities represent less than 1% of the total available-for-sale investment securities. The fair values of the pooled trust preferred securities have traditionally been based on the average of at least two quoted market prices obtained from independent external brokers since broker quotes in an active market are given the highest priority. As a result of the continued illiquidity in the pooled trust preferred securities market, it is the Company's view that current broker prices (which are typically non-binding) on certain pooled trust preferred securities are based on forced liquidation or distressed sale values in very inactive markets that are not representative of the fair value of these securities. As such, the Company considered what weight, if any, to place on transactions that are not orderly when estimating fair value.

For the pooled trust preferred securities, the fair value was derived based on discounted cash flow analyses (the income method) prepared by management. In order to determine the appropriate discount rate used in calculating fair values derived from the income method for the pooled trust preferred securities, the Company has made assumptions using an exit price approach related to the implied rate of return which have been adjusted for general changes in market rates, estimated changes in credit risk and liquidity risk premium, specific nonperformance, and default experience in the collateral underlying the securities. Significant increases (decreases) in any of those inputs in isolation would result in a significantly lower (higher) fair value measurement. Generally, a change in the assumption used for the probability of default is accompanied by a directionally similar change in the assumption used for credit risk and liquidity risk. The actual Level 3 unobservable assumption rates used as of March 31, 2013 include: a constant prepayment rate of 0% for year 1-5 and 1% thereafter, a constant default rate of 1.2% for year 1-5 and 0.75% thereafter, and a recovery assumption of 0% for existing deferrals/defaults and 15% for future deferrals with a recovery lag of 60 months. Losses arising during the period, if any, are recognized in noninterest income.

Derivative Liabilities The Company's derivative liabilities include derivatives payable that fall within Level 3 and all other derivative liabilities which fall within Level 2. The derivatives payable are recorded in conjunction with certain certificates of deposit (host instrument). These CDs pay interest based on changes in either the Chinese currency Renminbi (RMB) or the Hang Seng China Enterprises Index (HSCEI), as designated, and are included in interest-bearing deposits on the condensed consolidated balance sheets. CDs paying interest based on changes in the HSCEI matured during the fourth quarter of 2012. The fair value of these embedded derivatives is based on the income approach. The payable is divided by the portion under FDIC insurance coverage and the non-insured portion. For the FDIC insured portion the Company applied a risk premium comparable to an agency security risk premium. For the non-insured portion, the Company considered its own credit risk in determining the valuation by applying a risk premium based on our institutional credit rating, which resulted in a nominal adjustment to the valuation of the derivative liabilities for the three months ended March 31, 2013. Significant increases (decreases) in any of those inputs in isolation would result in a significantly lower (higher) fair value measurement. The valuation of the derivatives payable falls within Level 3 of the fair value hierarchy since the significant inputs used in deriving the fair value of these derivative contracts are not directly observable. The actual Level 3 unobservable input used as of March 31, 2013 was a credit risk adjustment with a range of 1.17% to 1.25%. The Level 2 derivative liabilities are mostly comprised of the offsetting interest rate swaps with other counterparties. Refer to **Interest Rate Swaps** within this footnote for complete discussion.

Table of Contents

Equity Swap Agreements The Company has entered into equity swap agreements to hedge against market fluctuations in a promotional equity index certificate of deposit product offered to bank customers. This deposit product, which has a term of 5 years, which matured during the fourth quarter of 2012, and paid interest based on the performance of the HSCEI. The fair value of these equity swap agreements is based on the income approach. The fair value is based on the change in the value of the HSCEI and the volatility of the call option over the life of the individual swap agreement. The option value is derived based on the volatility, the interest rate and the time remaining to maturity of the call option. The valuation of equity swap agreements falls within Level 2 of the fair value hierarchy due to the observable nature of the inputs used in deriving the fair value of these derivative contracts. The fair value of the derivative contracts is provided by a third party.

Foreign Exchange Options The Company has entered into foreign exchange option contracts with major investment firms. The settlement amount is determined based upon the performance of the Chinese currency RMB relative to the U.S. Dollar (USD) over the 5-year term of the contract. The performance amount is computed based on the average quarterly value of the RMB per the USD as compared to the initial value. The fair value of the derivative contract is provided by third parties and is determined based on the change in the RMB and the volatility of the option over the life of the agreement. The option value is derived based on the volatility of the option, interest rate, currency rate and time remaining to maturity. The Company's consideration of the counterparty's credit risk resulted in a nominal adjustment the valuation of the foreign exchange options for the three months ended March 31, 2013. The valuation of the option contract falls within Level 2 of the fair value hierarchy due to the observable nature of the inputs used in deriving the fair value of this derivative contract.

Interest Rate Swaps The Company has entered into pay-fixed, receive-variable swap contracts with institutional counterparties to hedge against interest rate swap products offered to bank customers. This product allows borrowers to lock in attractive intermediate and long-term interest rates by entering into a pay-fixed, receive-variable swap contract with the Company, resulting in the customer obtaining a synthetic fixed rate loan. The Company has also entered into pay-variable, receive-fixed swap contracts with institutional counterparties to hedge against certificates of deposit issued. This product allows the Company to lock in attractive floating rate funding. The fair value of the interest rate swap contracts is based on a discounted cash flow approach. The Company's consideration of the counterparty's credit risk resulted in a \$0.4 million adjustment to the valuation of the interest rate swaps for the three months ended March 31, 2013. The valuation of the interest rate swap falls within Level 2 of the fair value hierarchy due to the observable nature of the inputs used in deriving the fair value of this derivative contract.

Short-term Foreign Exchange Contracts The Company entered into short-term foreign exchange contracts to purchase/sell foreign currencies at set rates in the future. These contracts economically hedge against foreign exchange rate fluctuations. The Company enters into contracts with institutional counterparties to hedge against foreign exchange products offered to bank customers. These products allow customers to hedge the foreign exchange risk of their deposits and loans denominated in foreign currencies. The Company does not assume any foreign exchange rate risk as the contract with the customer and the contract with the institutional party mirror each other. The fair value is determined at each reporting period based on the change in the foreign exchange rate. Given the short-term nature of the contracts, the counterparties' credit risks are considered nominal and resulted in no adjustments to the valuation of the short-term foreign exchange contracts for the three months ended March 31, 2013. The valuation of the contract falls within Level 2 of the fair value hierarchy due to the observable nature of the inputs used in deriving the fair value of this derivative contract.

Impaired Loans The Company's impaired loans are generally measured using the fair value of the underlying collateral, which is determined based on the most recent valuation information received. The fair values may be adjusted as needed based on factors such as the Company's historical knowledge and changes in market conditions from the time of valuation. Impaired loans fall within Level 2 or Level 3 of the fair value hierarchy as appropriate. Level 2 values are measured at fair value based on the most recent valuation information received on the underlying collateral. Level 3 values, additionally include adjustments by the Company for historical knowledge and for changes in market conditions.

Table of Contents

Other Real Estate Owned The Company's OREO represents properties acquired through foreclosure or through full or partial satisfaction of loans and are recorded at estimated fair value less cost to sell at the time of foreclosure and at the lower of cost or estimated fair value less cost to sell subsequent to acquisition. The fair values of OREO properties are based on third party appraisals, broker price opinions or accepted written offers. These valuations are reviewed and approved by the Company's appraisal department, credit review department, or OREO department. OREO properties are classified as Level 2 assets in the fair value hierarchy.

Loans Held for Sale The Company's loans held for sale are carried at the lower of cost or market value. These loans are currently comprised of mostly student loans. For these loans, the fair value of loans held for sale is derived from current market prices and comparative current sales. For the remainder of the loans held for sale, which fall within Level 2, the fair value is derived from third party sale analysis, existing sale agreements, or appraisal reports on the loans underlying collateral. As such, the Company records any fair value adjustments on a nonrecurring basis.

Fair Value of Financial Instruments

The carrying amounts and fair values of the Company's financial instruments as of March 31, 2013 and December 31, 2012 were as follows:

	March 31, 2013		December 31, 2012	
	Carrying Amount or Notional Amount	Estimated Fair Value	Carrying Amount or Notional Amount	Estimated Fair Value
(In thousands)				
Financial Assets:				
Cash and cash equivalents	\$ 1,736,865	\$ 1,736,865	\$ 1,323,106	\$ 1,323,106
Short-term investments	379,029	379,029	366,378	366,378
Securities purchased under resale agreements	1,400,000	1,392,927	1,450,000	1,442,302
Investment securities available-for-sale	2,588,993	2,588,993	2,607,029	2,607,029
Loans held for sale	226,635	233,843	174,317	180,349
Loans receivable, net	14,872,172	14,818,860	14,645,785	14,743,218
Investment in Federal Home Loan Bank stock	96,795	96,795	107,275	107,275
Investment in Federal Reserve Bank stock	48,036	48,036	48,003	48,003
Accrued interest receivable	103,392	103,392	94,837	94,837
Foreign exchange options	85,614	5,340	85,614	5,011
Interest rate swaps	1,244,393	34,192	1,190,793	36,943
Short-term foreign exchange contracts	138,940	1,303	112,459	896
Financial Liabilities:				
Customer deposit accounts:				
Demand, savings and money market deposits	12,901,076	12,901,076	12,187,740	12,187,740
Time deposits	6,034,626	6,016,426	6,121,614	6,115,530
Federal Home Loan Bank advances	313,494	326,527	312,975	333,060
Securities sold under repurchase agreements	995,000	1,174,984	995,000	1,173,830
Other borrowings			20,000	20,000
Accrued interest payable	11,103	11,103	10,855	10,855
Long-term debt	137,178	88,379	137,178	83,762
Derivative liabilities	1,576,769	41,024	1,392,494	42,060

Edgar Filing: EAST WEST BANCORP INC - Form 10-Q

The following table shows the level in the fair value hierarchy for the estimated fair values of only financial instruments that are not already on the condensed consolidated balance sheets at fair value at March 31, 2013 and December 31, 2012.

Table of Contents

March 31, 2013				
	Estimated Fair Value Measurements	(In thousands)		
		Level 1	Level 2	Level 3
Financial Assets:				
Cash and cash equivalents	\$ 1,736,865	\$ 1,736,865		\$
Short-term investments	379,029		379,029	
Securities purchased under resale agreements	1,392,927		1,392,927	
Loans held for sale	233,843		233,843	
Loans receivable, net	14,818,860			14,818,860
Investment in Federal Home Loan Bank stock	96,795		96,795	
Investment in Federal Reserve Bank stock	48,036		48,036	
Accrued interest receivable	103,392		103,392	
Financial Liabilities:				
Customer deposit accounts:				
Demand, savings and money market deposits	12,901,076		12,901,076	
Time deposits	6,016,426			6,016,426
Federal Home Loan Bank advances	326,527		326,527	
Securities sold under repurchase agreements	1,174,984		1,174,984	
Other borrowings				
Accrued interest payable	11,103		11,103	
Long-term debt	88,379		88,379	

December 31, 2012				
	Estimated Fair Value Measurements	(In thousands)		
		Level 1	Level 2	Level 3
Financial Assets:				
Cash and cash equivalents	\$ 1,323,106	\$ 1,323,106		\$
Short-term investments	366,378		366,378	
Securities purchased under resale agreements	1,442,302		1,442,302	
Loans held for sale	180,349		180,349	
Loans receivable, net	14,743,218			14,743,218
Investment in Federal Home Loan Bank stock	107,275		107,275	
Investment in Federal Reserve Bank stock	48,003		48,003	
Accrued interest receivable	94,837		94,837	
Financial Liabilities:				
Customer deposit accounts:				
Demand, savings and money market deposits	12,187,740		12,187,740	
Time deposits	6,115,530			6,115,530
Federal Home Loan Bank advances	333,060		333,060	
Securities sold under repurchase agreements	1,173,830		1,173,830	
Other borrowings	20,000		20,000	
Accrued interest payable	10,855		10,855	
Long-term debt	83,762		83,762	

The methods and assumptions used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value are explained below:

Cash and Cash Equivalents The carrying amounts approximate fair values due to the short-term nature of these instruments. Due to the short-term nature, the estimated fair value is considered to be within Level 1 of the fair value hierarchy.

Table of Contents

Short-Term Investments The fair values of short-term investments generally approximate their book values due to their short maturities. Due to the observable nature of the inputs used in deriving the estimated fair value of these instruments, the estimate is considered to be within Level 2 of the fair value hierarchy.

Securities Purchased Under Resale Agreements Securities purchased under resale agreements with original maturities of 90 days or less are included in cash and cash equivalents. The fair value of securities purchased under resale agreements with original maturities of more than 90 days is estimated by discounting the cash flows based on expected maturities or repricing dates utilizing estimated market discount rates. Due to the observable nature of the inputs used in deriving the estimated fair value of these instruments, the estimate is considered to be within Level 2 of the fair value hierarchy.

Investment Securities Available-for-Sale The fair values of the investment securities available-for-sale are generally determined by reference to the average of at least two quoted market prices obtained from independent external brokers or independent external pricing service providers who have experience in valuing these securities. In obtaining such valuation information from third parties, the Company has reviewed the methodologies used to develop the resulting fair values. For pooled trust preferred securities, fair values are based on discounted cash flow analyses. Due to the unobservable inputs used within the discounted cash flow analysis, the estimate for pooled trust preferred securities is considered to be within Level 3 of the fair value hierarchy. The remainder of the portfolio is classified within Level 1 and Level 2, as discussed earlier in this footnote.

Loans Held for Sale The fair value of loans held for sale is derived from current market prices and comparative current sales or from third party sale analysis, existing sale agreements, or appraisal reports on the loans underlying collateral, as applicable. Due to the observable nature of the inputs used in deriving the estimated fair value of these instruments, the estimate is considered to be within Level 2 of the fair value hierarchy.

Loans Receivable, net (includes covered and non-covered loans) The fair value of loans is determined based on a discounted cash flow approach considered for an entry price value. The discount rate is derived from the associated yield curve plus spreads, and reflects the offering rates in the market for loans with similar financial characteristics. No adjustments have been made for changes in credit within any of the loan portfolios. It is management's opinion that the allowance for loan losses pertaining to performing and nonperforming loans results in a fair valuation of credit for such loans. Due to the unobservable nature of the inputs used in deriving the estimated fair value of these instruments, the estimate is considered to be within Level 3 of the fair value hierarchy.

Investment in Federal Home Loan Bank Stock and Federal Reserve Bank Stock The carrying amount approximates fair value, as the stock may be sold back to the Federal Home Loan Bank and the Federal Reserve Bank at carrying value. The valuation of these instruments is the carrying amount as these investments can only be sold and purchased from the Federal Home Loan Bank and Federal Reserve Bank respectively. The valuation of these investments is considered to be within Level 2 of the fair value hierarchy, as the restrictions and value of the investments are the same for all financial institutions which are required to hold these investments.

Accrued Interest Receivable The carrying amounts approximate fair values due to the short-term nature of these instruments, as such, due to the observable nature of the inputs used in deriving the estimated fair value, these instruments are considered to be within Level 2 of the fair value hierarchy.

Equity Swap Agreements Equity swap agreements matured during the fourth quarter of 2012. The fair value of the derivative contracts is provided by a third party and is determined based on the change in value of the HSCEI and the volatility of the call option over the life of the individual swap agreement. The option value is derived based on the volatility of the option, interest rate, and time remaining to maturity. We also considered the counterparty's credit risk in determining the fair value. Due to the observable nature of the inputs used in deriving the estimated fair value of these instruments, the estimate is considered to be within Level 2 of the fair value hierarchy.

Table of Contents

Foreign Exchange Options The fair value of the derivative contracts is provided by third parties and is determined based on the change in the RMB and the volatility of the option over the life of the agreement. The option value is derived based on the volatility of the option, interest rate, and time remaining to maturity. We also considered the counterparty's credit risk in determining the fair value. Due to the observable nature of the inputs used in deriving the estimated fair value of these instruments, the estimate is considered to be within Level 2 of the fair value hierarchy.

Interest Rate Swaps The fair value of the interest rate swap contracts is provided by a third party and is determined based on a discounted cash flow approach. The Company also considered the counterparty's credit risk in determining the fair value. Due to the observable nature of the inputs used in deriving the estimated fair value of these instruments, the estimate is considered to be within Level 2 of the fair value hierarchy.

Short-term Foreign Exchange Contracts The fair value of short-term foreign exchange contracts is determined based on the change in foreign exchange rate. We also considered the counterparty's credit risk in determining the fair value. Due to the observable nature of the inputs used in deriving the estimated fair value of these instruments, the estimate is considered to be within Level 2 of the fair value hierarchy.

Customer Deposit Accounts The carrying amounts approximate fair value for demand and interest checking deposits, savings deposits, and certain money market accounts as the amounts are payable on demand at the reporting date. Due to the observable nature of the inputs used in deriving the estimated fair value these instruments are considered to be within Level 2 of the fair value hierarchy. For time deposits, the cash flows are based on the contractual runoff and are discounted by the Bank's current offering rates, plus spread. Due to the unobservable nature of the inputs used in deriving the estimated fair value of these instruments, the estimate is considered to be within Level 3 of the fair value hierarchy.

Federal Home Loan Bank Advances The fair value of Federal Home Loan Bank (FHLB) advances is estimated based on the discounted value of contractual cash flows, using rates currently offered by the FHLB of San Francisco for advances with similar remaining maturities at each reporting date. Due to the observable nature of the inputs used in deriving the estimated fair value of these instruments, the estimate is considered to be within Level 2 of the fair value hierarchy.

Securities Sold Under Repurchase Agreements For securities sold under repurchase agreements with original maturities of 90 days or less, the carrying amounts approximate fair values due to the short-term nature of these instruments. At March 31, 2013 and December 31, 2012, most of the securities sold under repurchase agreements are long-term in nature and the fair values of securities sold under repurchase agreements are calculated by discounting future cash flows based on expected maturities or repricing dates, utilizing estimated market discount rates, and taking into consideration the call features of each instrument. Due to the observable nature of the inputs used in deriving the estimated fair value of these instruments, the estimate is considered to be within Level 2 of the fair value hierarchy.

Other Borrowings The carrying amounts approximate fair values due to the short-term nature of these instruments, as such, due to the observable nature of the inputs used in deriving the estimated fair value, these instruments are considered to be within Level 2 of the fair value hierarchy.

Accrued Interest Payable The carrying amounts approximate fair values due to the short-term nature of these instruments, as such, due to the observable nature of the inputs used in deriving the estimated fair value, these instruments are considered to be within Level 2 of the fair value hierarchy.

Table of Contents

Long-Term Debt The fair values of long-term debt are estimated by discounting the cash flows through maturity based on current market rates the Bank would pay for new issuances. Due to the observable nature of the inputs used in deriving the estimated fair value of these instruments, the estimate is considered to be within Level 2 of the fair value hierarchy.

Derivatives Liabilities The Company's derivative liabilities include derivatives payable and all other derivative liabilities. The Company's derivatives payable are recorded in conjunction with certain certificates of deposit (host instrument). These CDs pay interest based on changes in RMB or the HSCEI, as designated. CDs paying interest based on changes in the HSCEI matured during the fourth quarter of 2012. The fair value of derivatives payable is estimated using the income approach. Additionally, we considered our own credit risk in determining the valuation. The other derivative liabilities are mostly comprised of the off-setting interest rate swaps. The fair value of the interest rate swap contracts is provided by a third party and is determined based on a discounted cash flow approach. The Company also considered the counterparty's credit risk in determining the fair value. Due to the observable nature of the inputs used in deriving the estimated fair value of the interest rate swaps within derivative liabilities, the estimate is considered to be within Level 2 of the fair value hierarchy. Due to the unobservable nature of the inputs used in deriving the estimated fair value of derivatives payable within derivative liabilities, this estimate is considered to be within Level 3 of the fair value hierarchy.

The fair value estimates presented herein are based on pertinent information available to management as of each reporting date. Although we are not aware of any factors that would significantly affect the estimated fair value amounts, such amounts have not been comprehensively revalued for purposes of these financial statements since that date, and therefore, current estimates of fair value may differ significantly from the amounts presented herein.

NOTE 4 STOCK-BASED COMPENSATION

During the three months ended March 31, 2013, total compensation expense recognized in the condensed consolidated statements of income related to both stock options and restricted stock awards reduced income before taxes by \$2.5 million and net income by \$1.5 million.

During the three months ended March 31, 2012, total compensation expense recognized in the condensed consolidated statements of income related to both stock options and restricted stock awards reduced income before taxes by \$3.6 million and net income by \$2.1 million.

The Company received \$442 thousand and \$1.5 million during the three months ended March 31, 2013 and March 31, 2012, respectively, in cash proceeds from stock option exercises. The net tax benefit recognized in equity for stock compensation plans was \$2.6 million and \$29 thousand for the three months ended, March 31, 2013 and March 31, 2012, respectively.

As of March 31, 2013, there are 4,115,745 shares available to be issued, subject to the Company's current 1998 Stock Incentive Plan, as amended.

Stock Options

The Company issues fixed stock options to certain employees, officers, and directors. Stock options are issued at the current market price on the date of grant with a three-year or four-year vesting period and contractual terms of 7 or 10 years. The Company issues new shares upon the exercise of stock options.

Edgar Filing: EAST WEST BANCORP INC - Form 10-Q

Table of Contents

A summary of activity for the Company's stock options as of and for the three months ended March 31, 2013 is presented below:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (In thousands)
Outstanding at beginning of period	677,708	\$ 28.41		
Granted				
Exercised	(23,584)	18.73		
Expired	(141,291)	36.90		
Outstanding at end of period	512,833	\$ 26.52	1.56 years	\$ 1,786
Vested or expected to vest at end of period	512,833	\$ 26.52	1.56 years	\$ 1,786
Exercisable at end of period	512,833	\$ 26.52	1.56 years	\$ 1,786

A summary of changes in unvested stock options and related information for the three months ended March 31, 2013 is presented below:

	Shares	Weighted Average Grant Date Fair Value (per share)
Unvested at January 1, 2013	14,502	\$ 3.00
Granted		
Vested	(14,502)	3.00
Forfeited		
Unvested at March 31, 2013		\$

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions: 1) the expected term (estimated period of time outstanding) of stock options granted is estimated using the historical exercise behavior of employees; 2) the expected volatility is based on historical volatility for a period equal to the stock option's expected term; 3) the expected dividend yield is based on the Company's prevailing dividend rate at the time of grant; and 4) the risk-free rate is based on the U.S. Treasury strips in effect at the time of grant equal to the stock option's expected term. The Company did not issue any stock options during the three months ended March 31, 2013 and 2012.

During the three months ended March 31, 2013 and 2012, information related to stock options is presented as follows:

	Three Months Ended March 31,	
	2013	2012
Weighted average grant date fair value of stock options granted during the period (1)	N/A	N/A
Total intrinsic value of options exercised (in thousands)	\$ 127	\$ 575

Edgar Filing: EAST WEST BANCORP INC - Form 10-Q

Total fair value of options vested (in thousands)	\$	363	\$	3,001
---	----	-----	----	-------

(1) The Company did not issue any stock options during the three months ended March 31, 2013 and 2012.

As of March 31, 2013, all stock options are fully vested and all compensation cost related to stock options have been recognized.

Table of Contents**Restricted Stock Awards**

In addition to stock options, the Company also grants restricted stock awards to directors, officers and employees. The restricted stock awards fully vest after one to five years of continued employment from the date of grant; some of the awards are also subject to achievement of certain established financial goals. The Company becomes entitled to an income tax deduction in an amount equal to the taxable income reported by the holders of the restricted stock when the restrictions are released and the shares are issued. Restricted stock awards are forfeited if officers and employees terminate prior to the lapsing of restrictions or if established financial goals are not achieved. The Company records forfeitures of issued restricted stock as treasury share repurchases.

A summary of the activity for the Company's time-based and performance-based restricted stock awards as of March 31, 2013, including changes during the three months then ended, is presented below:

	March 31, 2013 Restricted Stock Awards			
	Time-Based		Performance-Based	
	Shares	Weighted Average Price	Shares	Weighted Average Price
Outstanding at beginning of period	1,512,396	\$ 16.30	694,838	\$ 22.43
Granted	11,432	22.31	477,165	25.25
Vested	(677,815)	15.66	(170,427)	22.58
Forfeited	(20,262)	17.54	(6,419)	22.65
Outstanding at end of period	825,751	\$ 16.87	995,157	\$ 23.75

Restricted stock awards are valued at the closing price of the Company's stock on the date of award. The weighted average fair values of time-based restricted stock awards granted during the period ended March 31, 2013 and 2012 were \$22.31 and \$20.98, respectively. The weighted average fair value of performance-based restricted stock awards granted during the period ended March 31, 2013 and 2012 were \$25.25 and \$22.05, respectively. The total fair value of time-based restricted stock awards vested for the three months ended March 31, 2013 and 2012 was \$16.3 million and \$1.8 million, respectively. The total fair value of performance-based restricted stock awards vested during the three months ended March 31, 2013 and 2012 was \$4.3 million and \$1.9 million, respectively.

Table of Contents

As of March 31, 2013, total unrecognized compensation cost related to time-based and performance-based restricted stock awards amounted to \$6.7 million and \$20.7 million, respectively. This cost is expected to be recognized over a weighted average period of 1.4 years and 2.4 years, respectively.

NOTE 5 INVESTMENT SECURITIES

An analysis of the investment securities available-for-sale portfolio is presented as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(In thousands)			
As of March 31, 2013				
Investment securities available-for-sale:				
U.S. Treasury securities	\$ 469,747	\$ 1,048	\$ (31)	\$ 470,764
U.S. Government agency and U.S. Government sponsored enterprise debt securities	197,137	520	(120)	197,537
U.S. Government agency and U.S. Government sponsored enterprise mortgage-backed securities:				
Commercial mortgage-backed securities	142,050	3,405	(411)	145,044
Residential mortgage-backed securities	1,018,638	18,078	(1,301)	1,035,415
Municipal securities	206,113	3,284	(2,639)	206,758
Other commercial mortgage-backed securities:				
Investment grade	50,998	361		51,359
Corporate debt securities:				
Investment grade	458,534	1,554	(6,765)	453,323
Non-investment grade (1)	24,534	200	(6,734)	18,000
Other securities	10,633	160		10,793
Total investment securities available-for-sale	\$ 2,578,384	\$ 28,610	\$ (18,001)	\$ 2,588,993
As of December 31, 2012				
Investment securities available-for-sale:				
U.S. Treasury securities	\$ 459,613	\$ 1,135	\$ (71)	\$ 460,677
U.S. Government agency and U.S. Government sponsored enterprise debt securities	197,264	673	(82)	197,855
U.S. Government agency and U.S. Government sponsored enterprise mortgage-backed securities:				
Commercial mortgage-backed securities	174,036	6,665	(36)	180,665
Residential mortgage-backed securities	1,123,880	20,883	(678)	1,144,085
Municipal securities	163,333	4,491	(731)	167,093
Other commercial mortgage-backed securities:				
Investment grade	16,999	85		17,084
Corporate debt securities:				
Investment grade	429,318	237	(17,572)	411,983

Edgar Filing: EAST WEST BANCORP INC - Form 10-Q

Non-investment grade (1)	24,620	355	(7,558)	17,417
Other securities	9,955	215		10,170
Total investment securities available-for-sale	\$ 2,599,018	\$ 34,739	\$ (26,728)	\$ 2,607,029

(1) For the three months ended March 31, 2013, the Company did not record any OTTI. The Company recorded \$99 thousand, on a pre-tax basis, of the credit portion of OTTI through earnings and \$5.1 million of the non-credit portion of OTTI for pooled trust preferred securities in other comprehensive income for the year ended December 31, 2012.

The Company did not have any investment securities held-to-maturity as of March 31, 2013 and December 31, 2012.

The fair values of investment securities are generally determined by reference to the average of at least two quoted market prices obtained from independent external brokers or prices obtained from independent external pricing service providers who have experience in valuing these securities. The Company performs a monthly analysis on the pricing service quotes and the broker quotes received from third parties to ensure that the prices represent a reasonable estimate of fair value. The procedures include, but are not limited to, initial and ongoing review of third party pricing methodologies, review of pricing trends, and monitoring of trading volumes. The Company assesses whether the prices received from independent brokers represent a reasonable estimate of fair value through the use of internal and external cash flow models developed that are based on spreads and, when available, market indices. As a result of this analysis, if the Company determines there is a more appropriate fair value based upon available market data, the price received from third parties is adjusted accordingly.

Table of Contents

Prices from third party pricing services are often unavailable for securities that are rarely traded or are traded only in privately negotiated transactions. As a result, certain securities are priced via independent broker quotations that utilize inputs that may be difficult to corroborate with observable market based data. Additionally, the majority of these independent broker quotations are non-binding.

As a result of the ongoing financial crisis in the U.S. and global markets, the market for the pooled trust preferred securities has been distressed since mid-2007. It is the Company's view that current broker prices (which are typically non-binding) on these securities are based on forced liquidation or distressed sale values in very inactive markets that are not representative of the fair value of these securities. As such, the Company considered what weight, if any, to place on transactions that are not orderly when estimating fair value. For the pooled trust preferred securities the Company determined their fair values using the methodologies set forth in Note 3 to the Company's condensed consolidated financial statements presented elsewhere in this report.

The following table shows the Company's rollforward of the amount related to OTTI credit losses for the periods shown:

	Three Months Ended March 31,		
	2013		2012
	(In thousands)		
Beginning balance, January 1,	\$	115,511	\$ 115,412
Addition of other-than-temporary impairment that was not previously recognized			
Additional increases to the amount related to the credit loss for which an other-than-temporary impairment was previously recognized			99
Reduction for securities sold			
Ending balance	\$	115,511	\$ 115,511

During the three months ended March 31, 2013, the Company recorded \$5.6 million of gross gains and no gross losses resulting in a net income statement impact of \$5.6 million of gain on sale of investment securities. During the three months ended March 31, 2012, the Company recorded \$1.7 million of gross gains and \$1.2 million of gross losses resulting in a net income statement impact of \$483 thousand of gain on sale of investment securities. The tax expense on the sale of investment securities available-for-sale amounted to \$2.3 million and \$203 thousand for the three months ended March 31, 2013 and 2012, respectively. Total net proceeds for these sales were \$196.9 million and \$260.3 million for the three months ended March 31, 2013 and 2012, respectively.

The following tables show the Company's investment portfolio's gross unrealized losses and related fair values, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, as of March 31, 2013 and December 31, 2012:

Table of Contents

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
As of March 31, 2013						
Investment securities available-for-sale:						
U.S. Treasury securities	\$ 52,587	\$ (31)	\$	\$	\$ 52,587	\$ (31)
U.S. Government agency and U.S. Government sponsored enterprise debt securities	24,874	(120)			24,874	(120)
U.S. Government agency and U.S. Government sponsored enterprise mortgage-backed securities:						
Commercial mortgage-backed securities	44,066	(411)			44,066	(411)
Residential mortgage-backed securities	203,984	(1,301)			203,984	(1,301)
Municipal securities	120,187	(2,639)			120,187	(2,639)
Corporate debt securities:						
Investment grade	94,204	(2,044)	105,279	(4,721)	199,483	(6,765)
Non-investment grade	2,078	(53)	13,386	(6,681)	15,464	(6,734)
Other securities						
Total investment securities available-for-sale	\$ 541,980	\$ (6,599)	\$ 118,665	\$ (11,402)	\$ 660,645	\$ (18,001)

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
As of December 31, 2012						
Investment securities available-for-sale:						
U.S. Treasury securities	\$ 95,232	\$ (71)	\$	\$	\$ 95,232	\$ (71)
U.S. Government agency and U.S. Government sponsored enterprise debt securities	24,912	(82)			24,912	(82)
U.S. Government agency and U.S. Government sponsored enterprise mortgage-backed securities:						
Commercial mortgage-backed securities	10,013	(36)			10,013	(36)
Residential mortgage-backed securities	215,826	(678)				