

CVB FINANCIAL CORP  
Form 10-Q  
November 12, 2013  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D. C. 20549**

**FORM 10-Q**

(Mark One)

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

**For the quarterly period ended September 30, 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: 0-10140**

**CVB FINANCIAL CORP.**

**(Exact name of registrant as specified in its charter)**

**California**  
**(State or other jurisdiction of**  
**incorporation or organization)**

**701 North Haven Ave, Suite 350,**

**Ontario, California**  
**(Address of Principal Executive Offices)**

**(909) 980-4030**

**95-3629339**  
**(I.R.S. Employer**  
**Identification No.)**

**91764**  
**(Zip Code)**

**(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, accelerated filer, non-accelerated filer or smaller reporting company. See definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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 of common stock of the registrant: 105,239,634 outstanding as of October 31, 2013.

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**Table of Contents****PART I FINANCIAL INFORMATION (UNAUDITED)****GENERAL*****Forward Looking Statements***

Certain statements in this Report on Form 10-Q, including, but not limited to, statements under the heading

Management Discussion and Analysis of Financial Condition and Results of Operations constitute forward-looking statements under the Private Securities Litigation Reform Act of 1995, including but not limited to, statements about anticipated future operating and financial performance, financial position and liquidity, business prospects, strategic alternatives, business strategies, regulatory policies, competitive outlook, capital and financing needs and availability, acquisition and divestiture opportunities, investment and expenditure plans, plans and objectives of management for future operations, management hiring and retention and other similar forecasts and statements of expectations of assumptions underlying any of the foregoing. Words such as will likely result, aims, anticipates, believes, could, estimates, expects, hopes, intends, may, plans, projects, seeks, should, will and variations of these expressions are intended to identify these forward looking statements, which involve risks and uncertainties. Our actual results may differ significantly from the results discussed in such forward-looking statements. Factors that might cause such a difference include, but are not limited to, local, regional, national and international economic conditions and events and the impact they may have on us and our customers; ability to attract and maintain deposits, borrowings and other sources of liquidity; supply of property inventory and renewed fluctuation or deterioration in values of real estate in California or other jurisdictions where we lend, whether involving residential or commercial property; a prolonged slowdown or decline in construction activity; changes in the financial performance and/or condition of our loan and deposit customers; changes in the levels of performing and nonperforming assets and charge-offs; the cost or effect of acquisitions or divestitures we may make; the effect of changes in laws and regulations (including laws, regulations and judicial decisions concerning financial reform, taxes, bank or holding company capital levels, securities, employment, executive compensation, insurance, and information security) with which we and our subsidiaries must comply; changes in the applicability or costs of deposit insurance; changes in estimates of future reserve requirements and minimum capital requirements based upon the periodic review thereof under relevant legal, regulatory and accounting requirements; inflation, interest rate, securities market and monetary fluctuations; internal and external fraud and cyber-security threats, including theft or loss of Company or customer funds, loss of system functionality or access, or theft or loss of data; political instability; acts of war or terrorism, or natural disasters, such as earthquakes, or the effects of pandemic diseases; the timely development and acceptance of new banking products and services (including technology-based services and products) and the perceived overall value of these products and services by users; changes in consumer spending, borrowing and savings habits; the effects of technological changes, the expanding use of technology in banking (including the adoption of mobile banking applications) and product innovation; the ability to retain or increase market share, retain or grow customers and control expenses; changes in the risk or competitive environment among financial and bank entities, holding companies and other financial service providers; continued volatility in the credit and equity markets and its effects on the general economy or local business conditions; the effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as by the Public Company Accounting Oversight Board, the Financial Accounting Standards Board and other national or international accounting standard setters; changes in our organization, management, compensation and benefit plans, and our ability to retain or expand our management team; the costs and effects of legal and regulatory changes or developments; the favorable or unfavorable resolution of legal proceedings or regulatory or other governmental inquiries, including, but not limited to, the current investigation by the Securities and Exchange Commission and the related class-action lawsuits filed against us; and the results of regulatory examinations or reviews or other government actions. The Company cautions that the foregoing factors are not exclusive. For additional information concerning these factors and other factors which may cause actual results to differ from the results discussed in our forward-looking statements, see the periodic filings the Company makes with

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the Securities and Exchange Commission, and, in particular, the information set forth in Item 1A herein and in Item 1A. Risk Factors contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2012. The Company does not undertake, and specifically disclaims, any obligation to update any forward-looking statements to reflect occurrences or unanticipated events or circumstances after the date of such statements except as required by law.

**Table of Contents****ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****CVB FINANCIAL CORP. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS***(Dollars in thousands, except share data)**(Unaudited)*

|  | <b>September 30,<br/>2013</b> | <b>December 31,<br/>2012</b> |
|--|-------------------------------|------------------------------|
| <b>ASSETS</b>  |                               |                              |
| Cash and due from banks  | \$ 127,728                    | \$ 87,274                    |
| Interest-earning balances due from Federal Reserve   | 3,714                         | 11,157                       |
| Total cash and cash equivalents  | 131,442                       | 98,431                       |
| Interest-earning balances due from depository institutions   | 70,000                        | 70,000                       |
| Investment securities available-for-sale, at fair value (with amortized cost of \$2,609,959 at September 30, 2013, and \$2,374,816 at December 31, 2012) | 2,617,307                     | 2,449,387                    |
| Investment securities held-to-maturity   | 1,850                         | 2,050                        |
| Investment in stock of Federal Home Loan Bank (FHLB)   | 39,420                        | 56,651                       |
| Loans and lease finance receivables, excluding covered loans   | 3,281,352                     | 3,252,313                    |
| Allowance for loan losses  | (80,713)                      | (92,441)                     |
| Net loans and lease finance receivables  | 3,200,639                     | 3,159,872                    |
| Covered loans and lease finance receivables, net   | 163,334                       | 195,215                      |
| Premises and equipment, net  | 33,604                        | 35,080                       |
| Bank owned life insurance  | 122,538                       | 119,744                      |
| Accrued interest receivable  | 21,860                        | 22,355                       |
| Intangibles  | 2,386                         | 3,389                        |
| Goodwill   | 55,097                        | 55,097                       |
| FDIC loss sharing asset  | 7,034                         | 18,489                       |
| Non-covered other real estate owned  | 6,524                         | 14,832                       |
| Covered other real estate owned  | 906                           | 1,067                        |
| Income tax assets, net   | 59,226                        | 16,978                       |
| Other assets   | 24,116                        | 44,727                       |
| <b>TOTAL ASSETS</b>  | <b>\$ 6,557,283</b>           | <b>\$ 6,363,364</b>          |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>   |                               |                              |
| <b>Liabilities:</b>  |                               |                              |
| <b>Deposits:</b>   |                               |                              |
| Noninterest-bearing  | \$ 2,538,461                  | \$ 2,420,993                 |

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|   |                     |                     |
|---|---------------------|---------------------|
| Interest-bearing  | 2,357,025           | 2,352,994           |
| Total deposits  | 4,895,486           | 4,773,987           |
| Customer repurchase agreements  | 565,883             | 473,244             |
| FHLB advances   | 199,138             | 198,934             |
| Other borrowings  | 42,482              | 26,000              |
| Accrued interest payable  | 1,106               | 1,493               |
| Deferred compensation   | 9,316               | 8,781               |
| Junior subordinated debentures  | 25,774              | 67,012              |
| Other liabilities   | 49,876              | 50,943              |
| <b>TOTAL LIABILITIES</b>  | <b>5,789,061</b>    | <b>5,600,394</b>    |
| <b>COMMITMENTS AND CONTINGENCIES</b>  |                     |                     |
| Stockholders' Equity:   |                     |                     |
| Common stock, authorized, 225,000,000 shares without par; issued and outstanding 105,209,875 at September 30, 2013, and 104,889,586 at December 31, 2012. | 488,555             | 484,709             |
| Retained earnings   | 275,405             | 235,010             |
| Accumulated other comprehensive income, net of tax  | 4,262               | 43,251              |
| <b>Total stockholders' equity</b>   | <b>768,222</b>      | <b>762,970</b>      |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>   | <b>\$ 6,557,283</b> | <b>\$ 6,363,364</b> |

See accompanying notes to the condensed consolidated financial statements.

**Table of Contents****CVB FINANCIAL CORP. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS AND COMPREHENSIVE INCOME***(Dollars in thousands, except per share amounts)**(Unaudited)*

|  | <b>For the Three Months Ended</b> |             | <b>For the Nine Months Ended</b> |             |
|--|-----------------------------------|-------------|----------------------------------|-------------|
|  | <b>September 30,</b>              |             | <b>September 30,</b>             |             |
|  | <b>2013</b>                       | <b>2012</b> | <b>2013</b>                      | <b>2012</b> |
| <b>Interest income:</b>                              |                                   |             |                                  |             |
| Loans and leases, including fees                     | \$ 41,706                         | \$ 45,559   | \$ 124,879                       | \$ 139,289  |
| Accretion on acquired loans                          | 2,947                             | 7,045       | 10,796                           | 19,258      |
| Loans, including fees                                | 44,653                            | 52,604      | 135,675                          | 158,547     |
| <b>Investment securities:</b>                        |                                   |             |                                  |             |
| Taxable  | 7,102                             | 7,246       | 19,280                           | 25,202      |
| Tax-advantaged                                       | 5,517                             | 5,640       | 16,569                           | 17,221      |
| Total investment income                              | 12,619                            | 12,886      | 35,849                           | 42,423      |
| Dividends from FHLB stock                            | 622                               | 79          | 1,432                            | 263         |
| Federal funds sold                                   | 58                                | 158         | 158                              | 539         |
| Interest-earning deposits with other institutions    | 122                               | 118         | 366                              | 317         |
| Total interest income                                | 58,074                            | 65,845      | 173,480                          | 202,089     |
| <b>Interest expense:</b>                             |                                   |             |                                  |             |
| Deposits   | 1,228                             | 1,398       | 3,627                            | 4,605       |
| Borrowings   | 2,768                             | 4,086       | 8,184                            | 13,933      |
| Junior subordinated debentures                       | 105                               | 617         | 512                              | 2,245       |
| Total interest expense                               | 4,101                             | 6,101       | 12,323                           | 20,783      |
| Net interest income before provision for loan losses | 53,973                            | 59,744      | 161,157                          | 181,306     |
| Provision for loan losses                            | (3,750)                           |             | (9,950)                          |             |
| Net interest income after provision for loan losses  | 57,723                            | 59,744      | 171,107                          | 181,306     |
| <b>Noninterest income:</b>                           |                                   |             |                                  |             |
| Service charges on deposit accounts                  | 4,011                             | 4,040       | 11,982                           | 12,232      |
| Trust and investment services                        | 2,021                             | 2,037       | 6,098                            | 6,264       |
| Bankcard services                                    | 920                               | 962         | 2,697                            | 2,888       |
| BOLI income  | 497                               | 781         | 1,867                            | 2,271       |
| Gain on sale of investment securities, net           |                                   |             | 2,094                            |             |
| Decrease in FDIC loss sharing asset, net             | (3,248)                           | (7,059)     | (10,715)                         | (19,339)    |
| Gain on OREO, net                                    | (3)                               | 524         | 3,129                            | 1,458       |



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|  |           |           |             |           |
|--|-----------|-----------|-------------|-----------|
| Other  | 759       | 1,341     | 2,245       | 4,400     |
| Total noninterest income   | 4,957     | 2,626     | 19,397      | 10,174    |
| Noninterest expense:   |           |           |             |           |
| Salaries and employee benefits   | 18,389    | 17,489    | 52,777      | 50,856    |
| Occupancy and equipment  | 3,641     | 4,010     | 10,888      | 11,582    |
| Professional services  | 1,316     | 1,570     | 4,299       | 5,666     |
| Software licenses and maintenance  | 1,077     | 1,062     | 3,392       | 2,960     |
| Promotion  | 1,105     | 1,176     | 3,503       | 3,741     |
| Provision for unfunded commitments   | 500       |           | 500         |           |
| Amortization of intangibles  | 127       | 449       | 1,002       | 1,717     |
| Debt termination expense   |           | 20,379    |             | 20,379    |
| OREO expense   | 21        | 405       | 384         | 1,458     |
| Insurance reimbursements   | (4,139)   | (48)      | (4,139)     | (451)     |
| Other  | 3,677     | 3,528     | 12,154      | 11,273    |
| Total noninterest expense  | 25,714    | 50,020    | 84,760      | 109,181   |
| Earnings before income taxes   | 36,966    | 12,350    | 105,744     | 82,299    |
| Income taxes   | 12,727    | 3,093     | 35,424      | 27,155    |
| Net earnings   | \$ 24,239 | \$ 9,257  | \$ 70,320   | \$ 55,144 |
| Other comprehensive income/(loss):   |           |           |             |           |
| Unrealized gain/(loss) on investment securities arising during the period                      | \$ 421    | \$ 8,417  | \$ (65,129) | \$ 12,064 |
| Less: Reclassification adjustment for net gain on investment securities included in net income |           |           | (2,094)     |           |
| Other comprehensive income (loss), before tax  | 421       | 8,417     | (67,223)    | 12,064    |
| Income tax (expense) benefit related to items of other comprehensive income (loss)             | (176)     | (3,536)   | 28,234      | (5,068)   |
| Other comprehensive income (loss), net of tax  | 245       | 4,881     | (38,989)    | 6,996     |
| Comprehensive income   | \$ 24,484 | \$ 14,138 | \$ 31,331   | \$ 62,140 |
| Basic earnings per common share  | \$ 0.23   | \$ 0.09   | \$ 0.67     | \$ 0.53   |
| Diluted earnings per common share  | \$ 0.23   | \$ 0.09   | \$ 0.67     | \$ 0.53   |
| Cash dividends declared per common share   | \$ 0.10   | \$ 0.085  | \$ 0.285    | \$ 0.255  |

See accompanying notes to the condensed consolidated financial statements.

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**CVB FINANCIAL CORP. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY**

**Nine Months Ended September 30, 2013 and 2012**

*(Dollars and shares in thousands)*

*(Unaudited)*

|   | Common<br>Shares<br>Outstanding | Common<br>Stock | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income/(Loss) | Total      |
|---|---------------------------------|-----------------|----------------------|--|------------|
| <b>Balance January 1, 2012</b>                          | 104,482                         | \$ 479,973      | \$ 193,372           | \$ 41,469  | \$ 714,814 |
| Exercise of stock options                               | 331                             | 2,412           |                      |  | 2,412      |
| Tax benefit from exercise of stock options              |                                 | 179             |                      |  | 179        |
| Shares issued pursuant to stock-based compensation plan |                                 | 1,387           |                      |  | 1,387      |
| Cash dividends declared Common (\$0.255 per share)      |                                 |                 | (26,725)             |  | (26,725)   |
| Net earnings  |                                 |                 | 55,144               |  | 55,144     |
| Other comprehensive income                              |                                 |                 |                      | 6,996  | 6,996      |
| <b>Balance September 30, 2012</b>                       | 104,813                         | \$ 483,951      | \$ 221,791           | \$ 48,465  | \$ 754,207 |
| <b>Balance January 1, 2013</b>                          | 104,890                         | \$ 484,709      | \$ 235,010           | \$ 43,251  | \$ 762,970 |
| Repurchase of common stock                              | (36)                            | (459)           |                      |  | (459)      |
| Exercise of stock options                               | 259                             | 2,651           |                      |  | 2,651      |
| Tax benefit from exercise of stock options              |                                 | 215             |                      |  | 215        |
| Shares issued pursuant to stock-based compensation plan | 97                              | 1,439           |                      |  | 1,439      |
| Cash dividends declared Common (\$0.285 per share)      |                                 |                 | (29,925)             |  | (29,925)   |
| Net earnings  |                                 |                 | 70,320               |  | 70,320     |
| Other comprehensive income                              |                                 |                 |                      | (38,989)   | (38,989)   |
| <b>Balance September 30, 2013</b>                       | 105,210                         | \$ 488,555      | \$ 275,405           | \$ 4,262   | \$ 768,222 |

See accompanying notes to the condensed consolidated financial statements.

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**CVB FINANCIAL CORP. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

*(Dollars in thousands)*

*(Unaudited)*

|   | <b>For the Nine Months Ended</b> |             |
|---|----------------------------------|-------------|
|   | <b>September 30,</b>             |             |
|   | <b>2013</b>                      | <b>2012</b> |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>               |                                  |             |
| Interest and dividends received                           | \$ 181,608                       | \$ 200,601  |
| Service charges and other fees received                   | 23,103                           | 28,144      |
| Interest paid   | (12,506)                         | (22,531)    |
| Net cash paid to vendors and employees                    | (69,441)                         | (105,347)   |
| Income taxes paid   | (50,200)                         | (3,455)     |
| Proceeds from FDIC loss share agreement                   | 239                              | 17,842      |
| Net cash provided by operating activities                 | 72,803                           | 115,254     |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>               |                                  |             |
| Proceeds from redemption of FHLB stock                    | 17,231                           | 10,261      |
| Proceeds from sale of investment securities               | 99,155                           |             |
| Proceeds from repayment of investment securities          | 344,660                          | 401,229     |
| Proceeds from maturity of investment securities           | 62,175                           | 74,287      |
| Purchases of investment securities                        | (759,609)                        | (567,391)   |
| Net decrease in loan and lease finance receivables        | 13,375                           | 61,475      |
| Proceeds from sales of premises and equipment             | 9                                | 26          |
| Purchase of premises and equipment                        | (2,080)                          | (3,382)     |
| Proceeds from sales of other real estate owned            | 12,922                           | 17,274      |
| Net cash used in investing activities                     | (212,162)                        | (6,221)     |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>               |                                  |             |
| Net increase in transaction deposits                      | 147,349                          | 275,109     |
| Net decrease in time deposits                             | (25,850)                         | (98,541)    |
| Repayment of FHLB advances                                |                                  | (250,000)   |
| Repayment of junior subordinated debentures               | (41,238)                         | (48,043)    |
| Net increase in other borrowings                          | 16,482                           |             |
| Net increase/(decrease) in customer repurchase agreements | 92,639                           | (60,582)    |
| Cash dividends on common stock                            | (19,419)                         | (26,725)    |
| Repurchase of common stock                                | (459)                            |             |
| Proceeds from exercise of stock options                   | 2,651                            | 2,412       |
| Tax benefit related to exercise of stock options          | 215                              | 179         |
| Net cash provided by/(used in) financing activities       | 172,370                          | (206,191)   |

|   |            |            |
|---|------------|------------|
| <b>NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS</b> | 33,011     | (97,158)   |
| <b>CASH AND CASH EQUIVALENTS, beginning of period</b>       | 98,431     | 345,343    |
| <b>CASH AND CASH EQUIVALENTS, end of period</b>             | \$ 131,442 | \$ 248,185 |

See accompanying notes to the condensed consolidated financial statements.

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**CVB FINANCIAL CORP. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)**

*(Dollars in thousands)*

*(Unaudited)*

|   | <b>For the Nine Months Ended<br/>September 30,</b> |               |
|---|--|---------------|
|   | <b>2013</b>  | <b>2012</b>   |
| <b>RECONCILIATION OF NET EARNINGS TO NET CASH PROVIDED BY OPERATING ACTIVITIES</b>  |  |               |
| Net earnings  | \$ 70,320  | \$ 55,144     |
| Adjustments to reconcile net earnings to net cash provided by operating activities: |  |               |
| Gain on sale of investment securities   | (2,094)  |               |
| Loss/(gain) on sale of premises and equipment, net                                  | 2  | (1)           |
| Gain on sale of other real estate owned   | (3,048)  | (1,341)       |
| Amortization of capitalized prepayment penalty on borrowings                        | 204  | 204           |
| Increase in bank owned life insurance   | (1,805)  | (2,252)       |
| Net amortization of premiums and discounts on investment securities                 | 20,770   | 17,578        |
| Accretion of SJB discount   | (10,796)   | (19,258)      |
| Provision for loan losses   | (9,950)  |               |
| Provision for unfunded commitments  | 500  |               |
| Valuation adjustment on other real estate owned                                     | 87   | 490           |
| Change in FDIC loss share asset   | 10,715   | 19,339        |
| Proceeds from FDIC loss share agreement   | 239  | 17,842        |
| Stock-based compensation  | 1,439  | 1,387         |
| Depreciation and amortization, net  | 2,029  | 5,776         |
| Change in accrued interest receivable   | 495  | 627           |
| Change in accrued interest payable  | (387)  | (1,952)       |
| Change in other assets and liabilities  | (5,917)  | 21,671        |
| <b>Total adjustments</b>  | <b>2,483</b>                                       | <b>60,110</b> |
| Net cash provided by operating activities   | \$ 72,803  | \$ 115,254    |
| <b>SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING ACTIVITIES</b>                      |  |               |
| Transfer of loans to other real estate owned  | \$ 1,492   | \$ 4,582      |
| See accompanying notes to the condensed consolidated financial statements.          |  |               |

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**CVB FINANCIAL CORP. AND SUBSIDIARIES**

**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**For the Three and Nine Months Ended September 30, 2013, and 2012**

*(Unaudited)*

**1. BUSINESS**

The condensed consolidated financial statements include the accounts of CVB Financial Corp. and its wholly owned subsidiaries (the Company) Citizens Business Bank (the Bank) after elimination of all intercompany transactions and balances. The Company also has three inactive subsidiaries; CVB Ventures, Inc.; Chino Valley Bancorp; and ONB Bancorp. The Company is also the common stockholder of CVB Statutory Trust III. CVB Statutory Trust III was created in January 2006 to issue trust preferred securities in order to raise capital for the Company. In accordance with ASC 810 Consolidation (previously Financial Accounting Standards Board (FASB) Interpretation No. 46R Consolidation of Variable Interest Entities), this trust does not meet the criteria for consolidation.

The Company's primary operations are related to traditional banking activities, including the acceptance of deposits and the lending and investing of money through the operations of the Bank. The Bank also provides automobile and equipment leasing to customers through its Citizens Financial Services Group and trust and investment-related services to customers through its CitizensTrust Division. The Bank's customers consist primarily of small to mid-sized businesses and individuals located in San Bernardino County, Riverside County, Los Angeles County, Orange County, San Diego County, Madera County, Fresno County, Tulare County, Kern County and San Joaquin County, California. The Bank operates 39 Business Financial Centers, six Commercial Banking Centers, and three trust office locations, with its headquarters located in the city of Ontario, California.

**2. BASIS OF PRESENTATION**

The accompanying unaudited condensed consolidated financial statements and notes thereto have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission (SEC) for Form 10-Q and conform to practices within the banking industry and include all of the information and disclosures required by accounting principles generally accepted in the United States of America (GAAP) for interim financial reporting. The results of operations for the three and nine months ended September 30, 2013 are not necessarily indicative of the results for the full year. These unaudited financial statements should be read in conjunction with the financial statements, accounting policies and financial notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2012, filed with the Securities and Exchange Commission. In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments), which are necessary for a fair presentation of financial results for the interim periods presented. A summary of the significant accounting policies consistently applied in the preparation of the accompanying unaudited condensed consolidated financial statements follows.

**Reclassification** Certain amounts in the prior periods' financial statements and related footnote disclosures have been reclassified to conform to the current presentation with no impact on previously reported net income or stockholders equity.

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Investment Securities** The Company classifies as held-to-maturity those debt securities that the Company has the positive intent and ability to hold to maturity. Securities classified as trading are those securities that are bought and held principally for the purpose of selling them in the near term. All other debt and equity securities are classified as available-for-sale. Securities held-to-maturity are accounted for at cost and adjusted for amortization of premiums and accretion of discounts. Trading securities are accounted for at fair value with the unrealized gains and losses being included in current earnings. Available-for-sale securities are accounted for at fair value, with the net unrealized gains and losses, net of income tax effects, presented as a separate component of stockholders' equity. Realized gains and losses on sales of securities are recognized in earnings at the time of sale and are determined on a specific-identification basis. Purchase premiums and discounts are recognized in interest income using the effective-yield method over the expected terms of the securities. For mortgage-backed securities ( MBS ), the amortization or accretion is based on the estimated average lives of the securities. The lives of these securities can fluctuate based on the amount of prepayments received on the underlying collateral of the securities. The Company's investment in the Federal Home Loan Bank of San Francisco ( FHLB ) stock is carried at cost.

At each reporting date, securities are assessed to determine whether there is an other-than-temporary impairment ( OTTI ). Other-than-temporary impairment on investment securities is recognized in earnings when there are credit losses on a debt security for which management does not intend to sell and for which it is more-likely-than-not that the Company will not have to sell prior to recovery of the noncredit impairment. In those situations, the portion of the total impairment that is attributable to the credit loss would be recognized in earnings, and the remaining difference between the debt security's amortized cost and its fair value would be included in other comprehensive income.

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***Loans and Lease Finance Receivables*** Non-covered loans and lease finance receivables that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, less deferred net loan origination fees. In the ordinary course of business, the Company enters into commitments to extend credit to its customers. To the extent that such commitments are unfunded, the related unfunded amounts are not reflected in the accompanying unaudited condensed consolidated financial statements.

Interest on non-covered loans and lease finance receivables is credited to income based on the principal amounts of such loans or receivables outstanding. Non-covered loans are considered delinquent when principal or interest payments are past due 30 days or more and generally remain on accrual status between 30 and 89 days past due. Interest income is not recognized on non-covered loans and lease finance receivables when collection of interest is deemed by management to be doubtful. Non-covered loans on which the accrual of interest has been discontinued are designated as nonaccrual loans. In general, the accrual of interest on non-covered loans is discontinued when the loan becomes 90 days past due, or when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Factors considered in determining that the full collection of principal and interest is no longer probable include cash flow and liquidity of the borrower or property, the financial position of the guarantors and their willingness to support the loan as well as other factors, and this determination involves significant judgment. When an asset is placed on nonaccrual status, previously accrued but unpaid interest is reversed against income. Subsequent collections of cash are applied as reductions to the principal balance unless the loan is returned to accrual status. Interest is not recognized using a cash-basis method. Nonaccrual loans may be restored to accrual status when principal and interest become current and when the borrower is able to demonstrate payment performance for a sustained period, typically for six months. A nonaccrual loan may return to accrual status sooner based on other significant events or mitigating circumstances. This policy is consistently applied to all classes of non-covered financing receivables.

The Company receives collateral to support loans, lease finance receivables, and commitments to extend credit for which collateral is deemed necessary. The most significant categories of collateral are real estate, principally commercial and industrial income-producing properties, real estate mortgages, and assets utilized in dairy, livestock and agribusiness, and various personal property assets utilized in commercial and industrial business governed by the Uniform Commercial Code.

Nonrefundable fees and direct costs associated with the origination or purchase of non-covered loans are deferred and netted against outstanding loan balances. The deferred net loan fees and costs are recognized in interest income over the loan term using the effective-yield method.

***Troubled Debt Restructurings*** Loans are reported as a Troubled Debt Restructuring ( TDR ) if the Company, for economic or legal reasons related to the debtor's financial difficulties, grants a concession to the debtor that it would not otherwise consider. Types of modifications that may be considered concessions, which in turn result in a TDR include, but are not limited to, (i) a reduction of the stated interest rate for the remaining original life of the debt, (ii) an extension of the maturity date or dates at a stated interest rate lower than the current market rate for new debt with similar risk, (iii) a reduction of the face amount or maturity amount of the debt as stated in the instrument or other agreement, or (iv) a reduction of interest. In addition, the Company may provide a concession to the debtor where the debtor offers collateral and the value of such collateral is significant in proportion to the nature of the concession requested, and it substantially reduces the Company's risk of loss. In such cases, these modifications may not be considered a TDR as, in substance, no concession was made as a result of the significant additional collateral obtained.

When determining whether or not a loan modification is a TDR under ASC 310-40, the Company evaluates loan modification requests from borrowers experiencing financial difficulties on a case-by-case basis. Any such



modifications granted are unique to the borrower's circumstances. Because of the Company's focus on the commercial lending sector, each business customer has unique attributes, which in turn means that modifications of loans to those customers are not easily categorized by type, key features, or other terms, but are evaluated individually based on all relevant facts and circumstances pertaining to the modification request and the borrower's/guarantor's financial condition at the time of the request. The evaluation of whether or not a borrower is experiencing financial difficulties will include, among other relevant factors considered by the Company, a review of (i) whether the borrower is in default on any of its debt, (ii) whether the borrower is experiencing payment delinquency, (iii) whether the global cash flows of the borrower and the owner guarantor(s) of the borrower have diminished below what is necessary to service existing debt obligations, (iv) whether the borrower's forecasted cash flows will be insufficient to service the debt in future periods or in accordance with the contractual terms of the existing agreement with the Company (or agreements with other lenders) through maturity, (v) whether the borrower is unable to refinance the subject debt from other financing sources with similar terms, and (vi) whether the borrower is in jeopardy as a going-concern and/or considering bankruptcy. In any case, the debtor is presumed to be experiencing financial difficulties if the Company determines it is probable the debtor will default on the original loan if the modification is not granted.

The types of loans subject to modification vary greatly, but during the subject period are concentrated in commercial and industrial loans, dairy and agricultural loans, and term loans to commercial real estate investors. Some examples of key features include payment deferrals and delays, interest rate reductions, and extensions or renewals where the contract rate may or may not be below the market rate of interest for debt with similar characteristics as those of the modified debt. The typical length of the modified

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terms ranges from three (3) to twelve (12) months but may in some cases apply for the remaining term of the loan; however, all actual modified terms will depend on the facts, circumstances and attributes of the specific borrower requesting a modification. In general, after a careful evaluation of all relevant facts and circumstances taken together, including the nature of any concession, certain modification requests will result in troubled debt restructurings while certain other modifications will not, pursuant to the criteria and judgments as discussed throughout this report. In certain cases, modification requests for delays or deferrals of principal were evaluated and determined to be exempt from TDR reporting because they constituted insignificant delays under ASC 310-40-15.

In situations where the Company has determined that the borrower is experiencing financial difficulties and is evaluating whether a concession is *insignificant*, and therefore does not result in a troubled debt restructuring, such analysis is based on an evaluation of both the *amount* and the *timing* of the restructured payments, including the following factors:

1. Whether the amount of the restructured payments subject to delay is insignificant relative to the unpaid principal balance or collateral value of the debt and will result in an insignificant shortfall in the contractual amount due; and
2. The delay is insignificant relative to any of the following:

The frequency of payments due;

The debt's original contractual maturity; or

The debt's original expected duration.

Most modified loans *not* classified and accounted for as troubled debt restructurings were performing and paying as agreed under their original terms in the six-month period immediately preceding a request for modification. Subsequently, these modified loans have continued to perform under the modified terms and deferrals that amounted to insignificant delays, which in turn is supported by the facts and circumstances of each individual customer and loan as described above. Payment performance continues to be monitored once modifications are made. The Company's favorable experience regarding re-defaults under modified terms, or upon return of the loan to its original terms, indicates that such relief may improve ultimate collection and reduces the Company's risk of loss.

A loan is generally considered impaired, when based on current events and information, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. A loan, including a restructured loan, for which there is an insignificant delay relative to the frequency of payments due, and/or the original contractual maturity, is not considered an impaired loan. Generally, impaired loans include loans on nonaccrual status and TDRs.

The Company's policy is to record a specific valuation allowance, which is included in the allowance for loan losses, or to charge off that portion of an impaired loan that represents the impairment or shortfall amount as determined utilizing one of the three methods described in ASC 310-10-35-22. Impairment on non-collateral dependent restructured loans is measured by comparing the present value of expected future cash flows on the restructured loans

discounted at the interest rate of the original loan agreement to the loan's carrying value. The impairment amount, if any, is generally charged off and recorded against the allowance for loan losses at the time impairment is measurable and a probable loss is determined. As a result, most of the TDRs have no specific allowance allocated because, consistent with the Company's stated practice, any impairment is typically charged off in the period in which it is identified. Impairment on collateral dependent restructured loans is measured by determining the amount by which the impaired loan exceeds the fair value of the collateral less estimated selling costs. The fair value is generally determined by one or more appraisals of the collateral, performed by a Company approved third-party independent appraiser. The majority of impaired loans that are collateral dependent are charged off down to their estimated fair value of the collateral (less selling costs) at each reporting date based on current appraised value.

Appraisals of the collateral for impaired collateral dependent loans are typically ordered at the time the loan is identified as showing signs of inherent weakness. These appraisals are normally updated at least annually, or more frequently, if there are concerns or indications that the value of the collateral may have changed significantly since the previous appraisal. On an exception basis, a specific valuation allowance is recorded on collateral dependent impaired loans when a current appraisal is not yet available, a recent appraisal is still under review or on single-family mortgage loans if the loans are currently under review for a loan modification. Such valuation allowances are generally based on previous appraisals adjusted for current market conditions, based on preliminary appraisal values that are still being reviewed or for single-family loans under review for modification on an appraisal or indications of comparable home sales from external sources.

Charge-offs of unsecured consumer loans are recorded when the loan reaches 120 days past due or sooner as circumstances indicate. Except for the charge-offs of unsecured consumer loans, the charge-off policy is generally applied consistently across all portfolio segments.

The Company measures impairment based on the present value of expected future cash flows discounted at the loan's effective interest rate, except that as a practical expedient, the Company may measure impairment based on a loan's observable market price, or the fair value of the collateral if the loan is a collateral-dependent loan. Impaired single-family mortgage loans that have been modified in accordance with the various government modification programs are also measured based on the present value of the expected cash flows discounted at the loan's pre-modification interest rate. The Company recognizes the change in present value attributable to the passage of time as interest income on such performing single-family mortgage loans and the amount of interest income recognized to date has been insignificant.

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**Covered Loans** We refer to covered loans as those loans that we acquired in the San Joaquin Bank ( SJB ) acquisition for which we will be reimbursed for a substantial portion of any future losses under the terms of the Federal Deposit Insurance Corporation ( FDIC ) loss sharing agreement. We account for loans under ASC 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality* ( acquired impaired loan accounting ) when (i) we acquire loans deemed to be impaired when there is evidence of credit deterioration since their origination and it is probable at the date of acquisition that we would be unable to collect all contractually required payments and (ii) as a general policy election for non-impaired loans that we acquire in a distressed bank acquisition. Acquired impaired loans are accounted for individually or in pools of loans based on common risk characteristics. The excess of the loan s or pool s scheduled contractual principal and interest payments over all cash flows expected at acquisition is the nonaccretable difference. The remaining amount, representing the excess of the loan s cash flows expected to be collected over the fair value is the accretable yield (accreted into interest income over the remaining life of the loan or pool).

**Provision and Allowance for Loan Losses** The allowance for loan losses is management s estimate of probable losses inherent in the loan and lease receivables portfolio. The allowance is increased by the provision for losses and decreased by charge-offs when management believes the uncollectability of a loan is confirmed. Subsequent recoveries, if any, are credited to the allowance. The determination of the balance in the allowance for loan losses is based on an analysis of the loan and lease finance receivables portfolio using a systematic methodology and reflects an amount that, in management s judgment, is appropriate to provide for probable loan losses inherent in the portfolio, after giving consideration to the character of the loan portfolio, current economic conditions, past loan loss experience, and such other factors that would deserve current recognition in estimating inherent loan losses.

There are different qualitative risks for the loans in each portfolio segment. The construction and real estate segments predominant risk characteristic is the collateral and the geographic location of the property collateralizing the loan as well as the operating cash flow for commercial real estate properties. The commercial and industrial segment s predominant risk characteristics are the cash flows of the businesses we lend to, the global cash flows and liquidity of the guarantors of such losses, as well as economic and market conditions. The dairy & livestock segment s predominant risk characteristics are milk and beef prices in the market as well as the cost of feed and cattle. The municipal lease segment s predominant risk characteristics are the municipality s general financial condition and tax revenues or if applicable the specific project related financial condition. The consumer, auto and other segment s predominant risk characteristics are employment and income levels as they relate to consumers and cash flows of the businesses as they relate to equipment and vehicle leases to businesses. The Agribusiness segment s predominant risk characteristics are the supply and demand conditions of the product, production seasonality, the scale of operations and ability to control costs, the availability and cost of water, and operator experience.

The Company s methodology is consistently applied across all portfolio segments taking into account the applicable historical loss rates and the qualitative factors applicable to each pool of loans. A key factor in the Company s methodology is the loan risk rating (Pass, Special Mention, Substandard, Doubtful and Loss). Loan risk ratings are updated as facts related to the loan or borrower become available. In addition, all term loans in excess of \$1.0 million are subject to an annual internal credit review process where all factors underlying the loan, borrower and guarantors are subject to review which may result in changes to the loan s risk rating. Periodically, we assess various attributes utilized in adjusting our historical loss factors to reflect our view of current economic conditions. The estimate is reviewed quarterly by the Board of Directors and management and periodically by various regulatory agencies and, as adjustments become necessary, they are reported in earnings in the periods in which they become known.

A provision for loan losses on the covered portfolio will be recorded if there is deterioration in the expected cash flows on covered loans as a result of deteriorated credit quality, compared to those previously estimated without regard to the reimbursement from the FDIC under the FDIC loss sharing agreement. The portion of the loss on covered loans reimbursable from the FDIC is recorded in noninterest income as an increase in the FDIC loss sharing

asset. Decreases in expected cash flows on the acquired impaired loans as of the measurement date compared to previously estimated are recognized by recording a provision for loan losses on acquired impaired loans. Loans accounted for as part of a pool are measured based on the expected cash flows of the entire pool.

***FDIC Loss Sharing Asset*** On October 16, 2009, the Bank acquired substantially all of the assets and assumed substantially all of the liabilities of SJB from the FDIC in an FDIC-assisted transaction. The Bank entered into a loss sharing agreement with the FDIC, whereby the FDIC will cover a substantial portion of any future losses on certain acquired assets. The acquired assets subject to the loss sharing agreement are referred to collectively as covered assets. Under the terms of such loss sharing agreement, the FDIC will absorb 80% of losses and share in 80% of loss recoveries up to \$144.0 million with respect to covered assets, after a first loss amount of \$26.7 million. The FDIC will reimburse the Bank for 95% of losses and share in 95% of loss recoveries in excess of \$144.0 million with respect to covered assets. The loss sharing agreement is in effect for 5 years for commercial loans and 10 years for single-family residential loans from the October 16, 2009 acquisition date and the loss recovery provisions are in effect for 8 and 10 years, respectively, for commercial and single-family residential loans from the acquisition date.

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The FDIC loss sharing asset was initially recorded at fair value which represents the present value of the estimated cash payments from the FDIC for future losses on covered loans. The ultimate collectability of this asset is dependent upon the performance of the underlying covered loans, the passage of time and claims paid by the FDIC. The loss estimates used in calculating the FDIC loss sharing asset are determined on the same basis as the loss estimates on the related covered loans and is the present value of the cash flows the Company expects to collect from the FDIC under the loss sharing agreement. The difference between the present value and the undiscounted cash flow the Company expects to collect from the FDIC is accreted (or amortized) into noninterest income over the life of the FDIC indemnification asset. The FDIC indemnification asset is adjusted for any changes in expected cash flows based on covered loan performance. Any increases in the cash flows of covered loans over those expected will reduce the FDIC indemnification asset and any decreases in the cash flows of covered loans over those expected will increase the FDIC indemnification asset, with the remaining balance amortized on the same basis as the discount, not to exceed its remaining contract life. These increases and decreases to the FDIC indemnification asset are recorded as adjustments to noninterest income.

***Goodwill and Intangible Assets*** Goodwill resulting from business combinations prior to January 1, 2009, represents the excess of the purchase price over the fair value of the net assets of the businesses acquired. Goodwill resulting from business combinations after January 1, 2009, is generally determined as the excess of the fair value of the consideration transferred, plus the fair value of any noncontrolling interest in the acquiree, over the fair value of the net assets acquired and liabilities assumed as of the acquisition date. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but tested for impairment at least annually, or more frequently if events and circumstances exist that indicate that a goodwill impairment test should be performed.

Intangible assets with definite useful lives are amortized over their estimated useful lives to their estimated residual values. Goodwill is the only intangible asset with an indefinite life on our balance sheet. Based on the Company's annual impairment test, there was zero recorded impairment as of September 30, 2013.

Other intangible assets consist of core deposit intangible assets arising from business combinations and are amortized using an accelerated method over their estimated useful lives.

At September 30, 2013, goodwill was \$55.1 million. As of September 30, 2013, intangible assets that continue to be subject to amortization include core deposit premiums of \$2.4 million (net of \$29.6 million of accumulated amortization). Amortization expense for such intangible assets was \$127,000, and \$1.0 million for the three and nine months ended September 30, 2013. Estimated amortization expense for the remainder of 2013 is expected to be \$124,000. Estimated amortization expense for the succeeding years is \$475,000 for 2014, \$437,000 for 2015, \$395,000 for 2016, \$366,000 for 2017, and \$589,000 for the period from 2018 to 2019. The weighted average remaining life of intangible assets is approximately 2.0 years.

***Fair Value of Financial Instruments*** We use fair value measurements to record fair value adjustments to certain financial instruments and to determine fair value disclosures. Investment securities available-for-sale and interest-rate swaps are financial instruments recorded at fair value on a recurring basis. Additionally, from time to time, we may be required to record at fair value other financial assets on a non-recurring basis, such as impaired loans and other real estate owned (OREO). These nonrecurring fair value adjustments typically involve application of lower-of-cost-or-market accounting or write-downs of individual assets. Further, we include in Note 8 of the unaudited condensed consolidated financial statements information about the extent to which fair value is used to measure assets and liabilities, the valuation methodologies used and its impact to earnings. Additionally, for financial instruments not recorded at fair value we disclose the estimate of their fair value.

**Earnings per Common Share** The Company calculates earnings per common share ( EPS ) using the two-class method. The two-class method requires the Company to present EPS as if all of the earnings for the period are distributed to common shareholders and any participating securities. All outstanding unvested share-based payment awards that contain rights to non-forfeitable dividends are considered participating securities. The Company grants restricted shares under the 2008 Equity Incentive Plan that qualify as participating securities. Restricted shares issued under this plan are entitled to dividends at the same rate as common stock. A reconciliation of the numerator and the denominator used in the computation of basic and diluted earnings per common share is included in Note 7 of these unaudited condensed consolidated financial statements.

**Stock-Based Compensation** Consistent with the provisions of ASC 718, *Stock Compensation* , we recognize expense for the grant date fair value of stock options and restricted shares issued to employees, officers and non-employee directors over the their requisite service periods (generally the vesting period). The service periods may be subject to performance conditions.

At September 30, 2013, the Company had three stock-based employee compensation plans. The Company accounts for stock compensation using the *modified prospective* method. Under this method, awards that are granted, modified, or settled after December 31, 2005, are measured at fair value as of the grant date with compensation costs recognized over the vesting period on a straight-lined basis. Also under this method, unvested stock awards as of January 1, 2006 are recognized over the remaining service period with no change in historical reported earnings.



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The fair value of each stock option grant is estimated as of the grant date using the Black-Scholes option-pricing model. Management assumptions used at the time of grant impact the fair value of the option calculated under the Black-Scholes option-pricing model, and ultimately, the expense that will be recognized over the life of the option.

The grant date fair value of restricted stock awards is measured at the fair value of the Company's common stock as if the restricted share was vested and issued on the date of grant.

Additional information is included in Note 19, "Stock Option Plan and Restricted Stock Awards", of the Company's Annual Report on Form 10-K.

***Derivative Financial Instruments*** All derivative instruments, including certain derivative instruments embedded in other contracts, are recognized on the consolidated balance sheets at fair value. For derivatives designated as fair value hedges, changes in the fair value of the derivative and the hedged item related to the hedged risk are recognized in earnings. Changes in fair value of derivatives designated and accounted for as cash flow hedges, to the extent they are effective as hedges, are recorded in Other Comprehensive Income, net of deferred taxes, and are subsequently reclassified to earnings when the hedged transaction affects earnings. Any hedge ineffectiveness would be recognized in the income statement line item pertaining to the hedged item.

***Use of Estimates in the Preparation of Financial Statements*** The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. A material estimate that is particularly susceptible to significant change in the near term relates to the determination of the allowance for loan losses. Other significant estimates which may be subject to change include fair value determinations and disclosures, impairment of investments, goodwill, loans, determining the amount and realization of the FDIC loss sharing asset, and valuation of deferred tax assets, other intangibles and OREO.

***Other Contingencies*** In the ordinary course of business, the Company becomes involved in litigation. Based upon the Company's internal records and discussions with legal counsel, the Company records reserves as appropriate, for estimates of the probable outcome of all cases brought against the Company. Except as discussed in Part II Other Information, Item 1. Legal Proceedings, at September 30, 2013, the Company does not have any litigation reserves, and is not aware of any material pending legal action or complaints asserted against the Company.

***Recent Accounting Pronouncements*** In July 2013, the FASB issued Accounting Standards Update (ASU) No. 2013-11, Income Taxes (Topic 740) *Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*. This ASU requires an entity to present an unrecognized tax benefit as a reduction of a deferred tax asset for a net operating loss carryforward, or similar tax loss or tax credit carryforward, rather than a liability when (1) the uncertain tax position would reduce the net operating loss or other carryforward under the tax law of the applicable jurisdiction and (2) the entity intends to use the deferred tax asset for that purpose. The ASU does not require new recurring disclosures. ASU No. 2013-11 is effective prospectively for fiscal years, and interim periods within those years, beginning after December 15, 2013. The adoption of this new guidance is not expected to have a material impact on the Company's consolidated financial statements.

#### **4. FEDERALLY ASSISTED ACQUISITION OF SAN JOAQUIN BANK**

On October 16, 2009, the Bank acquired SJB and entered into a loss sharing agreement with the FDIC that is more fully discussed in the Significant Accounting Policies (Note 3) included herein.

At September 30, 2013, the remaining discount associated with the SJB loans approximated \$14.5 million. Based on the Company's regular forecast of expected cash flows from these loans, approximately \$9.0 million of the related discount is expected to accrete into interest income over the remaining average lives of the respective pools and individual loans, which approximates 4.4 years and 1.0 year, respectively. Due to the decrease in estimated losses to be incurred in the remaining portfolio, the expected reimbursement from the FDIC under the loss sharing agreement decreased. The FDIC loss sharing asset of \$7.0 million at September 30, 2013 will continue to be reduced by reimbursements of loss claims submitted to the FDIC with the remaining balance amortized on the same basis as the discount on the related loans, not to exceed its remaining contract life of approximately 1.0 year.

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The amortized cost and estimated fair value of investment securities are summarized below. The majority of securities held are publicly traded, and the estimated fair values were obtained from an independent pricing service based upon market quotes.

|  | <b>September 30, 2013</b> |  |  |                     |                          |
|--|---------------------------|--|--|---------------------|--------------------------|
|  | <b>Amortized<br/>Cost</b> | <b>Gross<br/>Unrealized<br/>Holding<br/>Gain</b> | <b>Gross<br/>Unrealized<br/>Holding<br/>Loss</b> | <b>Fair Value</b>   | <b>Total<br/>Percent</b> |
|  |                           | <i>(Dollars in thousands)</i>                    |  |                     |                          |
| <b>Investment securities available-for-sale:</b> |                           |  |  |                     |                          |
| Government agency                                | \$ 353,580                | \$ 36  | \$ (20,603)                                      | \$ 333,013          | 12.72%                   |
| Residential mortgage-backed securities           | 1,286,448                 | 19,249   | (16,073)   | 1,289,624           | 49.28%                   |
| CMO s / REMIC s residential                      | 383,268                   | 7,002  | (1,062)  | 389,208             | 14.87%                   |
| Municipal bonds                                  | 581,663                   | 22,206   | (3,145)  | 600,724             | 22.95%                   |
| Other securities                                 | 5,000                     |  | (262)  | 4,738               | 0.18%                    |
| <b>Total investment securities</b>               | <b>\$ 2,609,959</b>       | <b>\$ 48,493</b>                                 | <b>\$ (41,145)</b>                               | <b>\$ 2,617,307</b> | <b>100.00%</b>           |

|  | <b>December 31, 2012</b>  |  |  |                     |                          |
|--|---------------------------|--|--|---------------------|--------------------------|
|  | <b>Amortized<br/>Cost</b> | <b>Gross<br/>Unrealized<br/>Holding<br/>Gain</b> | <b>Gross<br/>Unrealized<br/>Holding<br/>Loss</b> | <b>Fair Value</b>   | <b>Total<br/>Percent</b> |
|  |                           | <i>(Dollars in thousands)</i>                    |  |                     |                          |
| <b>Investment securities available-for-sale:</b> |                           |  |  |                     |                          |
| Government agency                                | \$ 357,960                | \$ 1,588   | \$ (248)   | \$ 359,300          | 14.67%                   |
| Residential mortgage-backed securities           | 862,196                   | 25,529   | (127)  | 887,598             | 36.24%                   |
| CMO s / REMIC s residential                      | 565,968                   | 7,402  | (1,410)  | 571,960             | 23.35%                   |
| Municipal bonds                                  | 583,692                   | 41,920   | (183)  | 625,429             | 25.53%                   |
| Other securities                                 | 5,000                     | 100  |  | 5,100               | 0.21%                    |
| <b>Total investment securities</b>               | <b>\$ 2,374,816</b>       | <b>\$ 76,539</b>                                 | <b>\$ (1,968)</b>                                | <b>\$ 2,449,387</b> | <b>100.00%</b>           |

Approximately 77% of the available-for-sale portfolio at September 30, 2013 represents securities issued by the U.S. government or U.S. government-sponsored agencies and enterprises, with the implied guarantee of payment of principal and interest. The remaining CMO/REMICs are backed by agency-pooled collateral or whole loan collateral. All non-agency available-for-sale CMO/REMIC issues held are rated investment grade or better by either Standard & Poor's or Moody's, as of September 30, 2013 and December 31, 2012. The Company had \$679,000 and \$1.2 million in CMO/REMICs backed by whole loans issued by private-label companies (non-government sponsored) as of September 30, 2013, and December 31, 2012, respectively.

During the first quarter of 2013, we identified 13 securities with a par value of \$94.2 million that were experiencing accelerated prepayment speeds that were causing a deterioration in yield. We elected to sell these securities and recognized a net pre-tax gain on sale of \$2.1 million. There were no gains or losses recognized during the second and third quarters of 2013. In the third quarter of 2013, we purchased \$314.7 million of investment securities and utilized short-term borrowings to facilitate a portion of these purchases.

The tables below show the Company's investment securities' gross unrealized losses and fair value by investment category and length of time that individual securities have been in a continuous unrealized loss position at September 30, 2013 and December 31, 2012. The Company has reviewed individual securities to determine whether a decline in fair value below the amortized cost basis is other-than-temporary.

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|  | <b>September 30, 2013</b>  |                   |                               |                   |                   |                   |  |
|--|----------------------------|-------------------|-------------------------------|-------------------|-------------------|-------------------|--|
|  | <b>Less Than 12 Months</b> |                   | <b>12 Months or</b>           |                   | <b>Total</b>      |                   |  |
|  | <b>Fair</b>                | <b>Gross</b>      | <b>Longer</b>                 | <b>Gross</b>      | <b>Fair</b>       | <b>Gross</b>      |  |
|  | <b>Value</b>               | <b>Unrealized</b> | <b>Unrealized</b>             | <b>Unrealized</b> | <b>Value</b>      | <b>Unrealized</b> |  |
|  |                            | <b>Holding</b>    | <b>Fair Value</b>             | <b>Holding</b>    |                   | <b>Holding</b>    |  |
|  |                            | <b>Losses</b>     |                               | <b>Losses</b>     |                   | <b>Losses</b>     |  |
|  |                            |                   | <i>(Dollars in thousands)</i> |                   |                   |                   |  |
| <b>Available-for-sale:</b>             |                            |                   |                               |                   |                   |                   |  |
| Government agency                      | \$ 312,948                 | \$ 20,603         | \$                            | \$                | \$ 312,948        | \$ 20,603         |  |
| Residential mortgage-backed securities | 473,190                    | 16,073            |                               |                   | 473,190           | 16,073            |  |
| CMO / REMICs residential               | 92,281                     | 988               | 18,700                        | 74                | 110,981           | 1,062             |  |
| Municipal bonds                        | 42,859                     | 2,671             | 10,393                        | 474               | 53,252            | 3,145             |  |
| Other securities                       | 4,738                      | 262               |                               |                   | 4,738             | 262               |  |
| <b>Total</b>                           | <b>\$ 926,016</b>          | <b>\$ 40,597</b>  | <b>\$ 29,093</b>              | <b>\$ 548</b>     | <b>\$ 955,109</b> | <b>\$ 41,145</b>  |  |

|  | <b>December 31, 2012</b>   |                   |                               |                   |                   |                   |  |
|--|----------------------------|-------------------|-------------------------------|-------------------|-------------------|-------------------|--|
|  | <b>Less Than 12 Months</b> |                   | <b>12 Months or</b>           |                   | <b>Total</b>      |                   |  |
|  | <b>Fair</b>                | <b>Gross</b>      | <b>Longer</b>                 | <b>Gross</b>      | <b>Fair</b>       | <b>Gross</b>      |  |
|  | <b>Value</b>               | <b>Unrealized</b> | <b>Unrealized</b>             | <b>Unrealized</b> | <b>Value</b>      | <b>Unrealized</b> |  |
|  |                            | <b>Holding</b>    | <b>Fair Value</b>             | <b>Holding</b>    |                   | <b>Holding</b>    |  |
|  |                            | <b>Losses</b>     |                               | <b>Losses</b>     |                   | <b>Losses</b>     |  |
|  |                            |                   | <i>(Dollars in thousands)</i> |                   |                   |                   |  |
| <b>Available-for-sale:</b>             |                            |                   |                               |                   |                   |                   |  |
| Government agency                      | \$ 51,134                  | \$ 248            | \$                            | \$                | \$ 51,134         | \$ 248            |  |
| Residential mortgage-backed securities | 55,118                     | 127               |                               |                   | 55,118            | 127               |  |
| CMO / REMICs residential               | 74,784                     | 572               | 69,042                        | 838               | 143,826           | 1,410             |  |
| Municipal bonds                        | 13,110                     | 162               | 975                           | 21                | 14,085            | 183               |  |
| Other securities                       |                            |                   |                               |                   |                   |                   |  |
| <b>Total</b>                           | <b>\$ 194,146</b>          | <b>\$ 1,109</b>   | <b>\$ 70,017</b>              | <b>\$ 859</b>     | <b>\$ 264,163</b> | <b>\$ 1,968</b>   |  |

The following summarizes our analysis of these securities and the unrealized losses. This assessment was based on the following factors: i) the length of the time and the extent to which the fair value has been less than amortized cost; ii) adverse condition specifically related to the security, an industry, or a geographic area and whether or not the Company expects to recover the entire amortized cost, iii) historical and implied volatility of the fair value of the security; iv) the payment structure of the security and the likelihood of the issuer being able to make payments in the future; v) failure of the issuer of the security to make scheduled interest or principal payments, vi) any changes to the rating of the security by a rating agency, and vii) recoveries or additional declines in fair value subsequent to the balance sheet date.

**CMO Held-to-Maturity** We have one investment security classified as held-to-maturity. This security was issued by Countrywide Financial and is collateralized by Alt-A mortgages. The mortgages are primarily fixed-rate, 30-year loans, originated in early 2006 with average FICO scores of 715 and an average LTV of 71% at origination. The security was a senior security in the securitization, was rated triple AAA at origination and was supported by

subordinate securities. This security is classified as held-to-maturity as we have both the intent and ability to hold this debt security to maturity. We acquired this security in February 2008 at a price of 98.25%. The significant decline in the fair value of the security first appeared in August 2008 at the time the financial crisis in the markets occurred and the market for securities collateralized by Alt-A mortgages diminished.

As of September 30, 2013, the unrealized loss on this security was zero and the current fair value on the security was 73% of the current par value. This Alt-A bond, with a book value of \$1.8 million as of September 30, 2013, has had \$1.9 million in net impairment losses to date. These losses have been recorded as a reduction to noninterest income. The security is rated non-investment grade. We evaluated the security for an other-than-temporary decline in fair value as of September 30, 2013. The key assumptions include default rates, loss severities and prepayment rates. There were no changes in credit related other-than temporary impairment recognized in earnings for the three and nine months ended September 30, 2013, and 2012.

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*Government Agency & Government-Sponsored Enterprise* The government agency bonds are backed by the full faith and credit of agencies of the U.S. Government. While the Government-Sponsored Enterprise bonds are not expressly guaranteed by the U.S. Government, they are currently being supported by the U.S. Government under a conservatorship arrangement. As of September 30, 2013, approximately \$144.4 million in U.S. government agency bonds are callable. These securities are bullet securities, that is, they have a defined maturity date on which the principal is paid. The contractual term of these investments provides that the Company will receive the face value of the bond at maturity which will equal the amortized cost of the bond. Interest is received throughout the life of the security.

*Mortgage-Backed Securities and CMO/REMICs* Almost all of the available-for-sale mortgage-backed and CMO/REMICs securities are issued by government agencies or government-sponsored enterprises such as Ginnie Mae, Fannie Mae and Freddie Mac. These securities are collateralized or backed by the underlying residential mortgages. All mortgage-backed securities are considered to be rated investment grade with a weighted average life of approximately 4.8 years. Of the total MBS/CMO, 99.96% have the implied guarantee of U.S. government-sponsored agencies and enterprises. The remaining 0.04% are issued by banks. Accordingly, it is expected the securities would not be settled at a price less than the amortized cost of the bonds.

*Municipal Bonds* The majority of our municipal bonds are insured by the largest bond insurance companies with maturities of approximately 8.9 years. The Company diversifies its holdings by owning selections of securities from different issuers and by holding securities from geographically diversified municipal issuers, thus reducing the Company's exposure to any single adverse event. Because we believe the decline in fair value is attributable to the changes in interest rates and not credit quality and because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized costs, which may be at maturity, management does not consider these investments to be other than temporarily impaired at September 30, 2013.

We are continually monitoring the quality of our municipal bond portfolio in light of the current financial problems exhibited by certain monoline insurance companies. Many of the securities that would not be rated without insurance are pre-refunded and/or are general obligation bonds. We continue to monitor municipalities, which includes a review of the respective municipalities' audited financial statements to determine whether there are any audit or performance issues. We use outside brokers to assist us in these analyses. Based on our monitoring of the municipal marketplace, to our knowledge, none of the municipalities are exhibiting financial problems that would lead us to believe that there is an OTTI for any given security.

At September 30, 2013 and December 31, 2012, investment securities having a carrying value of approximately \$2.61 billion and \$2.24 billion, respectively, were pledged to secure public deposits, short and long-term borrowings, and for other purposes as required or permitted by law.

The amortized cost and fair value of debt securities at September 30, 2013, by contractual maturity, are shown below. Although mortgage-backed securities and CMO/REMICs have contractual maturities through 2043, expected maturities will differ from contractual maturities because borrowers may have the right to prepay such obligations without penalty. Mortgage-backed securities and CMO/REMICs are included in maturity categories based upon estimated prepayment speeds.

**September 30, 2013**

**Weighted-**

|  | <b>Amortized<br/>Cost</b>     | <b>Fair<br/>Value</b> | <b>Average<br/>Yield</b> |
|--|-------------------------------|-----------------------|--------------------------|
|  | <i>(Dollars in thousands)</i> |                       |                          |
| <b>Available-for-sale:</b>             |                               |                       |                          |
| Due in one year or less                | \$ 130,984                    | \$ 133,474            | 2.39%                    |
| Due after one year through five years  | 1,895,032                     | 1,919,812             | 2.22%                    |
| Due after five years through ten years | 527,503                       | 508,724               | 2.37%                    |
| Due after ten years                    | 56,440                        | 55,297                | 3.49%                    |
| <br>Total                              | <br>\$ 2,609,959              | <br>\$ 2,617,307      | <br>2.28%                |

The investment in FHLB stock is periodically evaluated for impairment based on, among other things, the capital adequacy of the FHLB and its overall financial condition. No impairment losses have been recorded through September 30, 2013.



**Table of Contents****6. LOAN AND LEASE FINANCE RECEIVABLES AND ALLOWANCE FOR LOAN LOSSES**

The following tables provide a summary of the components of loan and lease finance receivables:

|  | <b>September 30, 2013</b>     |                      |                     |
|--|-------------------------------|----------------------|---------------------|
|  | <b>Non-Covered<br/>Loans</b>  | <b>Covered Loans</b> | <b>Total</b>        |
|  | <i>(Dollars in thousands)</i> |                      |                     |
| Commercial and industrial                                  | \$ 510,566                    | \$ 20,825            | \$ 531,391          |
| Real estate:   |                               |                      |                     |
| Commercial real estate                                     | 2,126,415                     | 147,289              | 2,273,704           |
| Construction   | 47,648                        | 661                  | 48,309              |
| SFR mortgage   | 192,130                       | 327                  | 192,457             |
| Dairy & livestock and agribusiness                         | 261,638                       | 3,659                | 265,297             |
| Municipal lease finance receivables                        | 99,188                        |                      | 99,188              |
| Consumer and other loans                                   | 52,886                        | 5,102                | 57,988              |
| <b>Gross loans</b>   | <b>3,290,471</b>              | <b>177,863</b>       | <b>3,468,334</b>    |
| Less:  |                               |                      |                     |
| Purchase accounting discount                               |                               | (14,529)             | (14,529)            |
| Deferred loan fees, net                                    | (9,119)                       |                      | (9,119)             |
| <b>Gross loans, net of deferred loan fees and discount</b> | <b>3,281,352</b>              | <b>163,334</b>       | <b>3,444,686</b>    |
| Less: Allowance for loan losses                            | (80,713)                      |                      | (80,713)            |
| <b>Net loans</b>   | <b>\$ 3,200,639</b>           | <b>\$ 163,334</b>    | <b>\$ 3,363,973</b> |

|                                     | <b>December 31, 2012</b>      |                      |                  |
|-------------------------------------|-------------------------------|----------------------|------------------|
|                                     | <b>Non-Covered<br/>Loans</b>  | <b>Covered Loans</b> | <b>Total</b>     |
|                                     | <i>(Dollars in thousands)</i> |                      |                  |
| Commercial and industrial           | \$ 547,422                    | \$ 26,149            | \$ 573,571       |
| Real estate:                        |                               |                      |                  |
| Commercial real estate              | 1,990,107                     | 179,428              | 2,169,535        |
| Construction                        | 59,721                        | 1,579                | 61,300           |
| SFR mortgage                        | 159,288                       | 1,415                | 160,703          |
| Dairy & livestock and agribusiness  | 336,660                       | 5,651                | 342,311          |
| Municipal lease finance receivables | 105,767                       |                      | 105,767          |
| Consumer and other loans            | 60,273                        | 6,337                | 66,610           |
| <b>Gross loans</b>                  | <b>3,259,238</b>              | <b>220,559</b>       | <b>3,479,797</b> |
| Less:                               |                               |                      |                  |
| Purchase accounting discount        |                               | (25,344)             | (25,344)         |
| Deferred loan fees, net             | (6,925)                       |                      | (6,925)          |

|   |              |            |              |
|---|--------------|------------|--------------|
| Gross loans, net of deferred loan fees and discount | 3,252,313    | 195,215    | 3,447,528    |
| Less: Allowance for loan losses                     | (92,441)     |            | (92,441)     |
| Net loans   | \$ 3,159,872 | \$ 195,215 | \$ 3,355,087 |

As of September 30, 2013, 65.56% of the total gross loan portfolio consisted of commercial real estate loans and 1.39% of the total gross loan portfolio consisted of construction loans, respectively. Substantially all of the Company's real estate loans and construction loans are secured by real properties located in California. At September 30, 2013, the Company held approximately \$1.73 billion of fixed rate loans.

At September 30, 2013 and December 31, 2012, loans totaling \$1.99 billion and \$2.32 billion, respectively, were pledged to secure borrowings from the FHLB and the Federal Reserve Bank.

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***Credit Quality Indicators***

Central to our credit risk management is our loan risk rating system. The originating credit officer assigns borrowers an initial risk rating, which is reviewed and confirmed or changed, as appropriate, by Credit Management. Approvals are made based upon the amount of inherent credit risk specific to the transaction and are reviewed for appropriateness by senior line and credit management personnel. Credits are monitored by line and credit management personnel for deterioration in a borrower's financial condition, which would impact the ability of the borrower to perform under the contract. Risk ratings are adjusted as necessary.

Loans are risk rated into the following categories (Credit Quality Indicators): Pass, Pass Watch List, Special Mention, Substandard, Doubtful and Loss. Each of these groups is assessed for the proper amount to be used in determining the adequacy of our allowance for losses. These categories can be described as follows:

**Pass** These loans range from minimal credit risk to lower than average, but still acceptable, credit risk.

**Pass Watch List** Pass Watch list loans usually require more than normal management attention. Loans which qualify for the Pass Watch List may involve borrowers with adverse financial trends, higher debt/equity ratios, or weaker liquidity positions, but not to the degree of being considered a defined weakness or problem loan where risk of loss may be apparent.

**Special Mention** Loans assigned to this category are currently protected but are weak. Although concerns exist, the Company is currently protected and loss is unlikely. Such loans have potential weaknesses that may, if not checked or corrected, weaken the asset or inadequately protect the Company's credit position at some future date.

**Substandard** Loans classified as substandard include poor liquidity, high leverage, and erratic earnings or losses. The primary source of repayment is no longer realistic, and asset or collateral liquidation may be the only source of repayment. Substandard loans are marginal and require continuing and close supervision by credit management. Substandard loans have the distinct possibility that the Company will sustain some loss if deficiencies are not corrected.

**Doubtful** Loans classified doubtful have all the weaknesses inherent in those classified substandard with the added provision that the weaknesses make collection or the liquidation, on the basis of currently existing facts, conditions and values, highly questionable and improbable. The possibility of loss is extremely high, but because of certain important and reasonable specific pending factors which may work to the advantage and strengthening of the assets, their classifications as losses are deferred until their more exact status may be determined.

**Loss** Loans classified as loss are considered uncollectible and of such little value that their continuance as active assets of the Company is not warranted. This classification does not mean that the loan has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be achieved in the future.

The following table summarizes our internal risk grouping by loan class as of September 30, 2013 and December 31, 2012:

**Credit Quality Indicators**

|  | <b>September 30, 2013</b>     |                       |                            |                    |                                |                     |
|--|-------------------------------|-----------------------|----------------------------|--------------------|--------------------------------|---------------------|
|  | <b>Pass</b>                   | <b>Watch<br/>List</b> | <b>Special<br/>Mention</b> | <b>Substandard</b> | <b>Doubtful &amp;<br/>Loss</b> | <b>Total</b>        |
|  | <i>(Dollars in thousands)</i> |                       |                            |                    |                                |                     |
| Commercial and industrial              | \$ 308,271                    | \$ 131,118            | \$ 53,972                  | \$ 16,730          | \$ 475                         | \$ 510,566          |
| Real estate:                           |                               |                       |                            |                    |                                |                     |
| Commercial real estate                 |                               |                       |                            |                    |                                |                     |
| Owner occupied                         | 441,739                       | 128,887               | 89,475                     | 65,455             |                                | 725,556             |
| Non-owner occupied                     | 1,040,758                     | 217,822               | 85,784                     | 56,495             |                                | 1,400,859           |
| Construction                           |                               |                       |                            |                    |                                |                     |
| Speculative                            | 7,568                         |                       | 1,538                      | 18,020             |                                | 27,126              |
| Non-speculative                        | 6,408                         | 4,895                 |                            | 9,219              |                                | 20,522              |
| SFR mortgage                           | 152,169                       | 20,960                | 4,319                      | 14,682             |                                | 192,130             |
| Dairy & livestock and<br>agribusiness  | 44,735                        | 39,360                | 102,464                    | 72,879             | 2,200                          | 261,638             |
| Municipal lease finance<br>receivables | 51,935                        | 19,540                | 21,283                     | 6,430              |                                | 99,188              |
| Consumer and other loans               | 41,555                        | 6,379                 | 3,410                      | 1,539              | 3                              | 52,886              |
| <b>Total non-covered loans</b>         | <b>2,095,138</b>              | <b>568,961</b>        | <b>362,245</b>             | <b>261,449</b>     | <b>2,678</b>                   | <b>3,290,471</b>    |
| Covered loans                          | 35,125                        | 67,347                | 23,477                     | 51,914             |                                | 177,863             |
| <b>Total gross loans</b>               | <b>\$ 2,130,263</b>           | <b>\$ 636,308</b>     | <b>\$ 385,722</b>          | <b>\$ 313,363</b>  | <b>\$ 2,678</b>                | <b>\$ 3,468,334</b> |

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|                                     | <b>December 31, 2012</b>      |                       |                            |                    |                                |                     |
|-------------------------------------|-------------------------------|-----------------------|----------------------------|--------------------|--------------------------------|---------------------|
|                                     | <b>Pass</b>                   | <b>Watch<br/>List</b> | <b>Special<br/>Mention</b> | <b>Substandard</b> | <b>Doubtful<br/>&amp; Loss</b> | <b>Total</b>        |
|                                     | <i>(Dollars in thousands)</i> |                       |                            |                    |                                |                     |
| Commercial and industrial           | \$ 347,275                    | \$ 131,186            | \$ 44,466                  | \$ 22,901          | \$ 1,594                       | \$ 547,422          |
| Real estate:                        |                               |                       |                            |                    |                                |                     |
| Commercial real estate              |                               |                       |                            |                    |                                |                     |
| Owner occupied                      | 382,111                       | 159,653               | 78,087                     | 84,116             |                                | 703,967             |
| Non-owner occupied                  | 888,777                       | 214,901               | 105,121                    | 77,341             |                                | 1,286,140           |
| Construction                        |                               |                       |                            |                    |                                |                     |
| Speculative                         | 1,417                         |                       | 15,163                     | 21,314             |                                | 37,894              |
| Non-speculative                     | 9,841                         | 2,767                 |                            | 9,219              |                                | 21,827              |
| SFR mortgage                        | 129,730                       | 10,215                | 3,107                      | 16,236             |                                | 159,288             |
| Dairy & livestock and agribusiness  | 72,113                        | 111,393               | 75,316                     | 77,721             | 117                            | 336,660             |
| Municipal lease finance receivables | 72,432                        | 20,237                | 11,124                     | 1,974              |                                | 105,767             |
| Consumer and other loans            | 49,321                        | 6,763                 | 2,714                      | 1,421              | 54                             | 60,273              |
| <b>Total non-covered loans</b>      | <b>1,953,017</b>              | <b>657,115</b>        | <b>335,098</b>             | <b>312,243</b>     | <b>1,765</b>                   | <b>3,259,238</b>    |
| Covered loans                       | 52,637                        | 72,803                | 31,689                     | 63,354             | 76                             | 220,559             |
| <b>Total gross loans</b>            | <b>\$ 2,005,654</b>           | <b>\$ 729,918</b>     | <b>\$ 366,787</b>          | <b>\$ 375,597</b>  | <b>\$ 1,841</b>                | <b>\$ 3,479,797</b> |

**Allowance for Loan Losses**

The Company's Credit Management Division is responsible for regularly reviewing the allowance for loan losses ( ALLL ) methodology, including loss factors and economic risk factors. The Bank's Director Loan Committee provides Board oversight of the ALLL process and approves the ALLL methodology on a quarterly basis.

Our methodology for assessing the appropriateness of the allowance is conducted on a regular basis and considers the Bank's overall loan portfolio. The Bank's methodology consists of two major phases.

In the first phase, individual loans are reviewed to identify loans for impairment. A loan is generally considered impaired when principal and interest are deemed uncollectible in accordance with the contractual terms of the loan. A loan for which there is an insignificant delay or shortfall in the amount of payments due is not considered an impaired loan. Impairment is measured as either the expected future cash flows discounted at each loan's effective interest rate, the fair value of the loan's collateral if the loan is collateral dependent, or an observable market price of the loan (if one exists). If we determine that the value of the impaired loan is less than the recorded investment of the loan, we either recognize an impairment reserve as a Specific Allowance, or charge off the impaired balance for collateral dependent loans if it is determined that such amount represents a confirmed loss. Loans determined to be impaired are excluded from the formula allowance so as not to double count the loss exposure.

The second phase is conducted by evaluating or segmenting the remainder of the loan portfolio into groups or pools of loans with similar characteristics. In this second phase, groups or pools of homogeneous loans are reviewed to determine a portfolio formula allowance. In the case of the portfolio formula allowance, homogeneous portfolios, such as small business loans, consumer loans, agricultural loans, and real estate loans, are aggregated or pooled in determining the appropriate allowance. The risk assessment process in this case emphasizes trends in the different portfolios for delinquency, loss, and other behavioral characteristics of the subject portfolios.

Included in this second phase is our considerations of qualitative factors, including, all known relevant internal and external factors that may affect the collectability of a loan. This includes our estimates of the amounts necessary for concentrations, economic uncertainties, the volatility of the market value of collateral, and other relevant factors. These qualitative factors are used to adjust the historical loan loss rates for each pool of loans to determine the probable loan losses inherent in the portfolio.

The methodology is consistently applied across all the portfolio segments taking into account the applicable historical loss rates and the qualitative factors applicable to each pool of loans. Periodically, we assess various attributes utilized in adjusting our historical loss factors to reflect current economic conditions. As a result of improved credit quality and better economic conditions, the allowance for loan losses was reduced by \$3.8 million and \$10.0 million for the three and nine months ended September 30, 2013, respectively. This compares with zero provision for loan losses for the same periods of 2012.

Management believes that the ALLL was appropriate at September 30, 2013. No assurance can be given that economic conditions which adversely affect our service areas or other circumstances will not be reflected in increased provisions for loan losses in the future.

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The following table presents the balance and activity in the allowance for loan losses; and the recorded investment in held-for-investment loans by portfolio segment and based upon our impairment method as of September 30, 2013, and 2012:

**Allowance for Loan losses and Recorded Investment in Financing Receivables****As of and For the Three and Nine Months Ended September 30, 2013**

|   | Real Estate                     |                              |              | Dairy & Municipal Consumer |                                  |                                 |                |                      |             |           |
|---|---------------------------------|------------------------------|--------------|----------------------------|----------------------------------|---------------------------------|----------------|----------------------|-------------|-----------|
|   | Commercial<br>and<br>Industrial | Commercial<br>Real<br>Estate | Construction | SFR<br>Mortgage            | Livestock<br>and<br>Agribusiness | Lease<br>Finance<br>Receivables | Other<br>Loans | Covered<br>Loans (1) | Unallocated | Total     |
|   | <i>(Dollars in thousands)</i>   |                              |              |                            |                                  |                                 |                |                      |             |           |
| Beginning<br>balance,<br>July 1, 2013       | \$ 12,586                       | \$ 44,392                    | \$ 1,172     | \$ 3,715                   | \$ 14,225                        | \$ 2,369                        | \$ 1,052       | \$                   | \$ 5,946    | \$ 85,457 |
| Charge-offs                                 | (1,235)                         |                              |              | (110)                      |                                  |                                 | (39)           |                      |             | (1,384)   |
| Recoveries                                  | 315                             | 34                           | 15           |                            | 14                               |                                 | 12             |                      |             | 390       |
| Provision /<br>reallocation of<br>LLL       | (1,022)                         | (1,007)                      | 412          | (144)                      | (2,152)                          | 69                              | 25             |                      | 69          | (3,750)   |
| Ending<br>balance,<br>September 30,<br>2013 | \$ 10,644                       | \$ 43,419                    | \$ 1,599     | \$ 3,461                   | \$ 12,087                        | \$ 2,438                        | \$ 1,050       | \$                   | \$ 6,015    | \$ 80,713 |
| Beginning<br>balance,<br>January 1,<br>2013 | \$ 11,652                       | \$ 47,457                    | \$ 2,291     | \$ 3,448                   | \$ 18,696                        | \$ 1,588                        | \$ 1,170       | \$                   | \$ 6,139    | \$ 92,441 |
| Charge-offs                                 | (2,339)                         |                              |              | (252)                      |                                  |                                 | (108)          |                      |             | (2,699)   |
| Recoveries                                  | 523                             | 100                          | 83           | 133                        | 42                               |                                 | 40             |                      |             | 921       |
| Provision /<br>reallocation of<br>LLL       | 808                             | (4,138)                      | (775)        | 132                        | (6,651)                          | 850                             | (52)           |                      | (124)       | (9,950)   |
| Ending<br>balance,<br>September 30,<br>2013 | \$ 10,644                       | \$ 43,419                    | \$ 1,599     | \$ 3,461                   | \$ 12,087                        | \$ 2,438                        | \$ 1,050       | \$                   | \$ 6,015    | \$ 80,713 |
| <b>Allowance for<br/>loan losses:</b>       |                                 |                              |              |                            |                                  |                                 |                |                      |             |           |
| Individually<br>evaluated for               | \$ 387                          | \$ 1                         | \$ 144       | \$ 290                     | \$ 2,658                         | \$                              | \$ 5           | \$                   | \$          | \$ 3,485  |

|                |            |              |           |            |            |           |           |            |          |              |
|----------------|------------|--------------|-----------|------------|------------|-----------|-----------|------------|----------|--------------|
| mpairment      |            |              |           |            |            |           |           |            |          |              |
| Collectively   |            |              |           |            |            |           |           |            |          |              |
| valuated for   |            |              |           |            |            |           |           |            |          |              |
| mpairment      | \$ 10,257  | \$ 43,418    | \$ 1,455  | \$ 3,171   | \$ 9,429   | \$ 2,438  | \$ 1,045  | \$         | \$ 6,015 | \$ 77,228    |
| loans and      |            |              |           |            |            |           |           |            |          |              |
| ancing         |            |              |           |            |            |           |           |            |          |              |
| receivables    |            |              |           |            |            |           |           |            |          |              |
| (2):           |            |              |           |            |            |           |           |            |          |              |
| alance,        |            |              |           |            |            |           |           |            |          |              |
| eptember 30,   |            |              |           |            |            |           |           |            |          |              |
| 013            | \$ 510,566 | \$ 2,126,415 | \$ 47,648 | \$ 192,130 | \$ 261,638 | \$ 99,188 | \$ 52,886 | \$ 163,334 | \$       | \$ 3,453,805 |
| ndividually    |            |              |           |            |            |           |           |            |          |              |
| valuated for   |            |              |           |            |            |           |           |            |          |              |
| mpairment      | \$ 4,983   | \$ 38,999    | \$ 27,239 | \$ 12,805  | \$ 24,494  | \$        | \$ 159    | \$         | \$       | \$ 108,679   |
| Collectively   |            |              |           |            |            |           |           |            |          |              |
| valuated for   |            |              |           |            |            |           |           |            |          |              |
| mpairment      | \$ 505,583 | \$ 2,087,416 | \$ 20,409 | \$ 179,325 | \$ 237,144 | \$ 99,188 | \$ 52,727 | \$         | \$       | \$ 3,181,792 |
| acquired loans |            |              |           |            |            |           |           |            |          |              |
| with           |            |              |           |            |            |           |           |            |          |              |
| eteriorated    |            |              |           |            |            |           |           |            |          |              |
| redit quality, |            |              |           |            |            |           |           |            |          |              |
| et of discount | \$         | \$           | \$        | \$         | \$         | \$        | \$        | \$ 163,334 | \$       | \$ 163,334   |

(1) Represents the allowance and related loan balances in accordance with ASC 310-30.

(2) Net of purchase accounting discount.



**Table of Contents****As of and For the Three and Nine Months Ended September 30, 2012**  
**Real Estate**

|   | <b>Commercial<br/>and<br/>Industrial</b> | <b>Commercial<br/>Real<br/>Estate</b> | <b>Construction</b> | <b>SFR<br/>Mortgage</b> | <b>Dairy &amp;<br/>Livestock<br/>and<br/>Agribusiness</b> | <b>Municipal<br/>Lease<br/>Finance<br/>Receivables</b> | <b>Consumer<br/>and<br/>Other<br/>Loans</b> | <b>Covered<br/>Loans (1)</b> | <b>Unallocated</b> | <b>Total</b> |
|---|--|---------------------------------------|---------------------|-------------------------|---|--|---|------------------------------|--------------------|--------------|
| <i>(Dollars in thousands)</i>                           |  |                                       |                     |                         |   |  |   |                              |                    |              |
| <b>Beginning<br/>balance,<br/>July 1, 2012</b>          | \$ 12,332                                | \$ 45,319                             | \$ 3,029            | \$ 3,039                | \$ 16,976   | \$ 1,656   | \$ 1,401                                    | \$                           | \$ 8,140           | \$ 91,892    |
| <b>Charge-offs</b>                                      | (294)                                    | (358)                                 |                     | (168)                   |   |  | (66)  |                              |                    | (886)        |
| <b>Recoveries</b>                                       | 106                                      | 134                                   | 77                  | 4                       | 9   |  | 3   | 728                          |                    | 1,061        |
| <b>Provision /<br/>allocation of<br/>LLL</b>            | (13)                                     | (280)                                 | 265                 | 366                     | 2,861   | (110)  | (52)  | (728)                        | (2,309)            |              |
| <b>Ending<br/>balance,<br/>September 30,<br/>2012</b>   | \$ 12,131                                | \$ 44,815                             | \$ 3,371            | \$ 3,241                | \$ 19,846   | \$ 1,546   | \$ 1,286                                    | \$                           | \$ 5,831           | \$ 92,067    |
| <b>Beginning<br/>balance,<br/>January 1,<br/>2012</b>   | \$ 10,654                                | \$ 47,841                             | \$ 4,947            | \$ 4,032                | \$ 17,278   | \$ 2,403   | \$ 1,590                                    | \$                           | \$ 5,219           | \$ 93,964    |
| <b>Charge-offs</b>                                      | (977)                                    | (1,840)                               |                     | (642)                   | (1,150)   |  | (154)                                       | (81)                         |                    | (4,844)      |
| <b>Recoveries</b>                                       | 694                                      | 481                                   | 1,129               | (108)                   | 11  |  | 12  | 728                          |                    | 2,947        |
| <b>Provision /<br/>allocation of<br/>LLL</b>            | 1,760                                    | (1,667)                               | (2,705)             | (41)                    | 3,707   | (857)  | (162)                                       | (647)                        | 612                |              |
| <b>Ending<br/>balance,<br/>September 30,<br/>2012</b>   | \$ 12,131                                | \$ 44,815                             | \$ 3,371            | \$ 3,241                | \$ 19,846   | \$ 1,546   | \$ 1,286                                    | \$                           | \$ 5,831           | \$ 92,067    |
| <b>Allowance for<br/>loan losses:</b>                   |  |                                       |                     |                         |   |  |   |                              |                    |              |
| <b>Individually<br/>evaluated for<br/>impairment</b>    | \$ 481                                   | \$ 25                                 | \$                  | \$ 348                  | \$ 1,043  | \$   | \$ 113                                      | \$                           | \$                 | \$ 2,010     |
| <b>Collectively<br/>evaluated for<br/>impairment</b>    | \$ 11,650                                | \$ 44,790                             | \$ 3,371            | \$ 2,893                | \$ 18,803   | \$ 1,546   | \$ 1,173                                    | \$                           | \$ 5,831           | \$ 90,057    |
| <b>Loans and<br/>financing<br/>receivables<br/>(1):</b> |  |                                       |                     |                         |   |  |   |                              |                    |              |

|  |            |              |           |            |            |            |           |            |    |              |
|--|------------|--------------|-----------|------------|------------|------------|-----------|------------|----|--------------|
| Balance, September 30, 2012                                      | \$ 525,801 | \$ 2,012,119 | \$ 70,740 | \$ 158,074 | \$ 297,932 | \$ 109,005 | \$ 60,071 | \$ 207,307 | \$ | \$ 3,441,049 |
| Individually evaluated for impairment                            | \$ 4,457   | \$ 41,955    | \$ 37,794 | \$ 13,852  | \$ 18,708  | \$ 471     | \$ 364    | \$         | \$ | \$ 117,601   |
| Collectively evaluated for impairment                            | \$ 521,344 | \$ 1,970,164 | \$ 32,946 | \$ 144,222 | \$ 279,224 | \$ 108,534 | \$ 59,707 | \$         | \$ | \$ 3,116,141 |
| Acquired loans with deteriorated credit quality, net of discount | \$         | \$           | \$        | \$         | \$         | \$         | \$        | \$ 207,307 | \$ | \$ 207,307   |

- (1) Represents the allowance and related loan balances in accordance with ASC 310-30.
- (2) Net of purchase accounting discount.

**Past Due and Nonperforming Loans**

We seek to manage asset quality and control credit risk through diversification of the non-covered loan portfolio and the application of policies designed to promote sound underwriting and loan monitoring practices. The Bank's Credit Management Division is in charge of monitoring asset quality, establishing credit policies and procedures and enforcing the consistent application of these policies and procedures across the Bank. Reviews of nonperforming, past due non-covered loans and larger credits, designed to identify potential charges to the allowance for loan losses, and to determine the adequacy of the allowance, are conducted on an ongoing basis. These reviews consider such factors as the financial strength of borrowers and any guarantors, the value of the applicable collateral, loan loss experience, estimated loan losses, growth in the loan portfolio, prevailing economic conditions and other factors.

Loans are reported as a troubled debt restructuring when the Bank grants a concession(s) to a borrower experiencing financial difficulties that the Bank would not otherwise consider. Examples of such concessions include a reduction in the interest rate, deferral of principal or accrued interest, extending the payment due dates or loan maturity date(s), or providing a lower interest rate than would be normally available for new debt of similar risk. As a result of these concessions, restructured loans are classified as impaired. Impairment reserves on non-collateral dependent restructured loans are measured by comparing the present value of expected future cash flows on the restructured loans discounted at the interest rate of the original loan agreement to the loan's carrying value. These impairment reserves are recognized as a specific component to be provided for in the allowance for loan losses.

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Generally, when loans are identified as impaired they are moved to our Special Assets Division. When we identify a loan as impaired, we measure the loan for potential impairment using discounted cash flows, except when the sole remaining source of the repayment for the loan is the liquidation of the collateral. In these cases, we use the current fair value of collateral, less selling costs. The starting point for determining the fair value of collateral is through obtaining external appraisals.

Speculative construction loans are generally for properties where there is no identified buyer or renter.

The following table presents the recorded investment in non-covered past due and nonaccrual loans and loans past due by class of loans as of September 30, 2013, and December 31, 2012:

**Non-Covered Past Due and Nonaccrual Loans**

|                                      | September 30, 2013  |                     |                                |                             |                  | Current             | Total Loans and Financing Receivables |
|--------------------------------------|---------------------|---------------------|--------------------------------|-----------------------------|------------------|---------------------|---------------------------------------|
|                                      | 30-59 Days Past Due | 60-89 Days Past Due | 90+ Days Past Due and Accruing | Total Past Due and Accruing | Nonaccrual (1)   |                     |                                       |
| Commercial and industrial            | \$ 417              | \$                  | \$                             | \$ 417                      | \$ 3,734         | \$ 506,415          | \$ 510,566                            |
| Real estate:                         |                     |                     |                                |                             |                  |                     |                                       |
| Commercial real estate               |                     |                     |                                |                             |                  |                     |                                       |
| Owner occupied                       |                     |                     |                                |                             | 4,180            | 721,376             | 725,556                               |
| Non-owner occupied                   | 772                 | 243                 |                                | 1,015                       | 13,649           | 1,386,195           | 1,400,859                             |
| Construction                         |                     |                     |                                |                             |                  |                     |                                       |
| Speculative                          |                     |                     |                                |                             | 10,368           | 16,758              | 27,126                                |
| Non-speculative                      |                     |                     |                                |                             |                  | 20,522              | 20,522                                |
| SFR mortgage                         |                     |                     |                                |                             | 10,421           | 181,709             | 192,130                               |
| Dairy & livestock and agribusiness   |                     |                     |                                |                             | 6,973            | 254,665             | 261,638                               |
| Municipal lease finance receivables  |                     |                     |                                |                             |                  | 99,188              | 99,188                                |
| Consumer and other loans             | 4                   | 251                 |                                | 255                         | 159              | 52,472              | 52,886                                |
| <b>Total non-covered gross loans</b> | <b>\$ 1,193</b>     | <b>\$ 494</b>       | <b>\$</b>                      | <b>\$ 1,687</b>             | <b>\$ 49,484</b> | <b>\$ 3,239,300</b> | <b>\$ 3,290,471</b>                   |

(1) As of September 30, 2013, \$23.7 million of nonaccruing loans were current, \$487,000 were 30-59 days past due, and \$25.3 million were 90+ days past due.

|  | December 31, 2012   |                     |                   |                             |                | Current | Total Loans and Financing |
|--|---------------------|---------------------|-------------------|-----------------------------|----------------|---------|---------------------------|
|  | 30-59 Days Past Due | 60-89 Days Past Due | 90+ Days Past Due | Total Past Due and Accruing | Nonaccrual (1) |         |                           |

**and  
Accruing** **Receivables**

*(Dollars in thousands)*

|                                      |               |               |           |               |                  |                     |                     |
|--------------------------------------|---------------|---------------|-----------|---------------|------------------|---------------------|---------------------|
| Commercial and industrial            | \$ 233        | \$ 457        | \$        | \$ 690        | \$ 3,136         | \$ 543,596          | \$ 547,422          |
| Real estate:                         |               |               |           |               |                  |                     |                     |
| Commercial real estate               |               |               |           |               |                  |                     |                     |
| Owner occupied                       |               |               |           |               | 5,415            | 698,552             | 703,967             |
| Non-owner occupied                   |               |               |           |               | 15,624           | 1,270,516           | 1,286,140           |
| Construction                         |               |               |           |               |                  |                     |                     |
| Speculative                          |               |               |           |               | 10,663           | 27,231              | 37,894              |
| Non-speculative                      |               |               |           |               |                  | 21,827              | 21,827              |
| SFR mortgage                         | 107           |               |           | 107           | 13,102           | 146,079             | 159,288             |
| Dairy & livestock and agribusiness   |               |               |           |               | 9,842            | 326,818             | 336,660             |
| Municipal lease finance receivables  |               |               |           |               |                  | 105,767             | 105,767             |
| Consumer and other loans             | 82            | 8             |           | 90            | 215              | 59,968              | 60,273              |
| <b>Total non-covered gross loans</b> | <b>\$ 422</b> | <b>\$ 465</b> | <b>\$</b> | <b>\$ 887</b> | <b>\$ 57,997</b> | <b>\$ 3,200,354</b> | <b>\$ 3,259,238</b> |

- (1) As of December 31, 2012, \$40.1 million of nonaccruing loans were current, \$2.6 million were 30-59 days past due, and \$15.3 million were 90+ days past due.

**Table of Contents****Non-Covered Impaired Loans**

At September 30, 2013, the Company had non-covered impaired loans of \$108.7 million. Of this amount, there was \$10.4 million in nonaccrual commercial construction loans, \$10.4 million of nonaccrual SFR mortgage loans, \$17.8 million of nonaccrual commercial real estate loans, \$3.7 million of nonaccrual commercial and industrial loans, \$7.0 million of nonaccrual dairy & livestock loans and \$159,000 of other loans. These non-covered impaired loans included \$87.2 million of loans whose terms were modified in a troubled debt restructure, of which \$28.0 million are classified as nonaccrual. The remaining balance of \$59.2 million consists of 41 loans performing according to the restructured terms. The impaired loans had a specific allowance of \$3.5 million at September 30, 2013. At December 31, 2012, the Company had classified as impaired, non-covered loans with a balance of \$108.4 million with a related allowance of \$2.3 million.

The following table presents held-for-investment, individually evaluated for impairment by class of loans, as of September 30, 2013 and December 31, 2012:

**Non-Covered Impaired Loans**

|  | September 30, 2013     |                                |                      |                                   |                                  |
|--|------------------------|--------------------------------|----------------------|-----------------------------------|----------------------------------|
|  | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized |
| <i>(Dollars in thousands)</i>              |                        |                                |                      |                                   |                                  |
| <b>With no related allowance recorded:</b> |                        |                                |                      |                                   |                                  |
| Commercial and industrial                  | \$ 4,595               | \$ 6,020                       | \$                   | \$ 5,131                          | \$ 161                           |
| Real estate:                               |                        |                                |                      |                                   |                                  |
| Commercial real estate                     |                        |                                |                      |                                   |                                  |
| Owner occupied                             | 13,361                 | 14,412                         |                      | 13,635                            | 494                              |
| Non-owner occupied                         | 25,631                 | 36,851                         |                      | 26,838                            | 553                              |
| Construction                               |                        |                                |                      |                                   |                                  |
| Speculative                                | 10,369                 | 10,956                         |                      | 10,522                            |                                  |
| Non-speculative                            | 9,219                  | 9,219                          |                      | 9,219                             | 428                              |
| SFR mortgage                               | 10,156                 | 11,838                         |                      | 9,487                             | 75                               |
| Dairy & livestock and agribusiness         | 17,553                 | 18,515                         |                      | 19,308                            | 445                              |
| Municipal lease finance receivables        |                        |                                |                      |                                   |                                  |
| Consumer and other loans                   | 142                    | 214                            |                      | 149                               |                                  |
| Total                                      | 91,026                 | 108,025                        |                      | 94,289                            | 2,156                            |
| <b>With a related allowance recorded:</b>  |                        |                                |                      |                                   |                                  |
| Commercial and industrial                  | 388                    | 408                            | 387                  | 417                               |                                  |
| Real estate:                               |                        |                                |                      |                                   |                                  |
| Commercial real estate                     |                        |                                |                      |                                   |                                  |
| Owner occupied                             | 7                      | 9                              | 1                    | 11                                |                                  |
| Non-owner occupied                         |                        |                                |                      |                                   |                                  |
| Construction                               |                        |                                |                      |                                   |                                  |
| Speculative                                | 7,651                  | 7,651                          | 144                  | 7,651                             | 232                              |
| Non-speculative                            |                        |                                |                      |                                   |                                  |

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|                                     |            |            |          |            |          |
|-------------------------------------|------------|------------|----------|------------|----------|
| SFR mortgage                        | 2,649      | 2,764      | 290      | 2,636      | 5        |
| Dairy & livestock and agribusiness  | 6,941      | 7,654      | 2,658    | 7,571      |          |
| Municipal lease finance receivables |            |            |          |            |          |
| Consumer and other loans            | 17         | 19         | 5        | 19         |          |
| Total                               | 17,653     | 18,505     | 3,485    | 18,305     | 237      |
| Total non-covered impaired loans    | \$ 108,679 | \$ 126,530 | \$ 3,485 | \$ 112,594 | \$ 2,393 |

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|  | <b>December 31, 2012</b>       |   |                              |  |   |
|--|--------------------------------|---|------------------------------|--|---|
|  | <b>Recorded<br/>Investment</b> | <b>Unpaid<br/>Principal<br/>Balance</b> | <b>Related<br/>Allowance</b> | <b>Average<br/>Recorded<br/>Investment</b> | <b>Interest<br/>Income<br/>Recognized</b> |
|  | <i>(Dollars in thousands)</i>  |   |                              |  |   |
| <b>With no related allowance recorded:</b> |                                |   |                              |  |   |
| Commercial and industrial                  | \$ 3,385                       | \$ 4,215                                | \$                           | \$ 3,766                                   | \$ 43                                     |
| Real estate:                               |                                |   |                              |  |   |
| Commercial real estate                     |                                |   |                              |  |   |
| Owner occupied                             | 13,478                         | 14,569                                  |                              | 14,459                                     | 397                                       |
| Non-owner occupied                         | 28,639                         | 38,633                                  |                              | 29,801                                     | 670                                       |
| Construction                               |                                |   |                              |  |   |
| Speculative                                | 21,314                         | 21,607                                  |                              | 21,650                                     | 311                                       |
| Non-speculative                            | 9,219                          | 9,219                                   |                              | 9,219                                      | 574                                       |
| SFR mortgage                               | 11,079                         | 14,342                                  |                              | 11,292                                     | 54  |
| Dairy & livestock and agribusiness         | 12,406                         | 13,756                                  |                              | 11,834                                     | 173                                       |
| Municipal lease finance receivables        | 263                            | 263                                     |                              | 443  | 5   |
| Consumer and other loans                   | 142                            | 196                                     |                              | 145  |   |
| Total                                      | 99,925                         | 116,800                                 |                              | 102,609                                    | 2,227                                     |
| <b>With a related allowance recorded:</b>  |                                |   |                              |  |   |
| Commercial and industrial                  | 304                            | 327                                     | 289                          | 387  |   |
| Real estate:                               |                                |   |                              |  |   |
| Commercial real estate                     |                                |   |                              |  |   |
| Owner occupied                             | 19                             | 19                                      | 2                            | 28   |   |
| Non-owner occupied                         |                                |   |                              |  |   |
| Construction                               |                                |   |                              |  |   |
| Speculative                                |                                |   |                              |  |   |
| Non-speculative                            |                                |   |                              |  |   |
| SFR mortgage                               | 3,766                          | 4,071                                   | 434                          | 3,363                                      |   |
| Dairy & livestock and agribusiness         | 4,303                          | 4,340                                   | 1,596                        | 4,017                                      | 73  |
| Municipal lease finance receivables        |                                |   |                              |  |   |
| Consumer and other loans                   | 73                             | 74                                      | 11                           | 75   |   |
| Total                                      | 8,465                          | 8,831                                   | 2,332                        | 7,870                                      | 73  |
| Total non-covered impaired loans           | \$ 108,390                     | \$ 125,631                              | \$ 2,332                     | \$ 110,479                                 | \$ 2,300                                  |

The Company recognizes the charge-off of impairment allowance on impaired loans in the period it arises for collateral dependent loans. Therefore, the majority of the nonaccrual loans as of September 30, 2013 and December 31, 2012 have already been written down to their estimated net realizable value. The impaired loans with a related allowance recorded are on nonaccrual loans where a charge-off is not yet processed, on nonaccrual SFR mortgage loans where there is a potential modification in process, or on smaller balance non-collateral dependent loans.

Impaired construction speculative loans increased in the third quarter of 2012 due to a participating interest in the Company's only Shared National Credit loan that was transferred to nonaccrual status. The outstanding balance was \$10.4 million as of September 30, 2013.

The allowance for off-balance sheet credit exposure relates to commitments to extend credit, letters of credit and undisbursed funds on lines of credit. The Company evaluates credit risk associated with the off-balance sheet commitments at the same time it evaluates credit risk associated with the loan and lease portfolio. The Company recorded \$500,000 and zero provision for unfunded commitments for the nine months ended September 30, 2013 and 2012, respectively. At September 30, 2013 and December 31, 2012, the balance in this reserve was \$9.1 million and was included in other liabilities.



**Table of Contents****Troubled Debt Restructurings ( TDR )**

As a result of adopting the amendments in ASU 2011-02, the Company reassessed all restructurings that occurred on or after January 1, 2011 for identification as troubled debt restructurings. Loans that are reported as TDRs are considered impaired and charge-off amounts are taken on an individual loan basis, as deemed appropriate. The majority of restructured loans are loans for which the terms of repayment have been renegotiated, resulting in a reduction in interest rate or deferral of principal. Refer to Note 3 Summary of Significant Accounting Policies, Troubled Debt Restructurings, included herein.

As of September 30, 2013, we had loans of \$87.2 million classified as TDR, of which \$28.0 million are nonperforming and \$59.2 million are performing. TDRs on accrual status are comprised of loans that were accruing interest at the time of restructuring or have demonstrated repayment performance in compliance with the restructured terms for a sustained period and for which the Company anticipates full repayment of both principal and interest. At September 30, 2013, performing TDRs were comprised of 15 commercial real estate loans of \$21.2 million, two construction loans of \$16.9 million, nine dairy & livestock loans of \$17.5 million, eight single-family residential loans of \$2.4 million, and seven commercial and industrial loans of \$1.2 million. There were no loans removed from TDR classification for the nine months ended September 30, 2013 and 2012.

The majority of TDRs have no specific allowance allocated as any impairment amount is normally charged off at the time a probable loss is determined. We have allocated \$2.9 million and \$1.4 million of specific allowance to TDRs as of September 30, 2013 and December 31, 2012, respectively.

The following tables provide a summary of the activity related to TDRs for the three and nine months ended September 30, 2013, and 2012:

|                                  | <b>For the Three Months Ended</b> |                  | <b>For the Nine Months Ended</b> |                  |
|----------------------------------|-----------------------------------|------------------|----------------------------------|------------------|
|                                  | <b>September 30,</b>              |                  | <b>September 30,</b>             |                  |
|                                  | <b>2013</b>                       | <b>2012</b>      | <b>2013</b>                      | <b>2012</b>      |
|                                  | <i>(Dollars in thousands)</i>     |                  |                                  |                  |
| <b>Performing TDRs:</b>          |                                   |                  |                                  |                  |
| Beginning balance                | \$ 61,566                         | \$ 45,243        | \$ 50,392                        | \$ 38,554        |
| New modifications                |                                   | 9,506            | 21,364                           | 20,106           |
| Payoffs and payments, net        | (2,481)                           | (480)            | (13,820)                         | (2,384)          |
| TDRs returned to accrual status  | 110                               |                  | 1,259                            | 517              |
| TDRs placed on nonaccrual status |                                   | (2,656)          |                                  | (5,180)          |
| <b>Ending balance</b>            | <b>\$ 59,195</b>                  | <b>\$ 51,613</b> | <b>\$ 59,195</b>                 | <b>\$ 51,613</b> |

|                            | <b>For the Three Months Ended</b> |             | <b>For the Nine Months Ended</b> |             |
|----------------------------|-----------------------------------|-------------|----------------------------------|-------------|
|                            | <b>September 30,</b>              |             | <b>September 30,</b>             |             |
|                            | <b>2013</b>                       | <b>2012</b> | <b>2013</b>                      | <b>2012</b> |
|                            | <i>(Dollars in thousands)</i>     |             |                                  |             |
| <b>Nonperforming TDRs:</b> |                                   |             |                                  |             |
| Beginning balance          | \$ 26,497                         | \$ 31,753   | \$ 31,309                        | \$ 23,844   |

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|                                  |           |           |           |           |
|----------------------------------|-----------|-----------|-----------|-----------|
| New modifications                | 3,676     | 1,612     | 3,804     | 14,563    |
| Charge-offs                      | (68)      |           | (68)      |           |
| Payoffs and payments, net        | (1,950)   | (2,922)   | (5,741)   | (9,971)   |
| TDRs returned to accrual status  | (110)     |           | (1,259)   | (517)     |
| TDRs placed on nonaccrual status |           | 2,656     |           | 5,180     |
| Ending balance                   | \$ 28,045 | \$ 33,099 | \$ 28,045 | \$ 33,099 |

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The following tables summarize loans modified as troubled debt restructurings during the three and nine months ended September 30, 2013, and 2012.

**Modifications (1)**

|  | <b>For the Three Months Ended September 30, 2013</b> |  |   |  |  |
|--|--|--|---|--|--|
|  | <b>Number of Loans</b>                               | <b>Pre-Modification Outstanding Investment</b> | <b>Post-Modification Outstanding Investment</b> | <b>Outstanding Recorded Investment at September 30, 2013</b> | <b>Financial Effect Resulting From Modifications (2)</b> |
| <b>Commercial and industrial:</b>              |  |  |   |  |  |
| Interest rate reduction                        |  | \$   | \$  | \$   | \$   |
| Change in amortization period or maturity      | 1  | 34   | 34  | 34   |  |
| <b>Real estate:</b>                            |  |  |   |  |  |
| <b>Commercial real estate:</b>                 |  |  |   |  |  |
| Owner occupied                                 |  |  |   |  |  |
| Interest rate reduction                        |  |  |   |  |  |
| Change in amortization period or maturity      |  |  |   |  |  |
| <b>Dairy &amp; livestock and agribusiness:</b> |  |  |   |  |  |
| Interest rate reduction                        |  |  |   |  |  |
| Change in amortization period or maturity      | 2  | 3,642  | 3,642   | 3,556  |  |
| Total non-covered loans                        | 3  | 3,676  | 3,676   | 3,590  |  |
| <b>Covered loans</b>                           |  |  |   |  |  |
| Total gross loans                              | 3  | \$ 3,676                                       | \$ 3,676  | \$ 3,590   | \$   |

|   | <b>For the Nine Months Ended September 30, 2013</b> |  |   |  |  |
|---|---|--|---|--|--|
|   | <b>Number of Loans</b>                              | <b>Pre-Modification Outstanding Investment</b> | <b>Post-Modification Outstanding Investment</b> | <b>Outstanding Recorded Investment at September 30, 2013</b> | <b>Financial Effect Resulting From Modifications (2)</b> |
| <b>Commercial and industrial:</b>         |   |  |   |  |  |
| Interest rate reduction                   |   | \$   | \$  | \$   | \$   |
| Change in amortization period or maturity | 4   | 265  | 265   | 223  | 122  |
| <b>Real estate:</b>                       |   |  |   |  |  |
| <b>Commercial real estate:</b>            |   |  |   |  |  |
| Owner occupied                            |   |  |   |  |  |

|  |    |           |           |           |    |     |
|--|----|-----------|-----------|-----------|----|-----|
| <b>Interest rate reduction</b>                 |    |           |           |           |    |     |
| Change in amortization period or maturity      | 1  | 168       | 168       | 143       |    |     |
| <b>Dairy &amp; livestock and agribusiness:</b> |    |           |           |           |    |     |
| Interest rate reduction                        |    |           |           |           |    |     |
| Change in amortization period or maturity      | 7  | 18,848    | 18,848    | 16,068    |    |     |
| Total non-covered loans                        | 12 | 19,281    | 19,281    | 16,434    |    | 122 |
| <b>Covered loans</b>                           |    |           |           |           |    |     |
| Total gross loans                              | 12 | \$ 19,281 | \$ 19,281 | \$ 16,434 | \$ | 122 |

- (1) The tables exclude modified loans that were paid off prior to the end of the period.
- (2) Financial effects resulting from modifications represent charge-offs and specific allowance recorded at modification date.

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|  | For the Three Months Ended September 30, 2012 |   |  |   |   |
|--|---|---|--|---|---|
|  | Number of Loans                               | Pre-Modification Outstanding Investment | Post-Modification Outstanding Investment | Outstanding Recorded Investment at September 30, 2012 | Financial Effect Resulting From Modifications (2) |
|  |   | (Dollars in thousands)                  |  |   |   |
| <b>Commercial and industrial:</b>              |   |   |  |   |   |
| Interest rate reduction                        |   | \$                                      | \$                                       | \$  | \$  |
| Change in amortization period or maturity      | 2   | 268                                     | 135                                      | 121   | 102   |
| <b>Real estate:</b>                            |   |   |  |   |   |
| <b>Commercial real estate:</b>                 |   |   |  |   |   |
| Owner occupied                                 |   |   |  |   |   |
| Interest rate reduction                        |   |   |  |   |   |
| Change in amortization period or maturity      | 1   | 853                                     | 853                                      | 853   |   |
| Non-owner occupied                             |   |   |  |   |   |
| Interest rate reduction                        |   |   |  |   |   |
| Change in amortization period or maturity      | 2   | 2,631                                   | 2,631                                    | 2,588   |   |
| <b>Construction:</b>                           |   |   |  |   |   |
| Speculative                                    |   |   |  |   |   |
| Interest rate reduction                        |   |   |  |   |   |
| Change in amortization period or maturity      |   |   |  |   |   |
| <b>Dairy &amp; livestock and agribusiness:</b> |   |   |  |   |   |
| Interest rate reduction                        |   |   |  |   |   |
| Change in amortization period or maturity      | 4   | 5,060                                   | 5,560                                    | 6,797   |   |
| <b>Municipal lease finance receivables</b>     |   |   |  |   |   |
| Interest rate reduction                        |   |   |  |   |   |
| Change in amortization period or maturity      | 2   | 519                                     | 519                                      | 472   |   |
| Total non-covered loans                        | 11  | 9,331                                   | 9,698                                    | 10,831  | 102   |
| <b>Covered loans</b>                           |   |   |  |   |   |
| Total gross loans                              | 11  | \$ 9,331                                | \$ 9,698                                 | \$ 10,831   | \$ 102  |

|   | For the Nine Months Ended September 30, 2012 |   |  |   |   |
|---|--|---|--|---|---|
|   | Number of Loans                              | Pre-Modification Outstanding Investment | Post-Modification Outstanding Investment | Outstanding Recorded Investment at September 30, 2012 | Financial Effect Resulting From Modifications (2) |
|   |  | (Dollars in thousands)                  |  |   |   |
| <b>Commercial and industrial:</b>         |  |   |  |   |   |
| Interest rate reduction                   | 1  | \$ 80                                   | \$ 80                                    | \$ 74   | \$  |
| Change in amortization period or maturity | 8  | 1,890                                   | 1,757                                    | 1,270   | 105   |

**Real estate:****Commercial real estate:**

## Owner occupied

## Interest rate reduction

|   |   |       |       |       |
|---|---|-------|-------|-------|
| Change in amortization period or maturity | 4 | 3,921 | 3,921 | 3,916 |
|---|---|-------|-------|-------|

## Non-owner occupied

## Interest rate reduction

|   |   |       |       |       |
|---|---|-------|-------|-------|
| Change in amortization period or maturity | 2 | 3,891 | 3,891 | 3,865 |
|---|---|-------|-------|-------|

|   |   |       |       |       |
|---|---|-------|-------|-------|
| Change in amortization period or maturity | 2 | 2,766 | 2,766 | 2,325 |
|---|---|-------|-------|-------|

**Construction:**

## Speculative

## Interest rate reduction

|   |   |        |        |        |
|---|---|--------|--------|--------|
| Change in amortization period or maturity | 1 | 10,966 | 10,966 | 10,618 |
|---|---|--------|--------|--------|

**Dairy & livestock and agribusiness:**

## Interest rate reduction

|   |   |       |       |        |
|---|---|-------|-------|--------|
| Change in amortization period or maturity | 8 | 9,447 | 9,947 | 10,804 |
|---|---|-------|-------|--------|

**Municipal lease finance receivables**

## Interest rate reduction

|   |   |     |     |     |
|---|---|-----|-----|-----|
| Change in amortization period or maturity | 2 | 519 | 519 | 472 |
|---|---|-----|-----|-----|

|                         |    |        |        |        |     |
|-------------------------|----|--------|--------|--------|-----|
| Total non-covered loans | 28 | 33,480 | 33,847 | 33,344 | 105 |
|-------------------------|----|--------|--------|--------|-----|

**Covered loans**

|                   |    |           |           |           |        |
|-------------------|----|-----------|-----------|-----------|--------|
| Total gross loans | 28 | \$ 33,480 | \$ 33,847 | \$ 33,344 | \$ 105 |
|-------------------|----|-----------|-----------|-----------|--------|

- (1) The tables exclude modified loans that were paid off prior to the end of the period.
- (2) Financial effects resulting from modifications represent charge-offs and specific allowance recorded at modification date.

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As of September 30, 2013, there was one commercial real estate loan with an outstanding balance of \$2.2 million that was previously modified as a troubled debt restructuring within the previous 12 months that subsequently defaulted during the nine months ended September 30, 2013.

**7. EARNINGS PER SHARE**

Basic earnings per common share are computed by dividing income allocated to common stockholders by the weighted-average number of common shares outstanding during each period. The computation of diluted earnings per common share considers the number of tax-effected shares issuable upon the assumed exercise of outstanding common stock options. Potentially dilutive common shares are excluded from the computation of diluted earnings per share in periods in which the effect would be antidilutive. The table below shows earnings per common share and diluted earnings per common share and reconciles the numerator and denominator of both earnings per common share calculations.

The table below presents the reconciliation of earnings per share for the periods indicated:

|   | <b>For the Three Months Ended</b>               |             | <b>For the Nine Months Ended</b> |             |
|---|---|-------------|----------------------------------|-------------|
|   | <b>September 30,</b>                            |             | <b>September 30,</b>             |             |
|   | <b>2013</b>                                     | <b>2012</b> | <b>2013</b>                      | <b>2012</b> |
|   | <i>(In thousands, except per share amounts)</i> |             |                                  |             |
| <b>Earnings per common share:</b>                               |   |             |                                  |             |
| Net earnings  | \$ 24,239                                       | \$ 9,257    | \$ 70,320                        | \$ 55,144   |
| Less: Net earnings allocated to restricted stock                | 74  | 30          | 218                              | 179         |
| Net earnings allocated to common shareholders                   | \$ 24,165                                       | \$ 9,227    | \$ 70,102                        | \$ 54,965   |
| Weighted average shares outstanding                             | 104,766   | 104,456     | 104,657                          | 104,380     |
| Earnings per common share                                       | \$ 0.23   | \$ 0.09     | \$ 0.67                          | \$ 0.53     |
| <b>Diluted earnings per common share:</b>                       |   |             |                                  |             |
| Net income allocated to common shareholders                     | \$ 24,165                                       | \$ 9,227    | \$ 70,102                        | \$ 54,965   |
| Weighted average shares outstanding                             | 104,766   | 104,456     | 104,657                          | 104,380     |
| Incremental shares from assumed exercise of outstanding options | 451   | 320         | 330                              | 259         |
| Diluted weighted average shares outstanding                     | 105,217   | 104,776     | 104,987                          | 104,639     |
| Diluted earnings per common share                               | \$ 0.23   | \$ 0.09     | \$ 0.67                          | \$ 0.53     |

**8. FAIR VALUE INFORMATION*****Fair Value Hierarchy***

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date.

The following disclosure provides the fair value information for financial assets and liabilities as of September 30, 2013. The fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value into three broad levels (Level 1, Level 2, and Level 3).

*Level 1* Valuation is based upon quoted prices for identical instruments traded in active markets.

*Level 2* Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

*Level 3* Valuation is generated from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect the Company's own estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flows and similar techniques.

There were no transfers in and out of Level 1 and Level 2 measurement during the nine months ended September 30, 2013 and 2012.



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**Table of Contents*****Determination of Fair Value***

The following is a description of valuation methodologies used for assets and liabilities recorded at fair value and for estimating fair value for financial instruments not recorded at fair value.

*Cash and Cash Equivalents* The carrying amount of cash and cash equivalents is considered to approximate fair value due to the liquidity of these instruments.

*Interest-Bearing Balances Due from Depository Institutions* The carrying value of due from depository institutions is considered to approximate fair value due to the short-term nature of these deposits.

*FHLB Stock* The carrying amount of FHLB stock approximates fair value, as the stock may be sold back to the FHLB at carrying value.

*Investment Securities Held to-Maturity* Investment securities held-to-maturity are valued based upon quotes obtained from an independent third-party pricing service. The Company categorized its held-to-maturity investment as a level 3 valuation.

*Investment Securities Available-for-Sale* Investment securities available-for-sale are generally valued based upon quotes obtained from an independent third-party pricing service. This service uses evaluated pricing applications and model processes. Observable market inputs, such as, benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers and reference data are considered as part of the evaluation. The inputs are related directly to the security being evaluated, or indirectly to a similarly situated security. Market assumptions and market data are utilized in the valuation models. The Company reviews the market prices provided by the third-party pricing service for reasonableness based on the Company's understanding of the market place and credit issues related to the securities. The Company has not made any adjustments to the market quotes provided by them and accordingly, the Company categorized its investment portfolio within Level 2 of the fair value hierarchy.

*Non-Covered Loans* The carrying amount of loans and lease finance receivables is their contractual amounts outstanding, reduced by deferred net loan origination fees and the allocable portion of the allowance for loan losses.

The fair value of loans, other than loans on nonaccrual status, was estimated by discounting the remaining contractual cash flows using the estimated current rate at which similar loans would be made to borrowers with similar credit risk characteristics and for the same remaining maturities, reduced by deferred net loan origination fees and the allocable portion of the allowance for loan losses. Accordingly, in determining the estimated current rate for discounting purposes, no adjustment has been made for any change in borrowers' credit risks since the origination of such loans. Rather, the allocable portion of the allowance for loan losses is considered to provide for such changes in estimating fair value. As a result, this fair value is not necessarily the value which would be derived using an exit price. These loans are included within Level 3 of the fair value hierarchy.

Non-covered impaired loans and OREO are generally measured using the fair value of the underlying collateral, which is determined based on the most recent appraisal information received, less costs to sell (approximately 8%). Appraised values may be adjusted based on factors such as the changes in market conditions from the time of valuation or discounted cash flows of the property. As such, these loans and OREO fall within Level 3 of the fair value hierarchy.

The majority of our commitments to extend credit carry current market interest rates if converted to loans. Because these commitments are generally unassignable by either the borrower or us, they only have value to the borrower and us. The estimated fair value approximates the recorded deferred fee amounts and is excluded from the following table because it is not material.

*Covered Loans* Covered loans were measured at fair value on the date of acquisition. Thereafter, covered loans are not measured at fair value on a recurring basis. The above valuation discussion for non-covered loans is applicable to covered loans following their acquisition date.

*Swaps* The fair value of the interest rate swap contracts are provided by our counterparty using a system that constructs a yield curve based on cash LIBOR rates, Eurodollar futures contracts, and 3-year through 30-year swap rates. The yield curve determines the valuations of the interest rate swaps. Accordingly, the swap is categorized as a Level 2 valuation.

*Deposits & Borrowings* The amounts payable to depositors for demand, savings, and money market accounts, and short-term borrowings are considered to approximate fair value. The fair value of fixed-maturity certificates of deposit is estimated using the rates currently offered for deposits of similar remaining maturities. The fair value of long-term borrowings and junior subordinated debentures is estimated using the rates currently offered for borrowings of similar remaining maturities. Interest-bearing deposits and borrowings are included within Level 2 of the fair value hierarchy.

*Accrued Interest Receivable/Payable* The amounts of accrued interest receivable on loans and lease finance receivables and investments and accrued interest payable on deposits and borrowings are considered to approximate fair value and are included within Level 2 of the fair value hierarchy.

**Table of Contents****Assets and Liabilities Measured at Fair Value on a Recurring Basis**

The tables below presents the balances of assets and liabilities measured at fair value on a recurring basis as of September 30, 2013 and December 31, 2012.

| Description of assets                  | Carrying Value at September 30, 2013 | Quoted Prices in Active Markets for Identical Assets Significant Other Inputs |              |           |
|--|--------------------------------------|---|--------------|-----------|
|  |                                      | (Level 1)   | (Level 2)    | (Level 3) |
| <i>(Dollars in thousands)</i>          |                                      |   |              |           |
| <b>Description of assets</b>           |                                      |   |              |           |
| Investment securities AFS:             |                                      |   |              |           |
| Government agency                      | \$ 333,013                           | \$  | \$ 333,013   | \$        |
| Residential mortgage-backed securities | 1,289,624                            |   | 1,289,624    |           |
| CMO s / REMIC s residential            | 389,208                              |   | 389,208      |           |
| Municipal bonds                        | 600,724                              |   | 600,724      |           |
| Other securities                       | 4,738                                |   | 4,738        |           |
| Total investment securities AFS        | 2,617,307                            |   | 2,617,307    |           |
| Interest rate swaps                    | 13,393                               |   | 13,393       |           |
| Total assets                           | \$ 2,630,700                         | \$  | \$ 2,630,700 | \$        |
| <b>Description of liability</b>        |                                      |   |              |           |
| Interest rate swaps                    | \$ 13,393                            | \$  | \$ 13,393    | \$        |
| Total liabilities                      | \$ 13,393                            | \$  | \$ 13,393    | \$        |

| Description of assets         | Carrying Value at December 31, 2012 | Quoted Prices in Active Markets for Identical Assets Significant Other Inputs |           |           |
|-------------------------------|-------------------------------------|---|-----------|-----------|
|                               |                                     | (Level 1)   | (Level 2) | (Level 3) |
| <i>(Dollars in thousands)</i> |                                     |   |           |           |
| <b>Description of assets</b>  |                                     |   |           |           |
| Investment securities AFS:    |                                     |   |           |           |

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|  |              |    |              |    |
|--|--------------|----|--------------|----|
| Government agency                      | \$ 359,300   | \$ | \$ 359,300   | \$ |
| Residential mortgage-backed securities | 887,598      |    | 887,598      |    |
| CMO s / REMIC s residential            | 571,960      |    | 571,960      |    |
| Municipal bonds                        | 625,429      |    | 625,429      |    |
| Other securities                       | 5,100        |    | 5,100        |    |
| Total investment securities AFS        | 2,449,387    |    | 2,449,387    |    |
| Interest rate swaps                    | 23,966       |    | 23,966       |    |
| Total assets                           | \$ 2,473,353 | \$ | \$ 2,473,353 | \$ |
| <b>Description of liability</b>        |              |    |              |    |
| Interest rate swaps                    | \$ 23,966    | \$ | \$ 23,966    | \$ |
| Total liabilities                      | \$ 23,966    | \$ | \$ 23,966    | \$ |

**Table of Contents****Assets and Liabilities Measured at Fair Value on a Non-Recurring Basis**

We may be required to measure certain assets at fair value on a non-recurring basis in accordance with GAAP. These adjustments to fair value usually result from application of lower-of-cost-or-market accounting or write-downs of individual assets. For assets measured at fair value on a non-recurring basis that were still held on the balance sheet at September 30, 2013 and December 31, 2012, respectively, the following tables provide the level of valuation assumptions used to determine each adjustment and the carrying value of the related assets for investments that had losses during the period.

| Description of assets         | Carrying Value at September 30, 2013 (Level 1) | Quoted Prices in                              |   |   | Total Losses for the Nine Months Ended September 30, 2013 |
|-------------------------------|--|---|---|---|---|
|                               |  | Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |   |
| <i>(Dollars in thousands)</i> |  |   |   |   |   |
| Impaired loans-non-covered    | \$ 13,857                                      | \$  | \$  | \$ 13,857                                 | \$ 3,288  |
| OREO-non-covered              |  |   |   |   |   |
| OREO-covered                  |  |   |   |   |   |
| <b>Total assets</b>           | <b>\$ 13,857</b>                               | <b>\$</b>                                     | <b>\$</b>                                     | <b>\$ 13,857</b>                          | <b>\$ 3,288</b>   |

| Description of assets         | Carrying Value at December 31, 2012 | Quoted Prices in                              |   |   | Total Losses for the Year Ended December 31, 2012 |
|-------------------------------|-------------------------------------|---|---|---|---|
|                               |                                     | Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |   |
| <i>(Dollars in thousands)</i> |                                     |   |   |   |   |
| Impaired loans-non-covered    | \$ 12,460                           | \$  | \$  | \$ 12,460                                 | \$ 3,930  |
| OREO-non-covered              | 3,008                               |   |   | 3,008                                     | 336   |
| OREO-covered                  | 1,067                               |   |   | 1,067                                     | 467   |
| <b>Total assets</b>           | <b>\$ 16,535</b>                    | <b>\$</b>                                     | <b>\$</b>                                     | <b>\$ 16,535</b>                          | <b>\$ 4,733</b>                                   |

**Table of Contents*****Fair Value of Financial Instruments***

The following disclosure presents estimated fair value of financial instruments. The estimated fair value amounts have been determined by the Company using available market information and appropriate valuation methodologies. However, considerable judgment is required to develop the estimates of fair value. Accordingly, the estimates presented below are not necessarily indicative of the amounts the Company could have realized in a current market exchange as of September 30, 2013 and December 31, 2012, respectively. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

|  | Carrying<br>Amount | September 30, 2013 |                      |           | Total        |
|--|--------------------|--------------------|----------------------|-----------|--------------|
|  |                    | Level 1            | Estimated Fair Value |           |              |
|  |                    |                    | Level 2              | Level 3   |              |
| <i>(Dollars in thousands)</i>                              |                    |                    |                      |           |              |
| <b>Assets</b>  |                    |                    |                      |           |              |
| Total cash and cash equivalents                            | \$ 131,442         | \$ 131,442         | \$                   | \$        | \$ 131,442   |
| Interest-earning balances due from depository institutions | 70,000             |                    | 70,000               |           | 70,000       |
| FHLB stock   | 39,420             |                    | 39,420               |           | 39,420       |
| Investment securities available-for-sale                   | 2,617,307          |                    | 2,617,307            |           | 2,617,307    |
| Investment securities held-to-maturity                     | 1,850              |                    |                      | 2,305     | 2,305        |
| Total loans, net of allowance for loan losses              | 3,363,973          |                    |                      | 3,423,040 | 3,423,040    |
| Accrued interest receivable                                | 21,860             |                    | 21,860               |           | 21,860       |
| Swaps  | 13,393             |                    | 13,393               |           | 13,393       |
| <b>Liabilities</b>   |                    |                    |                      |           |              |
| <b>Deposits:</b>   |                    |                    |                      |           |              |
| Noninterest-bearing  | \$ 2,538,461       | \$ 2,538,461       | \$                   | \$        | \$ 2,538,461 |
| Interest-bearing   | 2,357,025          |                    | 2,358,090            |           | 2,358,090    |
| Borrowings   | 807,503            |                    | 829,776              |           | 829,776      |
| Junior subordinated debentures                             | 25,774             |                    | 25,783               |           | 25,783       |
| Accrued interest payable                                   | 1,106              |                    | 1,106                |           | 1,106        |
| Swaps  | 13,393             |                    | 13,393               |           | 13,393       |

|  | Carrying<br>Amount | December 31, 2012 |                      |         | Total     |
|--|--------------------|-------------------|----------------------|---------|-----------|
|  |                    | Level 1           | Estimated Fair Value |         |           |
|  |                    |                   | Level 2              | Level 3 |           |
| <i>(Dollars in thousands)</i>                              |                    |                   |                      |         |           |
| <b>Assets</b>  |                    |                   |                      |         |           |
| Total cash and cash equivalents                            | \$ 98,431          | \$ 98,431         | \$                   | \$      | \$ 98,431 |
| Interest-earning balances due from depository institutions | 70,000             |                   | 70,000               |         | 70,000    |
| FHLB stock   | 56,651             |                   | 56,651               |         | 56,651    |
| Investment securities available-for-sale                   | 2,449,387          |                   | 2,449,387            |         | 2,449,387 |

|   |           |        |           |           |
|---|-----------|--------|-----------|-----------|
| Investment securities held-to-maturity        | 2,050     |        | 2,515     | 2,515     |
| Total loans, net of allowance for loan losses | 3,355,087 |        | 3,503,332 | 3,503,332 |
| Accrued interest receivable                   | 22,355    | 22,355 |           | 22,355    |
| Swaps   | 23,966    | 23,966 |           | 23,966    |

**Liabilities**

## Deposits:

|                                |              |              |           |    |              |
|--------------------------------|--------------|--------------|-----------|----|--------------|
| Noninterest-bearing            | \$ 2,420,993 | \$ 2,420,993 | \$        | \$ | \$ 2,420,993 |
| Interest-bearing               | 2,352,994    |              | 2,354,126 |    | 2,354,126    |
| Borrowings                     | 698,178      |              | 727,512   |    | 727,512      |
| Junior subordinated debentures | 67,012       |              | 67,415    |    | 67,415       |
| Accrued interest payable       | 1,493        |              | 1,493     |    | 1,493        |
| Swaps                          | 23,966       |              | 23,966    |    | 23,966       |

The fair value estimates presented herein are based on pertinent information available to management as of September 30, 2013 and December 31, 2012. Although management is 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 above.

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The Company has identified two principal reportable segments: Business Financial and Commercial Banking Centers (Centers) and the Treasury Department. The Company's subsidiary bank has 39 Business Financial Centers and six Commercial Banking Centers organized in geographic regions, which are the focal points for customer sales and services. The Company utilizes an internal reporting system to measure the performance of various operating segments within the Bank which is the basis for determining the Bank's reportable segments. The chief operating decision maker (currently our CEO) regularly reviews the financial information of these segments in deciding how to allocate resources and to assess performance. Business Financial and Commercial Banking Centers are considered one operating segment as their products and services are similar and are sold to similar types of customers, have similar production and distribution processes, have similar economic characteristics, and have similar reporting and organizational structures. The Treasury Department's primary focus is managing the Bank's investments, liquidity, and interest rate risk. Information related to the Company's remaining operating segments, which include construction lending, dairy & livestock lending, leasing, CitizensTrust, and centralized functions have been aggregated and included in Other. In addition, the Company allocates internal funds transfer pricing to the segments using a methodology that charges users of funds interest expense and credits providers of funds interest income with the net effect of this allocation being recorded in administration.

The following table represents the selected financial information for these two business segments. GAAP does not have an authoritative body of knowledge regarding the management accounting used in presenting segment financial information. The accounting policies for each of the business units is the same as those policies identified for the consolidated Company and disclosed in Note 3 - Summary of Significant Accounting Policies. The income numbers represent the actual income and expenses of each business unit. In addition, each segment has allocated income and expenses based on management's internal reporting system, which allows management to determine the performance of each of its business units. Loan fees included in the Centers category are the actual loan fees paid to the Company by its customers. These fees are eliminated and deferred in the Other category, resulting in deferred loan fees for the consolidated financial statements. All income and expense items not directly associated with the two business segments are grouped in the Other category. Future changes in the Company's management structure or reporting methodologies may result in changes in the measurement of operating segment results.

The following tables present the operating results and other key financial measures for the individual operating segments for the periods indicated:

|                                      | <b>For the Three Months Ended September 30, 2013</b> |                 |                |                     |               |
|--------------------------------------|--|-----------------|----------------|---------------------|---------------|
|                                      | <b>Centers</b>                                       | <b>Treasury</b> | <b>Other</b>   | <b>Eliminations</b> | <b>Total</b>  |
|                                      | <i>(Dollars in thousands)</i>                        |                 |                |                     |               |
| Interest income, including loan fees | \$ 36,024  | \$ 13,443       | \$ 8,607       | \$                  | \$ 58,074     |
| Credit for funds provided (1)        | 6,782  |                 | 2,617          | (9,399)             |               |
| <b>Total interest income</b>         | <b>42,806</b>  | <b>13,443</b>   | <b>11,224</b>  | <b>(9,399)</b>      | <b>58,074</b> |
| Interest expense                     | 1,551  | 2,435           | 115            |                     | 4,101         |
| Charge for funds used (1)            | 919  | 11,595          | (3,115)        | (9,399)             |               |
| <b>Total interest expense</b>        | <b>2,470</b>   | <b>14,030</b>   | <b>(3,000)</b> | <b>(9,399)</b>      | <b>4,101</b>  |



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|   |              |              |            |                |              |
|---|--------------|--------------|------------|----------------|--------------|
| Net interest income                                 | 40,336       | (587)        | 14,224     | 53,973         |              |
| Provision for loan losses                           |              |              | (3,750)    | (3,750)        |              |
| Net interest income after provision for loan losses | 40,336       | (587)        | 17,974     | 57,723         |              |
| Noninterest income                                  | 5,306        |              | (349)      | 4,957          |              |
| Noninterest expense                                 | 11,514       | 178          | 14,022     | 25,714         |              |
| Segment pre-tax profit (loss)                       | \$ 34,128    | \$ (765)     | \$ 3,603   | \$ 36,966      |              |
| Segment assets as of September 30, 2013             | \$ 5,305,357 | \$ 2,855,964 | \$ 732,999 | \$ (2,337,037) | \$ 6,557,283 |

(1) Credit for funds provided and charge for funds used is eliminated in the consolidated presentation.

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|  | <b>For the Three Months Ended September 30, 2012</b> |                    |                   |                     |                  |
|--|--|--------------------|-------------------|---------------------|------------------|
|  | <b>Centers</b>                                       | <b>Treasury</b>    | <b>Other</b>      | <b>Eliminations</b> | <b>Total</b>     |
|  | <i>(Dollars in thousands)</i>                        |                    |                   |                     |                  |
| Interest income, including loan fees                       | \$ 38,122  | \$ 13,263          | \$ 14,460         | \$                  | \$ 65,845        |
| Credit for funds provided (1)                              | 6,403  |                    | 2,608             | (9,011)             |                  |
| <b>Total interest income</b>                               | <b>44,525</b>  | <b>13,263</b>      | <b>17,068</b>     | <b>(9,011)</b>      | <b>65,845</b>    |
| Interest expense   | 1,665  | 3,819              | 617               |                     | 6,101            |
| Charge for funds used (1)                                  | 992  | 10,309             | (2,290)           | (9,011)             |                  |
| <b>Total interest expense</b>                              | <b>2,657</b>   | <b>14,128</b>      | <b>(1,673)</b>    | <b>(9,011)</b>      | <b>6,101</b>     |
| <b>Net interest income</b>                                 | <b>41,868</b>  | <b>(865)</b>       | <b>18,741</b>     |                     | <b>59,744</b>    |
| Provision for loan losses                                  |  |                    |                   |                     |                  |
| <b>Net interest income after provision for loan losses</b> | <b>41,868</b>  | <b>(865)</b>       | <b>18,741</b>     |                     | <b>59,744</b>    |
| Noninterest income   | 5,798  |                    | (3,172)           |                     | 2,626            |
| Noninterest expense  | 10,874   | 176                | 18,591            |                     | 29,641           |
| Debt termination   |  | 20,379             |                   |                     | 20,379           |
| <b>Segment pre-tax profit (loss)</b>                       | <b>\$ 36,792</b>                                     | <b>\$ (21,420)</b> | <b>\$ (3,022)</b> | <b>\$</b>           | <b>\$ 12,350</b> |
| Segment assets as of September 30, 2012                    | \$ 5,084,218   | \$ 2,604,648       | \$ 739,153        | \$ (2,106,678)      | \$ 6,321,341     |

(1) Credit for funds provided and charge for funds used is eliminated in the consolidated presentation.

|                                      | <b>For the Nine Months Ended September 30, 2013</b> |                 |                |                     |                |
|--------------------------------------|---|-----------------|----------------|---------------------|----------------|
|                                      | <b>Centers</b>                                      | <b>Treasury</b> | <b>Other</b>   | <b>Eliminations</b> | <b>Total</b>   |
|                                      | <i>(Dollars in thousands)</i>                       |                 |                |                     |                |
| Interest income, including loan fees | \$ 106,660  | \$ 37,872       | \$ 28,948      | \$                  | \$ 173,480     |
| Credit for funds provided (1)        | 19,603  |                 | 7,485          | (27,088)            |                |
| <b>Total interest income</b>         | <b>126,263</b>                                      | <b>37,872</b>   | <b>36,433</b>  | <b>(27,088)</b>     | <b>173,480</b> |
| Interest expense                     | 4,495   | 7,270           | 558            |                     | 12,323         |
| Charge for funds used (1)            | 3,025   | 32,973          | (8,910)        | (27,088)            |                |
| <b>Total interest expense</b>        | <b>7,520</b>  | <b>40,243</b>   | <b>(8,352)</b> | <b>(27,088)</b>     | <b>12,323</b>  |
| <b>Net interest income</b>           | <b>118,743</b>                                      | <b>(2,371)</b>  | <b>44,785</b>  |                     | <b>161,157</b> |
| Provision for loan losses            |   |                 | (9,950)        |                     | (9,950)        |

|   |              |              |            |                |              |
|---|--------------|--------------|------------|----------------|--------------|
| Net interest income after provision for loan losses | 118,743      | (2,371)      | 54,735     |                | 171,107      |
| Noninterest income                                  | 15,889       | 2,094        | 1,414      |                | 19,397       |
| Noninterest expense                                 | 34,410       | 539          | 49,811     |                | 84,760       |
| Debt termination                                    |              |              |            |                |              |
| Segment pre-tax profit (loss)                       | \$ 100,222   | \$ (816)     | \$ 6,338   | \$             | \$ 105,744   |
| Segment assets as of September 30, 2013             | \$ 5,305,357 | \$ 2,855,964 | \$ 732,999 | \$ (2,337,037) | \$ 6,557,283 |

(1) Credit for funds provided and charge for funds used is eliminated in the consolidated presentation.

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|  | <b>For the Nine Months Ended September 30, 2012</b> |                     |                   |                       |                     |
|--|---|---------------------|-------------------|-----------------------|---------------------|
|  | <b>Centers</b>                                      | <b>Treasury</b>     | <b>Other</b>      | <b>Eliminations</b>   | <b>Total</b>        |
|  | <i>(Dollars in thousands)</i>                       |                     |                   |                       |                     |
| Interest income, including loan fees                       | \$ 113,366  | \$ 43,609           | \$ 45,114         | \$                    | \$ 202,089          |
| Credit for funds provided (1)                              | 19,027  |                     | 7,758             | (26,785)              |                     |
| <b>Total interest income</b>                               | <b>132,393</b>                                      | <b>43,609</b>       | <b>52,872</b>     | <b>(26,785)</b>       | <b>202,089</b>      |
| Interest expense   | 5,581   | 12,936              | 2,266             |                       | 20,783              |
| Charge for funds used (1)                                  | 3,133   | 30,435              | (6,783)           | (26,785)              |                     |
| <b>Total interest expense</b>                              | <b>8,714</b>  | <b>43,371</b>       | <b>(4,517)</b>    | <b>(26,785)</b>       | <b>20,783</b>       |
| <b>Net interest income</b>                                 | <b>123,679</b>                                      | <b>238</b>          | <b>57,389</b>     |                       | <b>181,306</b>      |
| Provision for loan losses                                  |   |                     |                   |                       |                     |
| <b>Net interest income after provision for loan losses</b> | <b>123,679</b>                                      | <b>238</b>          | <b>57,389</b>     |                       | <b>181,306</b>      |
| Noninterest income   | 17,588  |                     | (7,414)           |                       | 10,174              |
| Noninterest expense  | 34,069  | 557                 | 54,176            |                       | 88,802              |
| Debt termination   |   | 20,379              |                   |                       | 20,379              |
| <b>Segment pre-tax profit (loss)</b>                       | <b>\$ 107,198</b>                                   | <b>\$ (20,698)</b>  | <b>\$ (4,201)</b> | <b>\$</b>             | <b>\$ 82,299</b>    |
| <b>Segment assets as of September 30, 2012</b>             | <b>\$ 5,084,218</b>                                 | <b>\$ 2,604,648</b> | <b>\$ 739,153</b> | <b>\$ (2,106,678)</b> | <b>\$ 6,321,341</b> |

(1) Credit for funds provided and charge for funds used is eliminated in the consolidated presentation.

**10. DERIVATIVE FINANCIAL INSTRUMENTS**

The Bank is exposed to certain risks relating to its ongoing business operations and utilizes interest rate swap agreements ( swaps ) as part of its asset/liability management strategy to help manage its interest rate risk position. As of September 30, 2013, the Bank has entered into 85 interest-rate swap agreements with customers and 85 with a counterparty bank. The swap agreements are not designated as hedging instruments. The purpose of entering into offsetting derivatives not designated as a hedging instrument is to provide the Bank a variable-rate loan receivable and provide the customer the financial effects of a fixed-rate loan without creating significant volatility in the Bank's earnings.

The structure of the swaps is as follows. The Bank enters into a swap with its customers to allow them to convert variable rate loans to fixed rate loans, and at the same time, the Bank enters into a swap with the counterparty bank to allow the Bank to pass on the interest-rate risk associated with fixed rate loans. The net effect of the transaction allows the Bank to receive interest on the loan from the customer at a variable rate based on LIBOR plus a spread. The changes in the fair value of the swaps primarily offset each other and therefore should not have a significant impact on the Company's results of operations. Our interest rate swap derivatives are subject to a master netting arrangement with one counterparty bank. None of our derivative assets and liabilities are offset in the balance sheet.

We believe our risk of loss associated with our counterparty borrowers related to interest rate swaps is mitigated as the loans with swaps are underwritten to take into account potential additional exposure, although there can be no assurances in this regard since the performance of our swaps is subject to market and counterparty risk.

***Balance Sheet Classification of Derivative Financial Instruments***

As of September 30, 2013, and December 31, 2012, the total notional amount of the Company's swaps was \$227.1 million, and \$240.1 million, respectively. The location of the asset and liability, and their respective fair values are summarized in the table below:

|   | <b>September 30, 2013</b> |                   |                              |                   |
|---|---------------------------|-------------------|------------------------------|-------------------|
|   | <b>Asset Derivatives</b>  |                   | <b>Liability Derivatives</b> |                   |
|   | <b>Balance Sheet</b>      | <b>Fair Value</b> | <b>Balance Sheet</b>         | <b>Fair Value</b> |
|   | <b>Location</b>           | <b>Value</b>      | <b>Location</b>              | <b>Value</b>      |
| <i>(Dollars in thousands)</i>                             |                           |                   |                              |                   |
| <b>Derivatives not designated as hedging instruments:</b> |                           |                   |                              |                   |
| Interest rate swaps                                       | Other assets              | \$ 13,393         | Other liabilities            | \$ 13,393         |
| <b>Total derivatives</b>                                  |                           | <b>\$ 13,393</b>  |                              | <b>\$ 13,393</b>  |

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|  | December 31, 2012      |                  |                        |                  |
|--|------------------------|------------------|------------------------|------------------|
|  | Asset Derivatives      |                  | Liability Derivatives  |                  |
|  | Balance Sheet Location | Fair Value       | Balance Sheet Location | Fair Value       |
| <i>(Dollars in thousands)</i>                      |                        |                  |                        |                  |
| Derivatives not designated as hedging instruments: |                        |                  |                        |                  |
| Interest rate swaps                                | Other assets           | \$ 23,966        | Other liabilities      | \$ 23,966        |
| <b>Total derivatives</b>                           |                        | <b>\$ 23,966</b> |                        | <b>\$ 23,966</b> |

***The Effect of Derivative Financial Instruments on the Consolidated Statements of Earnings***

The following table summarizes the effect of derivative financial instruments on the consolidated statements of earnings for the three and nine months ended September 30, 2013, and 2012:

**Derivatives Not****Designated as Hedging****Instruments**

| Location of Gain<br>Recognized in Income on<br>Derivative Instruments | Amount of Gain Recognized in Income on<br>Derivative Instruments<br>For<br>the Three Months Ended September 30, |               |
|---|---|---------------|
|   | 2013  | 2012          |
| <i>(Dollars in thousands)</i>   |   |               |
| Other income  | \$  | \$ 360        |
| <b>Total</b>  | <b>\$</b>   | <b>\$ 360</b> |

Interest rate swaps

Total

**Derivatives Not****Designated as Hedging****Instruments**

| Location of Gain<br>Recognized in Income on<br>Derivative Instruments | Amount of Gain<br>Recognized in Income on<br>Derivative Instruments<br>For the Nine Months<br>Ended September 30, |                 |
|---|---|-----------------|
|   | 2013  | 2012            |
| <i>(Dollars in thousands)</i>   |   |                 |
| Other income  | \$  | \$ 1,052        |
| <b>Total</b>  | <b>\$</b>   | <b>\$ 1,052</b> |

Interest rate swaps

Total



**Table of Contents****11. OTHER COMPREHENSIVE INCOME/(LOSS)**

The tables below provide a summary of the changes in accumulated other comprehensive income ( OCI ) for the three and nine months ended September 30, 2013.

**For the Three Months Ended September 30, 2013**

|  | <b>Before-Tax</b>             | <b>Tax Effect</b> | <b>After-Tax</b> |
|--|-------------------------------|-------------------|------------------|
|  | <i>(Dollars in thousands)</i> |                   |                  |
| <b>Investment securities available-for-sale:</b>     |                               |                   |                  |
| Net change in fair value recorded in accumulated OCI | \$ 421                        | \$ 176            | \$ 245           |
| <b>Net change</b>                                    | <b>\$ 421</b>                 | <b>\$ 176</b>     | <b>\$ 245</b>    |

**For the Nine Months Ended September 30, 2013**

|  | <b>Before-Tax</b>             | <b>Tax Effect</b>  | <b>After-Tax</b>   |
|--|-------------------------------|--------------------|--------------------|
|  | <i>(Dollars in thousands)</i> |                    |                    |
| <b>Investment securities available-for-sale:</b>     |                               |                    |                    |
| Net change in fair value recorded in accumulated OCI | \$ (65,129)                   | \$ (27,355)        | \$ (37,774)        |
| Net realized gains reclassified into earnings (1)    | (2,094)                       | (879)              | (1,215)            |
| <b>Net change</b>                                    | <b>\$ (67,223)</b>            | <b>\$ (28,234)</b> | <b>\$ (38,989)</b> |

(1) Net realized gains are included in noninterest income in the unaudited condensed consolidated statements of earnings and comprehensive income for the nine months ended September 30, 2013.

The following tables provide a summary of the change in accumulated other comprehensive income for the nine months ended September 30, 2013, and 2012:

|  | <b>Unrealized (Loss)/Gain<br/>on Investment Securities<br/>Available-for-Sale</b> |
|--|---|
|  | <i>(Dollars in thousands)</i>   |
| Balance, December 31, 2012                           | \$ 43,251   |
| Net change in fair value recorded in accumulated OCI | (37,774)  |
| Net realized gains reclassified into earnings        | (1,215)   |
| <b>Balance, September 30, 2013</b>                   | <b>\$ 4,262</b>   |



|  | <b>Unrealized (Loss)/Gain<br/>on Investment<br/>Securities<br/>Available-for-Sale</b><br><i>(Dollars in<br/>thousands)</i> |        |
|--|--|--------|
| Balance, December 31, 2011                           | \$   | 41,469 |
| Net change in fair value recorded in accumulated OCI |  | 6,996  |
| Balance, September 30, 2012                          | \$   | 48,465 |

**Table of Contents****12. BALANCE SHEET OFFSETTING**

Assets and liabilities relating to certain financial instruments, including, derivatives and securities sold under repurchase agreements ( repurchase agreements ), may be eligible for offset in the condensed consolidated balance sheets as permitted under accounting guidance. Our interest rate swap derivatives are subject to a master netting arrangement with one counterparty bank. Our interest rate swap derivatives require the Company to pledge investment securities as collateral based on certain risk thresholds. Investment securities that have been pledged by the Company to the counterparty bank continue to be reported in the Company's condensed consolidated balance sheets unless the Company defaults.

In November 2006, we began a repurchase agreement product with our customers, which include master netting agreements that allow for the netting of collateral positions. This product, known as Citizens Sweep Manager, sells our securities overnight to our customers under an agreement to repurchase them the next day. The repurchase agreements are not offset in the condensed consolidated balances.

|   | <b>Gross Amounts Recognized in the Condensed Consolidated Balance Sheets</b> |  | <b>Net Amounts offset in the Condensed Consolidated Balance Sheets</b> | <b>Gross Amounts Not Offset in the Condensed Consolidated Balance Sheets</b> |                           |                   |
|---|--|--|--|--|---------------------------|-------------------|
|   | <b>Condensed Consolidated Balance Sheets</b>                                 | <b>Condensed Consolidated Balance Sheets</b> | <b>Condensed Consolidated Balance Sheets</b>                           | <b>Financial Instruments</b>   | <b>Collateral Pledged</b> | <b>Net Amount</b> |
|   | <i>(Dollars in thousands)</i>  |  |  |  |                           |                   |
| <b>September 30, 2013</b>                         |  |  |  |  |                           |                   |
| <i>Financial assets:</i>                          |  |  |  |  |                           |                   |
| Derivatives not designated as hedging instruments | \$ 13,393  | \$   | \$   | \$ 13,393  | \$                        | \$ 13,393         |
| Total   | \$ 13,393  | \$   | \$   | \$ 13,393  | \$                        | \$ 13,393         |
| <i>Financial liabilities:</i>                     |  |  |  |  |                           |                   |
| Derivatives not designated as hedging instruments | \$ 14,464  | \$ (1,071)                                   | \$ 13,393  | \$ 1,071   | \$ (25,562)               | \$ (11,098)       |
| Repurchase agreements                             | 565,883  |  | 565,883  |  | (592,225)                 | (26,342)          |
| Total   | \$ 580,347   | \$ (1,071)                                   | \$ 579,276   | \$ 1,071   | \$ (617,787)              | \$ (37,440)       |
| <b>December 31, 2012</b>                          |  |  |  |  |                           |                   |
| <i>Financial assets:</i>                          |  |  |  |  |                           |                   |
| Derivatives not designated as hedging instruments | \$ 23,966  | \$   | \$   | \$ 23,966  | \$                        | \$ 23,966         |
| Total   | \$ 23,966  | \$   | \$   | \$ 23,966  | \$                        | \$ 23,966         |

*Financial liabilities:*

|   |            |    |            |    |              |             |
|---|------------|----|------------|----|--------------|-------------|
| Derivatives not designated as hedging instruments | \$ 23,966  | \$ | \$ 23,966  | \$ | \$ (26,589)  | \$ (2,623)  |
| Repurchase agreements                             | 473,244    |    | 473,244    |    | (505,000)    | (31,756)    |
| Total   | \$ 497,210 | \$ | \$ 497,210 | \$ | \$ (531,589) | \$ (34,379) |

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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion provides information about the results of operations, financial condition, liquidity, and capital resources of CVB Financial Corp. and its wholly owned subsidiaries. This information is intended to facilitate the understanding and assessment of significant changes and trends related to our financial condition and the results of our operations. This discussion and analysis should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2012, and the unaudited condensed consolidated financial statements and accompanying notes presented elsewhere in this report.

**CRITICAL ACCOUNTING POLICIES**

The discussion and analysis of the Company's unaudited condensed consolidated financial statements are based upon its unaudited condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these unaudited condensed consolidated financial statements requires management to make estimates and judgments that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities at the date of our financial statements. Actual results may differ from these estimates under different assumptions or conditions.

The following is a summary of the more judgmental and complex accounting estimates and principles. In each area, we have identified the variables most important in the estimation process. We have used the best information available to make the necessary estimates to value the related assets and liabilities. Actual performance that differs from our estimates and future changes in the key variables could change future valuations and impact the results of operations.

Allowance for Loan Losses ( ALLL )

Troubled Debt Restructurings

Investment Securities

Goodwill Impairment

Acquired Loans

Covered Loans

Covered Other Real Estate Owned

FDIC Loss Sharing Asset

Non-Covered Other Real Estate Owned

Fair Value of Financial Instruments

Income Taxes

Share-based Compensation

Our significant accounting policies are described in greater detail in our 2012 Annual Report on Form 10-K in the Critical Accounting Policies section of Management's Discussion and Analysis of Financial Condition and Results of Operations and in Note 3 to the Unaudited Condensed Consolidated Financial Statements, Significant Accounting Policies, which are essential to understanding Management's Discussion and Analysis of Financial Condition and Results of Operations.

## OVERVIEW

For the third quarter of 2013, we reported net income of \$24.2 million, compared with \$9.3 million for the third quarter of 2012, an increase of \$15.0 million, or 161.85%. Diluted earnings per share were \$0.23 per share for the third quarter of 2013, compared to \$0.09 for the same period in 2012. Net income for the third quarter of 2013 included a \$3.8 million loan loss provision recapture and \$4.1 million in insurance reimbursements for previous years legal costs. By comparison, the third quarter of 2012 was negatively impacted by a pre-tax debt termination expense of \$20.4 million. This was related to the redemption of \$250.0 million fixed rate borrowings, from the Federal Home Loan Bank ( FHLB ).

At September 30, 2013, total assets of \$6.56 billion increased \$193.9 million, or 3.05%, from total assets of \$6.36 billion at December 31, 2012. Earning assets totaled \$6.18 billion at September 30, 2013, an increase of \$140.2 million, or 2.32%, when compared with total earning assets of \$6.04 billion at December 31, 2012. The increase in earning assets during the first nine months of 2013 was primarily due to a \$167.7 million increase in investment securities, offset principally by a \$17.2 million decrease in FHLB stock and a \$7.4 million decrease in interest-earning balances due from the Federal Reserve.

Investment securities totaled \$2.62 billion at September 30, 2013, up from \$2.45 billion at December 31, 2012. As of September 30, 2013, we had a pre-tax unrealized net gain of \$7.3 million on our overall investment securities portfolio, compared to a pre-tax net unrealized gain of \$74.6 million at December 31, 2012. The decrease in the net unrealized holding gain resulted primarily from fluctuations in market interest rates. \$19.1 million of this unrealized net gain was attributable to our municipal securities portfolio, offset by unrealized net losses of \$11.7 million attributable to the remainder of the portfolio, consisting of predominantly government

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agency securities. During the third quarter of 2013, we purchased \$307.5 million in MBS with an average yield of 2.44% and an average duration of approximately four years. We also purchased \$7.2 million in municipal securities with an average tax-equivalent yield of 4.01%. During the first quarter of 2013, we identified 13 securities with a par value of \$94.2 million that were experiencing accelerated prepayment speeds that were causing an ongoing deterioration in yield. We elected to sell these securities and recognized a net gain on sale of \$2.1 million.

Total loans and leases, net of deferred fees and discount, of \$3.44 billion at September 30, 2013, increased by \$101.0 million, or 3.02%, from \$3.34 billion at June 30, 2013. Quarter-over-quarter, non-covered loans increased by \$111.5 million and covered loans decreased by \$10.5 million. The \$111.5 million increase in non-covered loans was principally due to increases of \$117.7 million in commercial real estate loans, \$12.0 million in total single family residential ( SFR ) mortgages (net of a \$7.3 million decrease in SFR pool loans), and \$4.4 million in dairy & livestock loans. This growth was partially offset by decreases of \$14.6 million in commercial and industrial loans, \$6.1 million in municipal lease finance receivables, and \$1.9 million in agribusiness loans. Our recent growth in total loans is due to a combination of a strengthened new loan pipeline and reduced loan runoff. The \$19.3 million growth in SFR mortgage-direct loans in the third quarter of 2013 was principally due to our enhanced lending program. This program is focused on owner-occupied SFR s with defined loan-to-value, debt-to-income and other credit criteria, such as FICO credit scores, that we believe are appropriate for loans which are primarily intended for retention in our Bank s loan portfolio. The program was changed recently to enable our Bank to underwrite and retain SFR mortgage loans generated through our internal referral channels, as opposed to our past practice of contracting with an outside party for certain underwriting and related loan origination services. The market for new loans continued to remain very competitive but the recent rise in long term interest rates has started to moderate refinance pressure on our existing loans, particularly from the larger banks.

Noninterest-bearing deposits were \$2.54 billion at September 30, 2013, an increase of \$117.5 million, or 4.85%, compared to \$2.42 billion at December 31, 2012. At September 30, 2013, noninterest-bearing deposits were 51.85% of total deposits, compared to 50.71% at December 31, 2012 and 48.62% at September 30, 2012. Our average cost of total deposits for the third quarter of 2013 was 10 basis points, compared to 12 basis points for the third quarter of 2012.

At September 30, 2013, we had \$25.8 million of junior subordinated debentures, compared to \$67.0 million at December 31, 2012. On January 7, 2013, we redeemed \$20.6 million, or 50%, of the outstanding capital and common securities issued by the Company s trust subsidiary, CVB Statutory Trust II. On April 7, 2013, we redeemed the remaining \$20.6 million of the outstanding capital and common securities issued by CVB Statutory Trust II. We took these actions to reduce our funding costs.

Improved credit quality and better economic factors resulted in a \$3.8 million loan loss provision recapture during the third quarter of 2013. This compares with a \$6.2 million recapture for the second quarter of 2013 and zero provision for loan losses for the previous eight consecutive quarters. The allowance for loan losses was \$80.7 million, or 2.46% of total non-covered loans at September 30, 2013, compared to \$85.5 million at June 30, 2013 and \$92.4 million at December 31, 2012. The allowance for loan losses was 2.46%, 2.70%, 2.89%, 2.84%, and 2.85% of total non-covered loans and leases outstanding at September 30, 2013, June 30, 2013, March 31, 2013, December 31, 2012, and September 30, 2012, respectively.

Our capital ratios remain well-above regulatory standards. As of September 30, 2013, our Tier 1 leverage capital ratio totaled 11.44%, our Tier 1 risk-based capital ratio totaled 17.87% and our total risk-based capital ratio totaled 19.13%.



**Table of Contents****ANALYSIS OF THE RESULTS OF OPERATIONS****Financial Performance**

|  | For the Three Months Ended                              |                       | For the Nine Months Ended |                       |
|--|---|-----------------------|---------------------------|-----------------------|
|  | September 30,<br>2013                                   | September 30,<br>2012 | September 30,<br>2013     | September 30,<br>2012 |
|  | <i>(Dollars in thousands, except per share amounts)</i> |                       |                           |                       |
| Net interest income                      | \$ 53,973   | \$ 59,744             | \$ 161,157                | \$ 181,306            |
| Recapture of (provision for) loan losses | 3,750   |                       | 9,950                     |                       |
| Noninterest income                       | 4,957   | 2,626                 | 19,397                    | 10,174                |
| Noninterest expense                      | (25,714)  | (50,020)              | (84,760)                  | (109,181)             |
| Provision for income taxes               | (12,727)  | (3,093)               | (35,424)                  | (27,155)              |
| Net earnings                             | \$ 24,239   | \$ 9,257              | \$ 70,320                 | \$ 55,144             |
| <b>Earnings per common share:</b>        |   |                       |                           |                       |
| Basic                                    | \$ 0.23   | \$ 0.09               | \$ 0.67                   | \$ 0.53               |
| Diluted                                  | \$ 0.23   | \$ 0.09               | \$ 0.67                   | \$ 0.53               |
| Return on average assets                 | 1.49%   | 0.57%                 | 1.48%                     | 1.13%                 |
| Return on average shareholders equity    | 12.58%  | 4.86%                 | 12.16%                    | 9.89%                 |
| Efficiency ratio                         | 43.63%  | 80.20%                | 46.94%                    | 57.02%                |

**Noninterest Expense and Efficiency Ratio Reconciliation (Non-GAAP)**

We use certain non-GAAP financial measures to provide supplemental information regarding our performance. Noninterest expense for the three and nine months ended September 30, 2012 includes debt termination expense of \$20.4 million. We believe that presenting the efficiency ratio, and the ratio of noninterest expense to average assets, excluding the impact of debt termination expense, provides additional clarity to the users of financial statements regarding core financial performance. The Company did not incur debt termination expense during the three and nine month periods ended September 30, 2013.

|                                | Three Months Ended            |                       | Nine Months Ended     |                       |
|--------------------------------|-------------------------------|-----------------------|-----------------------|-----------------------|
|                                | September 30,<br>2013         | September 30,<br>2012 | September 30,<br>2013 | September 30,<br>2012 |
|                                | <i>(Dollars in thousands)</i> |                       |                       |                       |
| Net interest income            | \$ 53,973                     | \$ 59,744             | \$ 161,157            | \$ 181,306            |
| Noninterest income             | 4,957                         | 2,626                 | 19,397                | 10,174                |
| Noninterest expense            | 25,714                        | 50,020                | 84,760                | 109,181               |
| Less: debt termination expense |                               | (20,379)              |                       | (20,379)              |
| Adjusted noninterest expense   | \$ 25,714                     | \$ 29,641             | \$ 84,760             | \$ 88,802             |
| Efficiency ratio               | 43.63%                        | 80.20%                | 46.94%                | 57.02%                |
| Adjusted efficiency ratio      | 43.63%                        | 47.52%                | 46.94%                | 46.38%                |



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|  |           |           |           |           |
|--|-----------|-----------|-----------|-----------|
| Adjusted noninterest expense                       | \$ 25,714 | \$ 29,641 | \$ 84,760 | \$ 88,802 |
| Average assets                                     | 6,451,473 | 6,454,500 | 6,356,927 | 6,509,019 |
| Adjusted noninterest expense to average assets [1] | 1.58%     | 1.83%     | 1.78%     | 1.82%     |

[1] Annualized

**Table of Contents*****Income and Expense Related to Covered Assets***

The following table summarizes the components of income and expense related to covered assets excluding normal accretion of interest income on covered loans for the periods indicated:

|  | <b>For the Three Months Ended</b> |                               | <b>For the Nine Months Ended</b> |                               |
|--|-----------------------------------|-------------------------------|----------------------------------|-------------------------------|
|  | <b>September 30,<br/>2013</b>     | <b>September 30,<br/>2012</b> | <b>September 30,<br/>2013</b>    | <b>September 30,<br/>2012</b> |
|  | <i>(Dollars in thousands)</i>     |                               |                                  |                               |
| Interest income  |                                   |                               |                                  |                               |
| Interest income-accretion                              | \$ 2,947                          | \$ 7,045                      | \$ 10,796                        | \$ 19,258                     |
| Other income   |                                   |                               |                                  |                               |
| Decrease in FDIC loss share asset                      | (3,248)                           | (7,059)                       | (10,715)                         | (19,339)                      |
| Net (loss)/gain on sale of OREO                        | (4)                               | 475                           | 372                              | 996                           |
| Gain on sale of loans held-for-sale                    |                                   |                               |                                  | 815                           |
| Expenses   |                                   |                               |                                  |                               |
| Legal and professional                                 | (114)                             | (395)                         | (336)                            | (1,167)                       |
| OREO write-down  |                                   | (172)                         | (14)                             | (365)                         |
| OREO expenses  | (5)                               | (186)                         | (67)                             | (283)                         |
| Other expenses (appraisals, and etc.)                  | (37)                              | (96)                          | (139)                            | (186)                         |
| Net (loss) before loss taxes related to covered assets | \$ (461)                          | \$ (388)                      | \$ (103)                         | \$ (271)                      |

Income and expense related to covered loans include accretion of the difference between the carrying amount of the covered loans and their expected cash flows, net decrease in the FDIC loss sharing asset as well as the other noninterest income and noninterest expenses related to covered loans.

The discount accretion of \$2.9 million for the third quarter 2013, recognized as part of interest income from covered loans, decreased \$4.1 million, compared to \$7.0 million for the third quarter of 2012. The discount accretion was reduced by the changes in the FDIC loss sharing asset, a net decrease of \$3.2 million for the third quarter of 2013, compared to a net decrease of \$7.1 million for the third quarter of 2012.

At September 30, 2013, the remaining discount associated with the SJB loans approximated \$14.5 million. Based on the current forecast of expected cash flows, approximately \$9.0 million of the discount is expected to accrete into interest income over the remaining lives of the respective pools and individual loans, which approximates 4.4 years and 1.0 year, respectively. The FDIC loss sharing asset totaled \$7.0 million at September 30, 2013. The loss sharing asset will continue to be reduced by loss claims submitted to the FDIC with the remaining balance amortized on the same basis as the discount, not to exceed its remaining contract life of approximately 1.0 year.

The Company also recognized net gain on sales of OREO of \$372,000 for the nine months ended September 30, 2013, compared to \$996,000 for the same period in 2012. An \$815,000 gain on sale of covered loans was also recognized in 2012.

Expenses related to covered assets, OREO expenses, legal and professional expenses and other covered asset expenses, totaled \$556,000 for the nine months ended September 30, 2013. This compares to \$2.0 million for the same

period of 2012. Covered loans decreased \$58.0 million to \$177.9 million at September 30, 2013 from \$235.9 million at September 30, 2012.

**Table of Contents****Net Interest Income**

The principal component of our earnings is net interest income, which is the difference between the interest and fees earned on loans and investments (earning assets) and the interest paid on deposits and borrowed funds (interest-bearing liabilities). Net interest margin is the taxable-equivalent of net interest income as a percentage of average earning assets for the period. The level of interest rates and the volume and mix of earning assets and interest-bearing liabilities impact net interest income and net interest margin. The net interest spread is the yield on average earning assets minus the cost of average interest-bearing liabilities. Our net interest income, interest spread, and net interest margin are sensitive to general business and economic conditions. These conditions include short-term and long-term interest rates, inflation, monetary supply, and the strength of the international, national and state economies, in general, and more specifically the local economies in which we conduct business. Our ability to manage net interest income during changing interest rate environments will have a significant impact on our overall performance. As of September 30, 2013, our balance sheet is well matched over a one year horizon and slightly asset-sensitive over a two year horizon assuming no balance sheet growth; meaning interest-earning assets will generally reprice faster than interest-bearing liabilities. Therefore, our net interest margin is likely to modestly increase in sustained periods of rising interest rates and decrease modestly in sustained periods of declining interest rates. We manage net interest income through affecting changes in the mix of earning assets as well as the mix of interest-bearing liabilities, changes in the level of interest-bearing liabilities in proportion to earning assets, and in the growth of earning assets.

The table below presents the interest rate spread, net interest margin and the composition of average interest-earning assets and average interest-bearing liabilities by category for the periods indicated, including the changes in average balance, composition, and average yield/rate between these respective periods:

**Interest-Earning Assets and Interest-Bearing Liabilities**

|   | For the Three Months Ended September 30, |          |                |                    |          |                |
|---|--|----------|----------------|--------------------|----------|----------------|
|   | 2013                                     |          |                | 2012               |          |                |
|   | Average<br>Balance                       | Interest | Yield/<br>Rate | Average<br>Balance | Interest | Yield/<br>Rate |
|   | <i>(Dollars in thousands)</i>            |          |                |                    |          |                |
| <b>INTEREST-EARNING ASSETS</b>  |  |          |                |                    |          |                |
| Investment securities (1)   |  |          |                |                    |          |                |
| Taxable   | \$ 1,886,925                             | \$ 7,102 | 1.53%          | \$ 1,608,415       | \$ 7,246 | 1.81%          |
| Tax-advantaged  | 603,200                                  | 5,517    | 5.01%          | 635,171            | 5,640    | 4.90%          |
| Investment in FHLB stock  | 42,507                                   | 622      | 5.81%          | 64,084             | 79       | 0.49%          |
| Federal funds sold & interest-earning<br>deposits with other institutions | 160,150                                  | 180      | 0.45%          | 316,240            | 276      | 0.35%          |
| Loans HFS   |  |          | 0.00%          | 1,145              | 6        | 2.08%          |
| Loans (2)   | 3,400,192                                | 41,706   | 4.87%          | 3,464,444          | 45,553   | 5.23%          |
| Yield adjustment to interest income from<br>discount accretion            | (16,798)                                 | 2,947    |                | (35,248)           | 7,045    |                |
| Total interest-earning assets   | 6,076,176                                | 58,074   | 3.95%          | 6,054,251          | 65,845   | 4.48%          |
| Total noninterest-earning assets  | 375,297                                  |          |                | 400,249            |          |                |

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|              |              |              |
|--------------|--------------|--------------|
| Total assets | \$ 6,451,473 | \$ 6,454,500 |
|--------------|--------------|--------------|

**INTEREST-BEARING LIABILITIES**

|   |              |       |       |              |       |       |
|---|--------------|-------|-------|--------------|-------|-------|
| Savings deposits (3)                      | \$ 1,658,055 | 889   | 0.21% | \$ 1,704,929 | 973   | 0.23% |
| Time deposits                             | 694,236      | 339   | 0.19% | 750,436      | 425   | 0.23% |
| Total interest-bearing deposits           | 2,352,291    | 1,228 | 0.21% | 2,455,365    | 1,398 | 0.23% |
| FHLB advances and other borrowings        | 773,032      | 2,873 | 1.47% | 908,529      | 4,703 | 2.03% |
| Interest-bearing liabilities              | 3,125,323    | 4,101 | 0.52% | 3,363,894    | 6,101 | 0.71% |
| Noninterest-bearing deposits              | 2,483,421    |       |       | 2,257,941    |       |       |
| Other liabilities                         | 78,424       |       |       | 75,096       |       |       |
| Stockholders equity                       | 764,305      |       |       | 757,569      |       |       |
| Total liabilities and stockholders equity | \$ 6,451,473 |       |       | \$ 6,454,500 |       |       |

|                     |           |           |
|---------------------|-----------|-----------|
| Net interest income | \$ 53,973 | \$ 59,744 |
|---------------------|-----------|-----------|

|  |           |           |
|--|-----------|-----------|
| Net interest income excluding discount | \$ 51,026 | \$ 52,699 |
|--|-----------|-----------|

|  |       |       |
|--|-------|-------|
| Net interest spread - tax equivalent                     | 3.43% | 3.77% |
| Net interest spread - tax equivalent excluding discount  | 3.23% | 3.28% |
| Net interest margin                                      | 3.55% | 3.94% |
| Net interest margin - tax equivalent                     | 3.68% | 4.08% |
| Net interest margin - tax equivalent excluding discount  | 3.48% | 3.60% |
| Net interest margin excluding loan fees                  | 3.49% | 3.89% |
| Net interest margin excluding loan fees - tax equivalent | 3.62% | 4.03% |

(1) Non tax-equivalent (TE) rate was 2.05%, and 2.31% for the three months ended September 30, 2013, and 2012, respectively.

(2) Includes loan fees of: \$813, and \$692 for the three months ended September 30, 2013, and 2012, respectively. Prepayment penalty fees of \$856, and \$1,266 are included in interest income for the three months ended September 30, 2013, and 2012, respectively.

(3) Includes interest-bearing demand and money market accounts.

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|   | For the Nine Months Ended September 30, |            |                |                    |            |                |
|---|---|------------|----------------|--------------------|------------|----------------|
|   | 2013                                    |            |                | 2012               |            |                |
|   | Average<br>Balance                      | Interest   | Yield/<br>Rate | Average<br>Balance | Interest   | Yield/<br>Rate |
| <i>(Dollars in thousands)</i>   |   |            |                |                    |            |                |
| <b>INTEREST-EARNING ASSETS</b>  |   |            |                |                    |            |                |
| Investment securities (1)   |   |            |                |                    |            |                |
| Taxable   | \$ 1,795,109                            | \$ 19,280  | 1.44%          | \$ 1,638,181       | \$ 25,202  | 2.07%          |
| Tax-advantaged  | 615,498                                 | 16,569     | 4.91%          | 642,277            | 17,221     | 4.93%          |
| Investment in FHLB stock  | 49,004                                  | 1,432      | 3.91%          | 67,911             | 263        | 0.52%          |
| Federal funds sold & interest-earning<br>deposits with other institutions | 153,338                                 | 524        | 0.46%          | 305,770            | 856        | 0.37%          |
| Loans HFS   | 25                                      | 1          | 5.35%          | 4,683              | 16         | 0.46%          |
| Loans (2)   | 3,383,436                               | 124,878    | 4.93%          | 3,465,900          | 139,273    | 5.37%          |
| Yield adjustment to interest income from<br>discount accretion            | (20,268)                                | 10,796     |                | (42,425)           | 19,258     |                |
| Total interest-earning assets   | 5,976,142                               | 173,480    | 4.03%          | 6,082,297          | 202,089    | 4.59%          |
| Total noninterest-earning assets  | 380,785                                 |            |                | 426,722            |            |                |
| Total assets  | \$ 6,356,927                            |            |                | \$ 6,509,019       |            |                |
| <b>INTEREST-BEARING LIABILITIES</b>                                       |   |            |                |                    |            |                |
| Savings deposits (3)  | \$ 1,635,086                            | 2,605      | 0.21%          | \$ 1,725,717       | 3,203      | 0.25%          |
| Time deposits   | 702,702                                 | 1,022      | 0.19%          | 782,547            | 1,402      | 0.24%          |
| Total interest-bearing deposits   | 2,337,788                               | 3,627      | 0.21%          | 2,508,264          | 4,605      | 0.25%          |
| FHLB advances and other borrowings  | 772,764                                 | 8,696      | 1.50%          | 1,014,337          | 16,178     | 2.10%          |
| Interest-bearing liabilities  | 3,110,552                               | 12,323     | 0.53%          | 3,522,601          | 20,783     | 0.78%          |
| Noninterest-bearing deposits  | 2,398,378                               |            |                | 2,167,497          |            |                |
| Other liabilities   | 75,058                                  |            |                | 74,405             |            |                |
| Stockholders equity   | 772,939                                 |            |                | 744,516            |            |                |
| Total liabilities and stockholders equity                                 | \$ 6,356,927                            |            |                | \$ 6,509,019       |            |                |
| Net interest income   |   | \$ 161,157 |                |                    | \$ 181,306 |                |
| Net interest income excluding discount                                    |   | \$ 150,361 |                |                    | \$ 162,048 |                |
| Net interest spread - tax equivalent                                      |   |            | 3.50%          |                    |            | 3.81%          |
| Net interest spread - tax equivalent<br>excluding discount                |   |            | 3.24%          |                    |            | 3.35%          |
| Net interest margin   |   |            | 3.61%          |                    |            | 4.00%          |
| Net interest margin - tax equivalent                                      |   |            | 3.75%          |                    |            | 4.14%          |

|   |       |       |
|---|-------|-------|
| Net interest margin - tax equivalent<br>excluding discount  | 3.49% | 3.69% |
| Net interest margin excluding loan fees                     | 3.56% | 3.95% |
| Net interest margin excluding loan fees -<br>tax equivalent | 3.69% | 4.09% |

- (1) Non tax-equivalent (TE) rate was 2.00%, and 2.50% for the nine months ended September 30, 2013, and 2012, respectively.
- (2) Includes loan fees of: \$2,340, and \$2,001 for the nine months ended September 30, 2013, and 2012, respectively. Prepayment penalty fees of \$2,949, and \$2,949 are included in interest income for the nine months ended September 30, 2013, and 2012, respectively.
- (3) Includes interest-bearing demand and money market accounts.

**Table of Contents****Net Interest Income and Net Interest Margin Reconciliations (Non-GAAP)**

We use certain non-GAAP financial measures to provide supplemental information regarding our performance. Net interest income for the three and nine months ended September 30, 2013, and 2012 include a yield adjustment of \$2.9 million, and \$7.0 million, respectively. Net interest income for the nine months ended September 30, 2013, and 2012 include a yield adjustment of \$10.8 million, and \$19.3 million, respectively. These yield adjustments relate to discount accretion on covered loans, and are reflected in the Company's net interest margin. We believe that presenting net interest income and the net interest margin excluding these yield adjustments provides additional clarity to the users of financial statements regarding core net interest income and net interest margin.

|   | <b>Three Months Ended September 30,</b> |                 |              |                            |                 |              |
|---|---|-----------------|--------------|----------------------------|-----------------|--------------|
|   | <b>2013</b>                             |                 |              | <b>2012</b>                |                 |              |
|   | <b>Average<br/>Balance</b>              | <b>Interest</b> | <b>Yield</b> | <b>Average<br/>Balance</b> | <b>Interest</b> | <b>Yield</b> |
|   | <i>(Dollars in thousands)</i>           |                 |              |                            |                 |              |
| Total interest-earning assets (TE)  | \$ 6,076,176                            | \$ 60,093       | 3.95%        | \$ 6,054,251               | \$ 67,973       | 4.48%        |
| Discount on acquired loans  | 16,798                                  | (2,947)         |              | 35,248                     | (7,045)         |              |
| Total interest-earning assets, excluding SJB loan discount and yield adjustment | \$ 6,092,974                            | \$ 57,146       | 3.75%        | \$ 6,089,499               | \$ 60,928       | 3.99%        |
| Net interest income and net interest margin (TE)                                |   | \$ 55,992       | 3.68%        |                            | \$ 61,872       | 4.08%        |
| Yield adjustment to interest income from discount accretion                     |   | (2,947)         |              |                            | (7,045)         |              |
| Net interest income and net interest margin (TE), excluding yield adjustment    |   | \$ 53,045       | 3.48%        |                            | \$ 54,827       | 3.60%        |

**Nine Months Ended September 30,**

|  | <b>2013</b>                   |                 |              | <b>2012</b>                |                 |              |
|--|-------------------------------|-----------------|--------------|----------------------------|-----------------|--------------|
|  | <b>Average<br/>Balance</b>    | <b>Interest</b> | <b>Yield</b> | <b>Average<br/>Balance</b> | <b>Interest</b> | <b>Yield</b> |
|  | <i>(Dollars in thousands)</i> |                 |              |                            |                 |              |



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|   |              |            |       |              |            |       |
|---|--------------|------------|-------|--------------|------------|-------|
| Total interest-earning assets (TE)  | \$ 5,976,142 | \$ 179,555 | 4.03% | \$ 6,082,297 | \$ 208,550 | 4.59% |
| Discount on acquired loans  | 20,269       | (10,796)   |       | 42,425       | (19,258)   |       |
| Total interest-earning assets, excluding SJB loan discount and yield adjustment | \$ 5,996,411 | \$ 168,759 | 3.77% | \$ 6,124,722 | \$ 189,292 | 4.13% |
| Net interest income and net interest margin (TE)                                |              | \$ 167,232 | 3.75% |              | \$ 187,767 | 4.14% |
| Yield adjustment to interest income from discount accretion                     |              | (10,796)   |       |              | (19,258)   |       |
| Net interest income and net interest margin (TE), excluding yield adjustment    |              | \$ 156,436 | 3.49% |              | \$ 168,509 | 3.69% |

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The following tables present a comparison of interest income and interest expense resulting from changes in the volumes and rates on average earning assets and average interest-bearing liabilities for the periods indicated. Changes in interest income or expense attributable to volume changes are calculated by multiplying the change in volume by the initial average interest rate. The change in interest income or expense attributable to changes in interest rates is calculated by multiplying the change in interest rate by the initial volume. The changes attributable to interest rate and volume changes are calculated by multiplying the change in rate times the change in volume.

**Rate and Volume Analysis for Changes in Interest Income, Interest Expense, and Net Interest Income**

**Comparison of Three Months Ended September 30,  
2013 Compared to 2012  
Increase (Decrease) Due to**

|  | Volume            | Rate              | Rate/<br>Volume | Total             |
|--|-------------------|-------------------|-----------------|-------------------|
| <i>(Dollars in thousands)</i>                                      |                   |                   |                 |                   |
| <b>Interest income:</b>  |                   |                   |                 |                   |
| Taxable investment securities                                      | \$ 2,254          | \$ (2,044)        | \$ (354)        | \$ (144)          |
| Tax-advantaged securities  | (209)             | 90                | (4)             | (123)             |
| Investment in FHLB stock   | (27)              | 859               | (289)           | 543               |
| Fed funds sold & interest-earning deposits with other institutions | (136)             | 78                | (38)            | (96)              |
| Loans HFS  | (6)               | (6)               | 6               | (6)               |
| Loans  | (822)             | (3,082)           | 57              | (3,847)           |
| Yield adjustment from discount accretion                           | (3,681)           | (876)             | 459             | (4,098)           |
| <b>Total interest income</b>                                       | <b>(2,627)</b>    | <b>(4,981)</b>    | <b>(163)</b>    | <b>(7,771)</b>    |
| <b>Interest expense:</b>   |                   |                   |                 |                   |
| Savings deposits   | (23)              | (63)              | 2               | (84)              |
| Time deposits  | (29)              | (61)              | 4               | (86)              |
| FHLB advances and other borrowings                                 | (714)             | (1,311)           | 195             | (1,830)           |
| <b>Total interest expense</b>                                      | <b>(766)</b>      | <b>(1,435)</b>    | <b>201</b>      | <b>(2,000)</b>    |
| <b>Net interest income</b>   | <b>\$ (1,861)</b> | <b>\$ (3,546)</b> | <b>\$ (364)</b> | <b>\$ (5,771)</b> |

**Comparison of Nine Months Ended September 30,  
2013 Compared to 2012  
Increase (Decrease) Due to**

|                               | Volume   | Rate       | Rate/<br>Volume | Total      |
|-------------------------------|----------|------------|-----------------|------------|
| <i>(Dollars in thousands)</i> |          |            |                 |            |
| <b>Interest income:</b>       |          |            |                 |            |
| Taxable investment securities | \$ 2,411 | \$ (7,605) | \$ (728)        | \$ (5,922) |

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|  |                   |                   |                   |                    |
|--|-------------------|-------------------|-------------------|--------------------|
| Tax-advantaged securities  | (609)             | (45)              | 2                 | (652)              |
| Investment in FHLB stock   | (73)              | 1,721             | (479)             | 1,169              |
| Fed funds sold & interest-earning deposits with other institutions | (432)             | 201               | (101)             | (332)              |
| Loans HFS  | (16)              | 172               | (171)             | (15)               |
| Loans  | (3,327)           | (11,337)          | 269               | (14,395)           |
| Yield adjustment from discount accretion                           | (10,070)          | 3,366             | (1,758)           | (8,462)            |
| <b>Total interest income</b>                                       | <b>(12,116)</b>   | <b>(13,527)</b>   | <b>(2,966)</b>    | <b>(28,609)</b>    |
| Interest expense:  |                   |                   |                   |                    |
| Savings deposits   | (163)             | (459)             | 24                | (598)              |
| Time deposits  | (142)             | (264)             | 26                | (380)              |
| FHLB advances and other borrowings                                 | (3,923)           | (4,672)           | 1,113             | (7,482)            |
| <b>Total interest expense</b>                                      | <b>(4,228)</b>    | <b>(5,395)</b>    | <b>1,163</b>      | <b>(8,460)</b>     |
| <b>Net interest income</b>   | <b>\$ (7,888)</b> | <b>\$ (8,132)</b> | <b>\$ (4,129)</b> | <b>\$ (20,149)</b> |

Net interest income, before the provision for loan losses of \$54.0 million for the third quarter of 2013 decreased \$5.8 million, or 9.66%, compared to the third quarter of 2012. Interest income and fees on loans for the third quarter of 2013 totaled \$44.7 million, which included \$2.9 million of discount accretion from accelerated principal reductions, payoffs and improved credit loss experienced on covered loans acquired SJB. This represents a \$322,000 decrease when compared to interest income and fees on loans of \$45.0 million for the second quarter of 2013, which included \$3.5 million of discount accretion from accelerated principal reductions,

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payoffs and improved credit loss experienced on acquired loans. Interest income and fees on loans of \$44.7 million decreased \$7.9 million, or 15.11%, for the third quarter of 2013, compared to \$52.6 million, for the third quarter of 2012, which included \$7.0 million of discount accretion from accelerated principal reductions, payoffs and improved credit loss experienced on acquired loans.

Excluding the impact of the yield adjustment on covered loans, our tax equivalent (TE) net interest margin was 3.48% for the third quarter of 2013, compared with 3.46% for the second quarter of 2013 and 3.60% for the third quarter of 2012. Total average earning asset yields (excluding discount) were 3.75% for the third quarter of 2013, compared to 3.73% for the second quarter of 2013 and 3.99% for the third quarter of 2012. Total cost of funds of 0.29% for the third quarter of 2013 was unchanged from the second quarter of 2013, and decreased 14 basis points from 0.43% for the third quarter of 2012.

The average balance of total loans decreased \$64.3 million to \$3.40 billion for the third quarter of 2013, compared to \$3.46 billion for the third quarter of 2012. The average yield on loans was 4.87% for the third quarter of 2013, compared to 5.23% for the third quarter of 2012. Lower rates on mortgages continued to result in refinancings during the third quarter of 2013 and we continued to see competitive pressure on rates in all classes of loans. We earned \$856,000 in loan prepayment penalty fees for the third quarter of 2013, compared with \$1.1 million for the second quarter of 2013 and \$1.3 million for the third quarter of 2012.

Total average earning assets of \$6.08 billion increased \$21.9 million, or 0.36%, from \$6.05 billion for the third quarter of 2012. This increase was principally due to a \$246.5 million increase in investment securities to \$2.49 billion for the third quarter of 2013, compared to \$2.24 billion for the third quarter of 2012. This increase was partially offset by a \$156.1 million decrease in interest-earning cash to \$160.2 million, compared to \$316.2 million for the third quarter of 2012 as a result of prepaying \$250.0 million of FHLB advances during the third quarter of 2012 and \$61.9 million redemption of junior subordinated debentures from the second quarter of 2012 through the second quarter of 2013. The total average loan balance, net of discount, also decreased \$45.8 million, primarily due to a \$42.4 million decrease in average covered loans to \$166.3 million for the third quarter of 2013, compared to \$208.7 million for the third quarter of 2012. The average investment in FHLB stock also decreased \$21.6 million to \$42.5 million for the third quarter of 2013, compared to \$64.1 million for the third quarter of 2012.

In general, we stop accruing interest on a loan after its principal or interest becomes 90 days or more past due. When a loan is placed on non-accrual, all interest previously accrued but not collected is charged against earnings. There was no interest income that was accrued and not reversed on non-accrual loans at September 30, 2013 and 2012. As of September 30, 2013 and 2012, we had \$49.5 million and \$66.0 million of non-covered non-accrual loans, respectively.

Fees collected on loans are an integral part of the loan pricing decision. Net loan fees and the direct costs associated with the origination of loans are deferred and deducted from total loans on our balance sheet. Net deferred loan fees are recognized in interest income over the term of the loan using the effective-yield method. We recognized loan fee income of \$813,000 and \$2.3 million for the three and nine months ended September 30, 2013, respectively, compared to \$692,000 and \$2.0 million for the three and nine months ended September 30, 2012, respectively.

Interest income on investments of \$12.6 million for the third quarter of 2013, decreased \$267,000, or 2.07%, from \$12.9 million for the third quarter of 2012. Total yield (TE) on investments was 2.38% for the third quarter of 2013, compared to 2.69% for the third quarter of 2012. During the third quarter of 2013, we purchased \$307.5 million in MBS with an average yield of 2.44% and an average duration of approximately four years. We also purchased \$7.2 million in municipal securities with an average tax-equivalent yield of 4.01% during the third quarter of 2013. We elected to utilize short-term borrowings to facilitate a portion of these purchases. We did this in anticipation of the

current interest rate environment which was foreshadowed by the Federal Reserve Bank signaling that they would taper the QE3 stimulus package.

Interest expense of \$4.1 million for the third quarter of 2013, decreased \$2.0 million, or 32.78%, compared to \$6.1 million for the third quarter of 2012. The average rate paid on interest-bearing liabilities decreased 19 basis points, to 0.52% for the third quarter of 2013, from 0.71% in 2012 as a result of the low interest rate environment experienced for the third quarter of 2013, as well as the mix of interest-bearing liabilities.

Contributing to the decline in interest expense was lower rates paid on deposits as reflected by the decrease in our average cost of interest-bearing deposits (0.21% for the third quarter of 2013, compared to 0.23% for the third quarter of 2012). Average noninterest-bearing deposits grew to \$2.48 billion, or 51.36% of total average deposits for the third quarter of 2013, compared to \$2.26 billion, or 47.91% of total average deposits for the third quarter of 2012. The decrease in rates paid on total deposits (0.10% for the third quarter of 2013, compared to 0.12% for the third quarter of 2012) also contributed to our lower cost of funds.

Other borrowings typically have higher interest costs than interest-bearing deposits. The \$1.8 million decrease in interest from other borrowings during the third quarter of 2013 was due to the redemption of \$250.0 million of fixed rate loans from the FHLB during the third quarter of 2012, and \$61.9 million redemption of junior subordinated debentures from June 30, 2012 through June 30, 2013. The remaining FHLB advance carries a coupon rate of 4.52% and matures in November 2016. We also repaid \$100.0 million of FHLB advances, with a coupon rate of 2.89%, at the end of December, 2011. On January 7, 2012, we redeemed all outstanding

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debentures and trust preferred securities issued by First Coastal Capital Trust II for a total consideration of approximately \$6.8 million. During 2012, we redeemed \$41.2 million of CVB Statutory Trust I junior subordinated debentures bearing interest at 2.85% above the 90-day LIBOR. During the nine months ended September 30, 2013, we redeemed \$41.2 million of the outstanding capital and common securities issued by the Company's trust subsidiary, CVB Statutory Trust II. At September 30, 2013, we had \$42.5 million in short-term borrowings. These borrowings were used to facilitate a portion of our investment purchases made in the third quarter of 2013. We had \$26.0 million in short-term borrowings at December 31, 2012.

***Provision for Loan Losses***

We maintain an allowance for loan losses that is increased by a provision for non-covered loan losses charged against operating results. The provision for loan losses is determined by management as the amount to be added to the allowance for loan losses after net charge-offs have been deducted to bring the allowance to an appropriate level which, in management's best estimate, is necessary to absorb probable credit losses within the existing loan portfolio.

As a result of improved credit quality and better economic conditions, the allowance for loan losses was reduced to \$80.7 million at September 30, 2013, compared to \$92.4 million at September 30, 2012. We recorded a \$3.8 million and \$10.0 million loan loss provision recapture for the three and nine months ended September 30, 2013, respectively, compared to zero provision for loan losses for the same periods of 2012. We believe the allowance is appropriate at September 30, 2013. We periodically assess the quality of our portfolio to determine whether additional provisions for loan losses are necessary. The ratio of the allowance for loan losses to total non-covered net loans as of September 30, 2013 and December 31, 2012 was 2.46% and 2.84%, respectively.

No assurance can be given that economic conditions which adversely affect the Company's service areas or other circumstances will not be reflected in increased provisions for loan losses in the future, as the nature of this process requires considerable judgment. Net charge-offs totaled \$1.8 million for the nine months ended September 30, 2013, compared to \$1.9 million for the same period of 2012. See "Allowance for Loan Losses" under Analysis of Financial Condition herein.

SJB loans acquired in the FDIC-assisted transaction were initially recorded at their fair value and are covered by a loss sharing agreement with the FDIC, which expires in October 2014. Due to the timing of the acquisition and the October 16, 2009 fair value estimate, there was no provision for loan losses on the covered SJB loans in 2009. During the nine months ended September 30, 2013 and 2012, there was zero and \$728,000, respectively, in net recoveries for loans in excess of the amount originally expected in the fair value of the loans at acquisition. An offsetting adjustment was recorded to the FDIC loss sharing asset based on the appropriate loss sharing percentage.

***Noninterest Income***

Noninterest income includes income derived from special services offered, such as CitizensTrust, BankCard services, international banking, and other business services. Also included in noninterest income are service charges and fees, primarily from deposit accounts; gains (net of losses) from the disposition of investment securities, loans, other real estate owned, and fixed assets; and other revenues not included as interest on earning assets.

The following table sets forth the various components of noninterest income for the periods indicated.

**For the Three Months Ended**

**For the Nine Months Ended**

|  | September 30,                 |                 |                 | September 30,    |                  |                 |
|--|-------------------------------|-----------------|-----------------|------------------|------------------|-----------------|
|  | 2013                          | 2012            | Variance        | 2013             | 2012             | Variance        |
|  | <i>(Dollars in thousands)</i> |                 |                 |                  |                  |                 |
| <b>Noninterest income:</b>                 |                               |                 |                 |                  |                  |                 |
| Service charges on deposit accounts        | \$ 4,011                      | \$ 4,040        | \$ (29)         | \$ 11,982        | \$ 12,232        | \$ (250)        |
| Trust and investment services              | 2,021                         | 2,037           | (16)            | 6,098            | 6,264            | (166)           |
| Bankcard services                          | 920                           | 962             | (42)            | 2,697            | 2,888            | (191)           |
| BOLI income                                | 497                           | 781             | (284)           | 1,867            | 2,271            | (404)           |
| Gain on sale of investment securities, net |                               |                 |                 | 2,094            |                  | 2,094           |
| Decrease in FDIC loss sharing asset, net   | (3,248)                       | (7,059)         | 3,811           | (10,715)         | (19,339)         | 8,624           |
| Gain on OREO, net                          | (3)                           | 524             | (527)           | 3,129            | 1,458            | 1,671           |
| Gain on loans held-for-sale                |                               |                 |                 |                  | 815              | (815)           |
| Other                                      | 759                           | 1,341           | (582)           | 2,245            | 3,585            | (1,340)         |
| <b>Total noninterest income</b>            | <b>\$ 4,957</b>               | <b>\$ 2,626</b> | <b>\$ 2,331</b> | <b>\$ 19,397</b> | <b>\$ 10,174</b> | <b>\$ 9,223</b> |

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**Table of Contents***Third Quarter of 2013 Compared to Third Quarter of 2012*

Noninterest income of \$5.0 million for the third quarter of 2013 increased \$2.3 million, or 88.77%, over noninterest income of \$2.6 million for the third quarter of 2012. Noninterest income for the third quarter of 2013 increased primarily due to a \$3.2 million net decrease in the FDIC loss sharing asset during the third quarter of 2013, compared to a \$7.1 million net decrease in the third quarter of 2012. This increase was partially offset by a \$527,000 decrease in gain on OREO and a \$359,000 decrease in swap fee income.

CitizensTrust consists of Wealth Management and Investment Services income. The Wealth Management group provides a variety of services, which include asset management, financial planning, estate planning, retirement planning, private and corporate trustee services, and probate services. Investment Services provides self-directed brokerage, 401(k) plans, mutual funds, insurance and other non-insured investment products. At September 30, 2013, CitizensTrust had approximately \$2.23 billion in assets under management and administration, including \$1.67 billion in assets under management. CitizensTrust generated fees of \$2.0 million for the third quarter of 2013, compared to \$2.0 million for the third quarter of 2012.

The Bank invests in Bank-Owned Life Insurance (BOLI). BOLI involves the purchasing of life insurance by the Bank on a selected group of employees. The Bank is the owner and beneficiary of these policies. BOLI is recorded as an asset at its cash surrender value. Increases in the cash value of these policies, as well as insurance proceeds received, are recorded in noninterest income and are not subject to income tax, as long as they are held for the life of the covered parties. BOLI income of \$497,000 for the third quarter of 2013 decreased \$284,000, or 36.36% from the third quarter of 2012.

Other noninterest income of \$759,000 for the third quarter of 2013 decreased \$582,000, or 43.40%, compared to \$1.3 million for the third quarter of 2012. This decrease was principally due to a \$359,000 decrease in swap fee income.

*Nine Months of 2013 Compared to Nine Months of 2012*

The \$9.2 million increase in noninterest income for the first nine months of 2013 was primarily due to a \$10.7 million net decrease in the FDIC loss sharing asset, compared to a \$19.3 million net decrease for the nine months ended September 30, 2012. Also contributing to the year-over-year increase was a \$2.1 million net pre-tax gain on the sale of investment securities during 2013 and a \$2.5 million net pre-tax gain on the sale of one OREO property. During 2012, we recorded \$815,000 in net gain on the sale of covered loans held-for-sale.

Other noninterest income of \$2.2 million for the nine months ended September 30, 2013 decreased \$1.3 million, or 37.38%, compared to \$3.6 million for the same period of 2012. This decrease was principally due to a \$1.1 million decrease in swap fee income.



**Table of Contents****Noninterest Expense**

The following table sets for the various components of noninterest expense for the periods indicated.

|   | For the Three Months Ended<br>September 30, |                  |                    | For the Nine Months Ended<br>September 30, |                   |                    |
|---|---|------------------|--------------------|--|-------------------|--------------------|
|   | 2013  | 2012             | Variance           | 2013                                       | 2012              | Variance           |
| <i>(Dollars in thousands)</i>   |   |                  |                    |  |                   |                    |
| Noninterest expense:  |   |                  |                    |  |                   |                    |
| Salaries and employee benefits  | \$ 18,389                                   | \$ 17,489        | \$ 900             | \$ 52,777                                  | \$ 50,856         | \$ 1,921           |
| Occupancy   | 2,714                                       | 2,771            | (57)               | 7,974                                      | 8,108             | (134)              |
| Equipment   | 927   | 1,239            | (312)              | 2,914                                      | 3,474             | (560)              |
| Professional services   | 1,316                                       | 1,570            | (254)              | 4,299                                      | 5,666             | (1,367)            |
| Software licenses and maintenance   | 1,077                                       | 1,062            | 15                 | 3,392                                      | 2,960             | 432                |
| Stationary and supplies   | 833   | 901              | (68)               | 2,681                                      | 2,753             | (72)               |
| Promotion   | 1,105                                       | 1,176            | (71)               | 3,503                                      | 3,741             | (238)              |
| Amortization of intangibles   | 127   | 449              | (322)              | 1,002                                      | 1,717             | (715)              |
| Provision for unfunded commitments  | 500   |                  | 500                | 500  |                   | 500                |
| Debt termination  |   | 20,379           | (20,379)           |  | 20,379            | (20,379)           |
| OREO expense  | 21  | 405              | (384)              | 384  | 1,458             | (1,074)            |
| Insurance reimbursements  | (4,139)                                     | (48)             | (4,091)            | (4,139)                                    | (451)             | (3,688)            |
| Regulatory assessments  | 884   | 901              | (17)               | 2,639                                      | 2,662             | (23)               |
| Loan expense  | 438   | 495              | (57)               | 1,251                                      | 1,494             | (243)              |
| Other   | 1,522                                       | 1,231            | 291                | 5,583                                      | 4,364             | 1,219              |
| <b>Total noninterest expense</b>  | <b>\$ 25,714</b>                            | <b>\$ 50,020</b> | <b>\$ (24,306)</b> | <b>\$ 84,760</b>                           | <b>\$ 109,181</b> | <b>\$ (24,421)</b> |
| Noninterest expense to average assets, annualized, excluding debt termination |   |                  |                    |  |                   |                    |
|   | 1.58%                                       | 1.83%            | 0.25%              | 1.78%                                      | 1.82%             | 0.04%              |
| Efficiency ratio excluding debt termination (1)                               |   |                  |                    |  |                   |                    |
|   | 43.63%                                      | 47.52%           | 3.89%              | 46.94%                                     | 46.38%            | 0.56%              |

(1) Noninterest expense divided by net interest income before provision for loan losses plus noninterest income. *Third Quarter of 2013 Compared to Third Quarter of 2012*

Our ability to control noninterest expenses in relation to asset growth can be measured in terms of total noninterest expense as a percentage of average assets. Excluding the impact of the debt termination expense, noninterest expense measured as a percentage of average assets was 1.58% for the third quarter of 2013, compared to 1.83% for the third quarter of 2012.

Our ability to control noninterest expenses in relation to the level of total revenue (net interest income before provision for loan losses plus noninterest income) is measured by the efficiency ratio and indicates the percentage of

net revenue that is used to cover expenses. For the third quarter of 2013, the efficiency ratio was 43.63%, compared to 47.52% (excluding impact of the debt termination expense) for the third quarter of 2012.

Noninterest expense for the third quarter of 2013 decreased \$24.3 million, or 48.59%. The overall decrease was primarily due to a \$20.4 million debt termination expense incurred during the third quarter of 2012 and \$4.1 million in insurance reimbursements for previous years' legal costs recognized in the third quarter of 2013. Also contributing to the overall decrease in noninterest expense were reductions of \$657,000 in OREO costs, legal expenses, and loan related expenses as a result of the improved credit quality in our loan portfolio, and \$417,000 in office equipment expenses, other professional services and supplies. These expenses were partially offset by increases of \$900,000 in salaries and related expense due to increases in employee benefits and payroll taxes, and a \$500,000 provision for unfunded loan commitments.

The \$254,000 decrease in total professional services expense was primarily due to a \$216,000 decrease in legal expenses associated with credit and collection issues, the federal securities class action litigation, and other litigation issues in which the Company is involved. See Part II, Item 1 - Legal Proceedings .

#### *Nine Months of 2013 Compared to Nine Months of 2012*

Excluding the \$20.4 million debt termination expense for the nine months ended September 30, 2012, total noninterest expense for the nine months ended September 30, 2013 decreased \$4.0 million, primarily due to an increase of \$3.7 million in insurance reimbursements for previous years' legal costs. Also contributing to the overall decrease in noninterest expense were reductions of \$1.9 million in OREO costs, legal expenses and loan related expenses a result of the improved credit quality in our loan portfolio and \$1.4 million in office equipment, other professional services and supplies. These decreases were partially offset by increases of \$1.9 million in salaries and related benefits due to increases in employee benefits and payroll taxes, a \$1.0 million accrual for potential interest penalties associated with previous years' federal and state income tax returns included in other expense, and a \$500,000 provision for unfunded loan commitments.

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The \$1.4 million decrease in total professional services expense was primarily due to a \$783,000 decrease in other professional services and a \$584,000 decrease in legal expenses associated with credit and collection issues, the federal securities class action litigation, and other litigation issues in which the Company is involved.

***Income Taxes***

The Company's effective tax rate for the three and nine months ended September 30, 2013 was 34.43%, and 33.50%, respectively, compared to 25.04% and 33.00% for the three and nine months ended September 30, 2012, respectively. Our estimated annual effective tax rate varies depending upon tax-advantaged income as well as available tax credits. We also benefited from \$1.4 million of enterprise zone tax credits reflected during the first quarter of 2013. Due to recent California legislation, these tax credits will be limited in the future.

The effective tax rates are below the nominal combined Federal and State tax rate as a result of tax-advantaged income from certain investments and municipal loans and leases as a percentage of total income as well as available tax credits for each period. The majority of tax-advantaged income is derived from municipal securities.

**Table of Contents****RESULTS BY BUSINESS SEGMENTS**

We have two reportable business segments: which are (i) Business Financial and Commercial Banking Centers and (ii) Treasury. The results of these two segments are included in the reconciliation between business segment totals and our consolidated total. Our business segments do not include the results of administration units that do not meet the definition of an operating segment. There are no provisions for loan losses or taxes in the segments as these are accounted for at the corporate level.

Key measures we use to evaluate the segments performance are included in the following table for the three and nine months ended September 30, 2013 and 2012. These tables also provide additional significant segment measures useful to understanding the performance of this segment.

***Business Financial and Commercial Banking Centers***

|   | <b>For the Three Months<br/>Ended<br/>September 30,</b> |              | <b>For the Nine Months<br/>Ended<br/>September 30,</b> |              |
|---|---|--------------|--|--------------|
|   | <b>2013</b>   | <b>2012</b>  | <b>2013</b>  | <b>2012</b>  |
|   | <i>(Dollars in thousands)</i>                           |              |  |              |
| <b>Key Measures:</b>  |   |              |  |              |
| <i>Statement of Operations</i>                                  |   |              |  |              |
| Interest income (1)   | \$ 42,806   | \$ 44,525    | \$ 126,263   | \$ 132,393   |
| Interest expense (1)  | 2,470   | 2,657        | 7,520  | 8,714        |
| Net interest income   | \$ 40,336   | \$ 41,868    | \$ 118,743   | \$ 123,679   |
| Noninterest income  | 5,306   | 5,798        | 15,889   | 17,588       |
| Noninterest expense   | 11,514  | 10,874       | 34,410   | 34,069       |
| Segment pre-tax profit  | \$ 34,128   | \$ 36,792    | \$ 100,222   | \$ 107,198   |
| <i>Balance Sheet</i>  |   |              |  |              |
| Average loans   | \$ 2,652,559  | \$ 2,634,142 | \$ 2,616,293   | \$ 2,616,140 |
| Average interest-bearing deposits and customer repurchases      | \$ 2,635,002  | \$ 2,682,738 | \$ 2,611,972   | \$ 2,764,699 |
| Yield on loans (2)  | 5.39%   | 5.76%        | 5.45%  | 5.79%        |
| Rate paid on interest-bearing deposits and customer repurchases | 0.23%   | 0.25%        | 0.23%  | 0.27%        |

(1) Interest income and interest expense include credit for funds provided and charge for funds used, respectively. These are eliminated in the consolidated presentation.

(2) Yield on loans excludes SJB discount accretion as this is accounted for at the Corporate level.

For the third quarter of 2013, Business Financial and Commercial Banking Centers segment pre-tax profit decreased by \$2.7 million, or 7.24%, primarily due to a decrease in net interest income of \$1.5 million, or 3.66%, compared to

the third quarter of 2012. The \$1.7 million decrease in interest income for the third quarter of 2013 was principally due to a 37 basis point drop in the loan yield to 5.39% for the third quarter of 2013, compared to 5.76% for the third quarter of 2012. Average loans also decreased \$18.4 million. The market for new loans continued to remain very competitive but the recent rise in long term interest rates has started to moderate refinance pressure on our existing loans, particularly from the larger banks. The drop in interest income was offset by a decrease of \$187,000 in interest expense. Noninterest income also decreased \$492,000, or 8.49% for the three months ended September 30, 2013, compared to the same period in 2012.

**Table of Contents****Treasury**

|                                   | For the Three Months<br>Ended<br>September 30, |              | For the Nine Months<br>Ended<br>September 30, |              |
|-----------------------------------|--|--------------|---|--------------|
|                                   | 2013   | 2012         | 2013  | 2012         |
| <i>(Dollars in thousands)</i>     |  |              |   |              |
| <b>Key Measures:</b>              |  |              |   |              |
| <i>Statement of Operations</i>    |  |              |   |              |
| Interest income (1)               | \$ 13,443                                      | \$ 13,263    | \$ 37,872                                     | \$ 43,609    |
| Interest expense (1)              | 14,030   | 14,128       | 40,243  | 43,371       |
| Net interest income               | \$ (587)                                       | \$ (865)     | \$ (2,371)                                    | \$ 238       |
| Noninterest income                |  |              | 2,094   |              |
| Noninterest expense               | 178  | 176          | 539   | 557          |
| Debt termination                  |  | 20,379       |   | 20,379       |
| Segment pre-tax (loss) profit     | \$ (765)                                       | \$ (21,420)  | \$ (816)                                      | \$ (20,698)  |
| <i>Balance Sheet</i>              |  |              |   |              |
| Average investments               | \$ 2,490,125                                   | \$ 2,243,586 | \$ 2,410,608                                  | \$ 2,280,458 |
| Average interest-bearing deposits | \$ 240,001                                     | \$ 240,006   | \$ 240,001                                    | \$ 240,003   |
| Average borrowings                | \$ 212,863                                     | \$ 356,449   | \$ 213,322                                    | \$ 417,762   |
| Yield on investments-TE           | 2.38%  | 2.69%        | 2.33%   | 2.88%        |
| Non-tax equivalent yield          | 2.05%  | 2.31%        | 2.00%   | 2.50%        |
| Average cost of borrowings        | 4.44%  | 4.11%        | 4.44%   | 4.01%        |

(1) Interest income and interest expense include credit for funds provided and charge for funds used, respectively. These are eliminated in the consolidated presentation.

For the third quarter of 2013, the Company's Treasury department reported a pre-tax loss of \$765,000, compared to pre-tax loss of \$21.4 million for the third quarter of 2012. Excluding the \$20.4 million debt termination expense for the third quarter of 2013, segment pre-tax loss decreased by \$276,000. The improvement was primarily due to a \$180,000 increase in interest income due to a \$246.5 million increase in average investment securities for the third quarter of 2013, compared to the third quarter of 2012.

**Other**

|                               | For the Three Months Ended |               | For the Nine Months Ended |               |
|-------------------------------|----------------------------|---------------|---------------------------|---------------|
|                               | September 30,              | September 30, | September 30,             | September 30, |
|                               | 2013                       | 2012          | 2013                      | 2012          |
| <i>(Dollars in thousands)</i> |                            |               |                           |               |

**Key Measures:***Statement of Operations*

|  |           |            |           |            |
|--|-----------|------------|-----------|------------|
| Interest income (1)                      | \$ 11,224 | \$ 17,068  | \$ 36,433 | \$ 52,872  |
| Interest expense (1)                     | (3,000)   | (1,673)    | (8,352)   | (4,517)    |
| Net interest income                      | \$ 14,224 | \$ 18,741  | \$ 44,785 | \$ 57,389  |
| (Recapture of) provision for loan losses | (3,750)   |            | (9,950)   |            |
| Noninterest income                       | (349)     | (3,172)    | 1,414     | (7,414)    |
| Noninterest expense                      | 14,022    | 18,591     | 49,811    | 54,176     |
| Segment pre-tax profit (loss)            | \$ 3,603  | \$ (3,022) | \$ 6,338  | \$ (4,201) |

(1) Interest income and interest expense include credit for funds provided and charge for funds used, respectively. These are eliminated in the consolidated presentation.

The Company's administration and other operating departments reported pre-tax profit of \$3.6 million for the third quarter of 2013, an increase of \$6.6 million, or 219.23%, from pre-tax loss of \$3.0 million for the third quarter of 2012. The increase in pre-tax profit was principally due to a \$3.8 million loan loss provision recapture and \$3.7 million in insurance reimbursements for previous years' legal costs. Interest income decreased \$5.8 million primarily due to a \$4.1 million decrease in discount accretion. Noninterest income increased \$2.8 million due to a net decrease in the FDIC loss sharing asset of \$3.2 million for the third quarter of 2013, compared to a net decrease of \$7.1 million for the third quarter of 2012.

**ANALYSIS OF FINANCIAL CONDITION**

The Company reported total assets of \$6.56 billion at September 30, 2013. This represented an increase of \$193.9 million, or 3.05%, from total assets of \$6.36 billion at December 31, 2012. Earning assets of \$6.18 billion at September 30, 2013 increased \$140.2 million, or 2.32% when compared with \$6.04 billion at December 31, 2012. The increase in earning assets during the first nine months of 2013 was primarily due to \$167.7 million increase in investment securities, offset principally by a \$17.2 million decrease in FHLB stock and a \$7.4 million decrease in interest-earning balances due from the Federal Reserve. Total liabilities were

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\$5.79 billion at September 30, 2013, an increase of \$188.7 million, or 3.37%, from total liabilities of \$5.60 billion at December 31, 2012. Total equity increased \$5.3 million, or 0.69%, to \$768.2 million at September 30, 2013, compared to total equity of \$763.0 million at December 31, 2012.

**Investment Securities**

The Company maintains a portfolio of investment securities to provide interest income and to serve as a source of liquidity for its ongoing operations. At September 30, 2013, we reported total investment securities of \$2.62 billion. This represented an increase of \$167.7 million, or 6.84%, from total investment securities of \$2.45 billion at December 31, 2012. As of September 30, 2013, the Company had a pre-tax net unrealized holding gain on total investment securities of \$7.3 million, compared to a pre-tax net unrealized gain of \$74.6 million at December 31, 2012. The changes in the net unrealized holding gain resulted primarily from fluctuations in market interest rates. At September 30, 2013, \$19.1 million of the net unrealized holding gain is attributed to our municipal securities portfolio, and \$11.7 million in net unrealized holding loss is attributed to the remainder of the portfolio, which is predominantly government agency securities. For the nine months ended September 30, 2013, total repayments/maturities and proceeds from sales of investment securities totaled \$406.8 million and \$99.2 million, respectively. The Company purchased additional investment securities totaling \$759.6 million and \$567.4 million for the nine months ended September 30, 2013 and 2012, respectively. The proceeds from sales of investment securities, which included the 13 investment securities that were sold for a net gain on sale of \$2.1 million in the first quarter of 2013, were used to purchase additional investment securities. In the third quarter of 2013, we purchased \$314.7 million of investment securities and utilized short-term borrowings to facilitate a portion of these purchases. No investment securities were sold during the first nine months of 2012.

The table below sets forth investment securities available-for-sale at September 30, 2013 and December 31, 2012.

|  | <b>September 30, 2013</b> |  |  |                     |                          |
|--|---------------------------|--|--|---------------------|--------------------------|
|  | <b>Amortized<br/>Cost</b> | <b>Gross<br/>Unrealized<br/>Holding<br/>Gain</b> | <b>Gross<br/>Unrealized<br/>Holding<br/>Loss</b> | <b>Fair Value</b>   | <b>Total<br/>Percent</b> |
| <i>(Dollars in thousands)</i>                    |                           |  |  |                     |                          |
| <b>Investment securities available-for-sale:</b> |                           |  |  |                     |                          |
| Government agency                                | \$ 353,580                | \$ 36  | \$ (20,603)                                      | \$ 333,013          | 12.72%                   |
| Residential mortgage-backed securities           | 1,286,448                 | 19,249   | (16,073)   | 1,289,624           | 49.28%                   |
| CMO s / REMIC s - residential                    | 383,268                   | 7,002  | (1,062)  | 389,208             | 14.87%                   |
| Municipal bonds                                  | 581,663                   | 22,206   | (3,145)  | 600,724             | 22.95%                   |
| Other securities                                 | 5,000                     |  | (262)  | 4,738               | 0.18%                    |
| <b>Total investment securities</b>               | <b>\$ 2,609,959</b>       | <b>\$ 48,493</b>                                 | <b>\$ (41,145)</b>                               | <b>\$ 2,617,307</b> | <b>100.00%</b>           |

|  | <b>December 31, 2012</b>  |   |   |                   |                          |
|--|---------------------------|---|---|-------------------|--------------------------|
|  | <b>Amortized<br/>Cost</b> | <b>Gross<br/>Unrealized<br/>Holding</b> | <b>Gross<br/>Unrealized<br/>Holding</b> | <b>Fair Value</b> | <b>Total<br/>Percent</b> |



**Gain                  Loss**  
*(Dollars in thousands)*

| Investment securities available-for-sale: |                     |                  |                   |                     |                |
|---|---------------------|------------------|-------------------|---------------------|----------------|
| Government agency                         | \$ 357,960          | \$ 1,588         | \$ (248)          | \$ 359,300          | 14.67%         |
| Residential mortgage-backed securities    | 862,196             | 25,529           | (127)             | 887,598             | 36.24%         |
| CMO s / REMIC s - residential             | 565,968             | 7,402            | (1,410)           | 571,960             | 23.35%         |
| Municipal bonds                           | 583,692             | 41,920           | (183)             | 625,429             | 25.53%         |
| Other securities                          | 5,000               | 100              |                   | 5,100               | 0.21%          |
| <b>Total investment securities</b>        | <b>\$ 2,374,816</b> | <b>\$ 76,539</b> | <b>\$ (1,968)</b> | <b>\$ 2,449,387</b> | <b>100.00%</b> |

The weighted-average yield (TE) on the investment portfolio at September 30, 2013 was 2.28% with a weighted-average life of 4.6 years. This compares to a weighted-average yield of 2.47% at December 31, 2012 with a weighted-average life of 3.1 years and a yield of 2.71% at September 30, 2012 with a weighted-average life of 3.6 years.

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Approximately 77% of the securities in the total investment portfolio, at September 30, 2013, are issued by the U.S. government or U.S. government-sponsored agencies and enterprises, which have the implied guarantee payment of principal and interest. As of September 30, 2013, approximately \$144.4 million in U.S. government agency bonds are callable.

The remaining CMO/REMICs are backed by agency-pooled collateral or whole loan collateral. All non-agency available-for-sale CMO/REMIC issues held are rated investment grade or better by either Standard & Poor's or Moody's, as of September 30, 2013 and December 31, 2012.

The tables below show the Company's investment securities' gross unrealized losses and fair value by investment category and length of time that individual securities have been in a continuous unrealized loss position, at September 30, 2013 and December 31, 2012. The unrealized losses on these securities were attributed to changes in interest rates. The issuers of these securities have not, to our knowledge, established any cause for default on these securities. These securities have fluctuated in value since their purchase dates as market rates have fluctuated. However, we have the ability and the intention to hold these securities until their fair values recover to cost or maturity. As such, management does not deem these securities to be other-than-temporarily-impaired except for one investment security classified as held-to-maturity. A summary of our analysis of these securities and the unrealized losses is described more fully in Note 5 - Investment Securities in the notes to the unaudited condensed consolidated financial statements. Economic trends may adversely affect the value of the portfolio of investment securities that we hold.

|  | Less Than 12 Months |                                 | September 30, 2013<br>12 Months or<br>Longer |                                 | Total             |                                 |
|--|---------------------|---------------------------------|--|---------------------------------|-------------------|---------------------------------|
|  | Fair Value          | Gross Unrealized Holding Losses | Fair Value                                   | Gross Unrealized Holding Losses | Fair Value        | Gross Unrealized Holding Losses |
| <i>(Dollars in thousands)</i>          |                     |                                 |  |                                 |                   |                                 |
| Available-for-sale:                    |                     |                                 |  |                                 |                   |                                 |
| Government agency                      | \$ 312,948          | \$ 20,603                       | \$   | \$                              | \$ 312,948        | \$ 20,603                       |
| Residential mortgage-backed securities | 473,190             | 16,073                          |  |                                 | 473,190           | 16,073                          |
| CMO / REMICs - residential             | 92,281              | 988                             | 18,700                                       | 74                              | 110,981           | 1,062                           |
| Municipal bonds                        | 42,859              | 2,671                           | 10,393                                       | 474                             | 53,252            | 3,145                           |
| Other securities                       | 4,738               | 262                             |  |                                 | 4,738             | 262                             |
| <b>Total</b>                           | <b>\$ 926,016</b>   | <b>\$ 40,597</b>                | <b>\$ 29,093</b>                             | <b>\$ 548</b>                   | <b>\$ 955,109</b> | <b>\$ 41,145</b>                |

|  | Less Than 12 Months |                                 | December 31, 2012<br>12 Months or<br>Longer |                                 | Total      |                                 |
|--|---------------------|---------------------------------|---|---------------------------------|------------|---------------------------------|
|  | Fair Value          | Gross Unrealized Holding Losses | Fair Value                                  | Gross Unrealized Holding Losses | Fair Value | Gross Unrealized Holding Losses |

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|  | Losses                        |                 | Losses           |               | Losses            |                 |
|--|-------------------------------|-----------------|------------------|---------------|-------------------|-----------------|
|  | <i>(Dollars in thousands)</i> |                 |                  |               |                   |                 |
| Available-for-sale:                    |                               |                 |                  |               |                   |                 |
| Government agency                      | \$ 51,134                     | \$ 248          | \$               | \$            | \$ 51,134         | \$ 248          |
| Residential mortgage-backed securities | 55,118                        | 127             |                  |               | 55,118            | 127             |
| CMO / REMICs - residential             | 74,784                        | 572             | 69,042           | 838           | 143,826           | 1,410           |
| Municipal bonds                        | 13,110                        | 162             | 975              | 21            | 14,085            | 183             |
| Other securities                       |                               |                 |                  |               |                   |                 |
| <b>Total</b>                           | <b>\$ 194,146</b>             | <b>\$ 1,109</b> | <b>\$ 70,017</b> | <b>\$ 859</b> | <b>\$ 264,163</b> | <b>\$ 1,968</b> |

During the nine months ended September 30, 2013 and 2012, we recorded zero other-than-temporary impairment recognized on the held-to-maturity investment security.

**Table of Contents****Loans**

At September 30, 2013, we reported total loans and lease finance receivables, net of deferred loan fees and discount, of \$3.44 billion. This represented a decrease of \$2.8 million, or 0.08%, from total loans, net of deferred loan fees, of \$3.45 billion at December 31, 2012. Non-covered loans increased by \$29.0 million and covered loans decreased by \$31.9 for the nine months ended September 30, 2013. The \$29.0 million increase in non-covered loans was principally due to increases of \$136.3 million in commercial real estate loans, \$32.8 million in SFR mortgage loans (net of an \$18.5 million decrease in SFR pool loans). This growth was partially offset by decreases of \$72.9 million in dairy and livestock loans, \$36.9 million in commercial and industrial loans, \$12.1 million in construction loans, and \$14.0 million in municipal lease finance receivables and other loans.

Total loans, net of deferred loan fees, comprise 55.77% of our total earning assets. The following tables present our loan portfolio, excluding held-for-sale loans, segregated into covered versus non-covered loans, by category as of September 30, 2013 and December 31, 2012.

|  | <b>September 30, 2013</b>     |                      |                     |
|--|-------------------------------|----------------------|---------------------|
|  | <b>Non-Covered<br/>Loans</b>  | <b>Covered Loans</b> | <b>Total</b>        |
|  | <i>(Dollars in thousands)</i> |                      |                     |
| Commercial and industrial                                  | \$ 510,566                    | \$ 20,825            | \$ 531,391          |
| Real estate:   |                               |                      |                     |
| Commercial real estate                                     | 2,126,415                     | 147,289              | 2,273,704           |
| Construction   | 47,648                        | 661                  | 48,309              |
| SFR mortgage   | 192,130                       | 327                  | 192,457             |
| Dairy & livestock and agribusiness                         | 261,638                       | 3,659                | 265,297             |
| Municipal lease finance receivables                        | 99,188                        |                      | 99,188              |
| Consumer and other loans                                   | 52,886                        | 5,102                | 57,988              |
| <b>Gross loans</b>   | <b>3,290,471</b>              | <b>177,863</b>       | <b>3,468,334</b>    |
| Less:  |                               |                      |                     |
| Purchase accounting discount                               |                               | (14,529)             | (14,529)            |
| Deferred loan fees, net                                    | (9,119)                       |                      | (9,119)             |
| <b>Gross loans, net of deferred loan fees and discount</b> | <b>3,281,352</b>              | <b>163,334</b>       | <b>3,444,686</b>    |
| Less: Allowance for loan losses                            | (80,713)                      |                      | (80,713)            |
| <b>Net loans</b>   | <b>\$ 3,200,639</b>           | <b>\$ 163,334</b>    | <b>\$ 3,363,973</b> |

Allowance for loan losses as a % of loans,  
net of deferred loan fees 2.46%

| <b>December 31, 2012</b> |              |
|--------------------------|--------------|
| <b>Covered Loans</b>     | <b>Total</b> |

**Non-Covered  
Loans**

*(Dollars in thousands)*

|  |                     |                   |                     |
|--|---------------------|-------------------|---------------------|
| Commercial and industrial                                  | \$ 547,422          | \$ 26,149         | \$ 573,571          |
| Real estate:   |                     |                   |                     |
| Commercial real estate                                     | 1,990,107           | 179,428           | 2,169,535           |
| Construction   | 59,721              | 1,579             | 61,300              |
| SFR mortgage   | 159,288             | 1,415             | 160,703             |
| Dairy & livestock and agribusiness                         | 336,660             | 5,651             | 342,311             |
| Municipal lease finance receivables                        | 105,767             |                   | 105,767             |
| Consumer and other loans                                   | 60,273              | 6,337             | 66,610              |
| <b>Gross loans</b>   | <b>3,259,238</b>    | <b>220,559</b>    | <b>3,479,797</b>    |
| Less:  |                     |                   |                     |
| Purchase accounting discount                               |                     | (25,344)          | (25,344)            |
| Deferred loan fees, net                                    | (6,925)             |                   | (6,925)             |
| <b>Gross loans, net of deferred loan fees and discount</b> | <b>3,252,313</b>    | <b>195,215</b>    | <b>3,447,528</b>    |
| Less: Allowance for loan losses                            | (92,441)            |                   | (92,441)            |
| <b>Net loans</b>   | <b>\$ 3,159,872</b> | <b>\$ 195,215</b> | <b>\$ 3,355,087</b> |

Allowance for loan losses as a % of loans,  
net of deferred loan fees 2.84%

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Commercial and industrial loans are loans to commercial entities to finance capital purchases or improvements, or to provide cash flow for operations. Real estate loans are loans secured by conforming trust deeds on real property, including property under construction, land development, commercial property and single-family and multi-family residences. Consumer loans include auto and equipment leases, installment loans to consumers as well as home equity loans and other loans secured by junior liens on real property. Municipal lease finance receivables are leases to municipalities. Dairy & livestock and agribusiness loans are loans to finance the operating needs of wholesale dairy farm operations, cattle feeders, livestock raisers, and farmers.

Our loan portfolio is from a variety of areas throughout our marketplace. The following is the breakdown of our total held-for-investment loans and commercial real estate loans by region as of September 30, 2013.

| Non-Covered Loans by Market Area | September 30, 2013            |        | Commercial        |        |
|----------------------------------|-------------------------------|--------|-------------------|--------|
|                                  | Total Non-Covered Loans       |        | Real Estate Loans |        |
|                                  | <i>(Dollars in thousands)</i> |        |                   |        |
| Los Angeles County               | \$ 1,242,392                  | 37.8%  | \$ 878,235        | 41.3%  |
| Inland Empire                    | 605,779                       | 18.4%  | 498,228           | 23.4%  |
| Central Valley                   | 689,656                       | 20.9%  | 401,874           | 18.9%  |
| Orange County                    | 490,385                       | 14.9%  | 205,509           | 9.7%   |
| Other areas (1)                  | 262,259                       | 8.0%   | 142,569           | 6.7%   |
|                                  | \$ 3,290,471                  | 100.0% | \$ 2,126,415      | 100.0% |

(1) Other areas include loans that are out-of-state or in other areas of California.

| Covered Loans by Market Area | September 30, 2013            |        | Covered Commercial |        |
|------------------------------|-------------------------------|--------|--------------------|--------|
|                              | Total Covered Loans           |        | Real Estate Loans  |        |
|                              | <i>(Dollars in thousands)</i> |        |                    |        |
| Los Angeles County           | \$ 10,580                     | 5.9%   | \$ 8,331           | 5.7%   |
| Inland Empire                | 962                           | 0.5%   | 372                | 0.3%   |
| Central Valley               | 156,076                       | 87.8%  | 133,431            | 90.5%  |
| Orange County                |                               |        |                    |        |
| Other areas (1)              | 10,245                        | 5.8%   | 5,155              | 3.5%   |
|                              | \$ 177,863                    | 100.0% | \$ 147,289         | 100.0% |

(1) Other areas include loans that are out-of-state or in other areas of California.

Our real estate loans are comprised of industrial, office, retail, single-family residences, multi-family residences, and farmland. We strive to have an original loan-to-value ratio less than 75%. The table below breaks down our non-covered real estate portfolio, with the exception of construction loans which are addressed in a separate table.

| <b>Non-Covered Commercial and SFR Real Estate Loans</b> | <b>Percent<br/>Owner- Average Loan</b> |                             |                |        |
|---|--|-----------------------------|----------------|--------|
| <i>(Dollars in thousands)</i>                           | <b>Loan Balance</b>                    | <b>Percent Occupied (1)</b> | <b>Balance</b> |        |
| SFR mortgage - Direct                                   | \$ 104,443                             | 4.5%                        | 100.0%         | \$ 544 |
| SFR mortgage - Mortgage pools                           | 87,687                                 | 3.8%                        | 100.0%         | 245    |
| Multi-family  | 138,977                                | 6.0%                        |                | 1,121  |
| Industrial  | 587,617                                | 25.3%                       | 35.6%          | 930    |
| Office  | 400,612                                | 17.3%                       | 29.8%          | 1,077  |
| Retail  | 355,890                                | 15.4%                       | 9.1%           | 1,447  |
| Medical   | 158,574                                | 6.8%                        | 40.0%          | 1,844  |
| Secured by farmland                                     | 144,422                                | 6.2%                        | 100.0%         | 2,006  |
| Other   | 340,323                                | 14.7%                       | 46.0%          | 1,361  |
|   | \$ 2,318,545                           | 100.0%                      | 39.6%          | 1,196  |

(1) Represents percentage of reported owner-occupied at origination in each real estate loan category. The SFR mortgage - Direct loans in the table above include SFR mortgage loans which are currently generated through an internal program which utilizes Bank associate referrals through our Business Financial and Commercial Banking Centers. This

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program is focused on owner-occupied SFR s with defined loan-to-value, debt-to-income and other credit criteria, such as FICO credit scores, that we believe are appropriate for loans which are primarily intended for retention in our Bank s loan portfolio. The program was changed recently to enable our Bank to underwrite and retain SFR mortgage loans generated through our internal referral channels, as opposed to our past practice of contracting with an outside party for certain underwriting and related loan origination services. This program involving Bank-generated referrals, credit guidelines and underwriting was initiated during the quarter ended December 31, 2012, and we originated loan volume in the aggregate principal amount of \$24.0 million under this program during the third quarter of 2013.

In addition, we previously purchased pools of owner-occupied single-family loans from real estate lenders, SFR mortgage - Mortgage Pools, totaling \$87.7 million. These loans were purchased with average FICO scores predominantly ranging from 700 to over 800 and overall original loan-to-value ratios of 60% to 80%. These pools were purchased to diversify our loan portfolio. Due to market conditions, we have not purchased any mortgage pools since August 2007.

The table below provides a breakdown of our covered real estate loans.

| Covered Commercial and SFR Real Estate Loans | September 30, 2013 |         |                    |                      |
|--|--------------------|---------|--------------------|----------------------|
|  | Loan Balance       | Percent | Owner-Occupied (1) | Average Loan Balance |
| <i>(Dollars in thousands)</i>                |                    |         |                    |                      |
| SFR mortgage - Direct                        | \$ 327             | 0.2%    | 100.0%             | \$ 65                |
| SFR mortgage - Mortgage pools                |                    |         |                    |                      |
| Multi-family                                 | 3,419              | 2.3%    |                    | 855                  |
| Industrial                                   | 29,684             | 20.1%   | 48.2%              | 618                  |
| Office                                       | 15,839             | 10.7%   | 40.3%              | 546                  |
| Retail                                       | 17,981             | 12.2%   | 31.1%              | 719                  |
| Medical                                      | 14,277             | 9.7%    | 83.2%              | 1,190                |
| Secured by farmland                          | 9,047              | 6.1%    | 100.0%             | 393                  |
| Other (2)                                    | 57,042             | 38.7%   | 54.6%              | 983                  |
|  | \$ 147,616         | 100.0%  | 53.3%              | 809                  |

(1) Represents percentage of reported owner-occupied at origination in each real estate loan category.

(2) Includes loans associated with hospitality, churches, gas stations, and hospitals, which represents approximately 73% of other loans.

As of September 30, 2013, the Company had \$47.6 million in non-covered construction loans. This represents 1.45% of total non-covered gross loans outstanding of \$3.29 billion. Of this \$47.6 million in construction loans, approximately 11.87%, or \$5.6 million, were for single-family residences, residential land loans, and multi-family land development loans. The remaining construction loans, totaling \$42.0 million, were related to commercial construction. The average balance of any single construction loan was approximately \$1.6 million. Our construction loans are located throughout our marketplace as can be seen in the table below.

As of September 30, 2013, the Company had \$48.3 million in construction loans, both non-covered and covered. This represents 1.39% of gross loans outstanding of \$3.47 billion. The following table presents a break-down of our



non-covered construction loans excluding held for sale loans by county and type.

**Table of Contents****Non-Covered Construction Loans***(Dollars in thousands)*

|                            | <b>Land Development</b> |        | <b>September 30, 2013</b>     |        | <b>Total</b> |        |
|----------------------------|-------------------------|--------|-------------------------------|--------|--------------|--------|
|                            |                         |        | <b>SFR &amp; Multi-family</b> |        |              |        |
|                            |                         |        | <b>Construction</b>           |        |              |        |
| Los Angeles County         | \$ 340                  | 7.9%   | \$                            |        | \$ 340       | 6.0%   |
| Inland Empire              | 1,350                   | 31.4%  |                               |        | 1,350        | 23.9%  |
| Central Valley             | 1,311                   | 30.5%  | 1,361                         | 100.0% | 2,672        | 47.2%  |
| Orange County              |                         |        |                               |        |              |        |
| Other areas (1)            | 1,296                   | 30.2%  |                               |        | 1,296        | 22.9%  |
|                            | \$ 4,297                | 100.0% | \$ 1,361                      | 100.0% | \$ 5,658     | 100.0% |
| <b>Total Nonperforming</b> | <b>\$</b>               |        | <b>\$</b>                     |        | <b>\$</b>    |        |

|                            | <b>Land Development</b> |        | <b>Commercial</b>   |              | <b>Total</b>     |              |
|----------------------------|-------------------------|--------|---------------------|--------------|------------------|--------------|
|                            |                         |        | <b>Construction</b> |              |                  |              |
|                            |                         |        |                     |              |                  |              |
| Los Angeles County         | \$ 3,301                | 43.7%  | \$ 12,837           | 37.3%        | \$ 16,138        | 38.5%        |
| Inland Empire              | 578                     | 7.7%   | 9,515               | 27.6%        | 10,093           | 24.0%        |
| Central Valley             | 3,656                   | 48.4%  | 1,720               | 5.0%         | 5,376            | 12.8%        |
| Orange County              |                         |        |                     |              |                  |              |
| Other areas (1)            | 15                      | 0.2%   | 10,368              | 30.1%        | 10,383           | 24.7%        |
|                            | \$ 7,550                | 100.0% | \$ 34,440           | 100.0%       | \$ 41,990        | 100.0%       |
| <b>Total Nonperforming</b> | <b>\$</b>               |        | <b>\$ 10,368</b>    | <b>30.1%</b> | <b>\$ 10,368</b> | <b>24.7%</b> |

(1) Other areas include loans that are out-of-state or in other areas of California.

The following table presents a break-down of our covered construction loans by county and type.

**Covered Construction Loans***(Dollars in thousands)*

|                | <b>Land Development</b> |        | <b>September 30, 2013</b>     |        | <b>Total</b> |        |
|----------------|-------------------------|--------|-------------------------------|--------|--------------|--------|
|                |                         |        | <b>SFR &amp; Multi-family</b> |        |              |        |
|                |                         |        | <b>Construction</b>           |        |              |        |
| Central Valley | \$ 17                   | 100.0% | \$ 644                        | 100.0% | \$ 661       | 100.0% |
|                | \$ 17                   | 100.0% | \$ 644                        | 100.0% | \$ 661       | 100.0% |

There were no covered commercial construction loans outstanding as of September 30, 2013.

**Table of Contents****Nonperforming Assets (Non-Covered)**

The following table provides information on non-covered nonperforming assets as of September 30, 2013 and December 31, 2012.

|   | <b>September 30,<br/>2013</b> | <b>December 31,<br/>2012</b> |
|---|-------------------------------|------------------------------|
|   | <i>(Dollars in thousands)</i> |                              |
| Nonaccrual loans  | \$ 21,439                     | \$ 26,688                    |
| Troubled debt restructured loans (nonperforming)  | 28,045                        | 31,309                       |
| Other real estate owned ( OREO )  | 6,524                         | 14,832                       |
| <br>Total nonperforming assets  | <br>\$ 56,008                 | <br>\$ 72,829                |
| <br>Troubled debt restructured performing loans   | <br>\$ 59,195                 | <br>\$ 50,392                |
| <br>Percentage of nonperforming assets to total loans<br>outstanding, net of deferred fees & OREO | <br>1.70%                     | <br>2.23%                    |
| <br>Percentage of nonperforming assets to total assets  | <br>0.85%                     | <br>1.14%                    |

We had loans with a gross balance of \$108.7 million classified as impaired as of September 30, 2013. This balance included nonperforming loans of \$49.5 million. Impaired loans which were restructured in a troubled debt restructuring represented \$87.2 million, of which \$28.0 million were nonperforming and \$59.2 million were performing, as of September 30, 2013. Of the \$28.0 million in nonperforming TDRs, \$2.5 million are not paying in accordance with the modified terms at September 30, 2013 and the remaining \$25.5 million have either not demonstrated repayment performance for a sustained period and/or we have not received all necessary documents to determine the borrower's ability to meet all future principal and interest payments under the modified terms. As of December 31, 2012, we had impaired loans with a balance of \$108.4 million. Impaired loans measured 3.31% of total non-covered loans as of September 30, 2013, compared to 3.33% as of December 31, 2012.

Of the total impaired loans as of September 30, 2013, \$79.8 million were considered collateral dependent and measured using the fair value of the collateral based on current appraisals (obtained within 1 year). The amount of impaired loans measured using the present value of expected future cash flows discounted at the loans effective rate were \$28.9 million.

At September 30, 2013 and December 31, 2012, TDRs of \$59.2 million and \$50.4 million, respectively, were classified as accruing restructured loans, respectively. At September 30, 2013, performing TDRs were comprised of 15 commercial real estate loans of \$21.2 million, two construction loans of \$16.9 million, nine dairy and livestock loans of \$17.5 million, eight SFR mortgage loans of \$2.4 million, and seven commercial and industrial loans of \$1.2 million. The performing restructurings were granted in response to borrower financial difficulty, and generally provide for a modification of loan repayment terms. The performing restructured loans represent the only impaired loans accruing interest at each respective date. A performing restructured loan is reasonably assured of repayment and is performing according to the modified terms.

At September 30, 2013 and December 31, 2012, there was \$2.9 million and \$1.4 million of related allowance on TDRs, respectively. Impairment amounts identified are typically charged off against the allowance at the time a probable loss is determined. Total charge-offs on TDRs for the nine months ended September 30, 2013 and 2012 were \$68,000 and \$585,000, respectively.

We have not restructured loans into multiple loans in what is typically referred to as an A/B note structure, where normally the A note meets current underwriting standards and the B note is typically immediately charged-off upon restructuring.

At September 30, 2013, we had \$6.5 million in OREO, a decrease of \$8.3 million from the seven OREO properties totaling \$14.8 million at December 31, 2012. During the nine months of 2013, we sold five OREO properties with a carrying value of \$7.8 million, realizing a net gain on sale of \$2.7 million. There were no additions to OREO during the first nine months of 2013. We now have two non-covered OREO properties.

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The table below provides trends in our non-covered nonperforming assets and delinquencies over the past year.

**Nonperforming Assets & Delinquency Trends****(Non-Covered Loans)**

|                                    | September 30,<br>2013 | June 30,<br>2013 | March 31,<br>2013 | December 31,<br>2012 | September 30,<br>2012 |
|------------------------------------|-----------------------|------------------|-------------------|----------------------|-----------------------|
| <i>(Dollars in thousands)</i>      |                       |                  |                   |                      |                       |
| <b>Nonperforming Loans</b>         |                       |                  |                   |                      |                       |
| Commercial and industrial          | \$ 3,734              | \$ 5,012         | \$ 3,387          | \$ 3,136             | \$ 3,896              |
| Real estate:                       |                       |                  |                   |                      |                       |
| Commercial real estate             | 17,829                | 18,610           | 19,964            | 21,039               | 21,354                |
| Construction - speculative         | 10,368                | 10,494           | 10,620            | 10,663               | 17,708                |
| Construction - non speculative     |                       |                  |                   |                      |                       |
| SFR mortgage                       | 10,421                | 11,423           | 11,561            | 13,102               | 12,321                |
| Dairy & livestock and agribusiness | 6,973                 | 7,655            | 9,371             | 9,842                | 10,345                |
| Consumer and other loans           | 159                   | 157              | 226               | 215                  | 364                   |
| <b>Total</b>                       | <b>\$ 49,484</b>      | <b>\$ 53,351</b> | <b>\$ 55,129</b>  | <b>\$ 57,997</b>     | <b>\$ 65,988</b>      |
| <b>% of Total gross loans</b>      | <b>1.51%</b>          | <b>1.68%</b>     | <b>1.73%</b>      | <b>1.78%</b>         | <b>2.04%</b>          |
| <b>Past Due 30-89 Days</b>         |                       |                  |                   |                      |                       |
| Commercial and industrial          | \$ 417                | \$ 373           | \$ 2,026          | \$ 690               | \$ 286                |
| Real estate:                       |                       |                  |                   |                      |                       |
| Commercial real estate             | 1,015                 | 1,251            | 1,820             |                      | 298                   |
| Construction - speculative         |                       |                  |                   |                      |                       |
| Construction - non speculative     |                       |                  |                   |                      |                       |
| SFR mortgage                       |                       |                  | 824               | 107                  | 650                   |
| Dairy & livestock and agribusiness |                       |                  |                   |                      | 170                   |
| Consumer and other loans           | 255                   | 8                | 63                | 90                   | 285                   |
| <b>Total</b>                       | <b>\$ 1,687</b>       | <b>\$ 1,632</b>  | <b>\$ 4,733</b>   | <b>\$ 887</b>        | <b>\$ 1,689</b>       |
| <b>% of Total gross loans</b>      | <b>0.05%</b>          | <b>0.05%</b>     | <b>0.15%</b>      | <b>0.03%</b>         | <b>0.05%</b>          |
| <b>OREO</b>                        |                       |                  |                   |                      |                       |
| Commercial and industrial          | \$                    | \$               | \$                | \$                   | \$ 203                |
| Real estate:                       |                       |                  |                   |                      |                       |
| Commercial real estate             |                       |                  | 828               | 2,319                | 3,153                 |
| Construction - speculative         | 6,524                 | 6,524            | 12,513            | 12,513               | 7,117                 |
| Construction - non speculative     |                       |                  |                   |                      |                       |
| SFR mortgage                       |                       |                  |                   |                      |                       |
| Consumer and other loans           |                       |                  |                   |                      |                       |
| <b>Total</b>                       | <b>\$ 6,524</b>       | <b>\$ 6,524</b>  | <b>\$ 13,341</b>  | <b>\$ 14,832</b>     | <b>\$ 10,473</b>      |

|  |                  |                  |                  |                  |                  |
|--|------------------|------------------|------------------|------------------|------------------|
| <b>Total nonperforming, past due, and OREO</b> | <b>\$ 57,695</b> | <b>\$ 61,507</b> | <b>\$ 73,203</b> | <b>\$ 73,716</b> | <b>\$ 78,150</b> |
|--|------------------|------------------|------------------|------------------|------------------|

|                               |              |              |              |              |              |
|-------------------------------|--------------|--------------|--------------|--------------|--------------|
| <b>% of Total gross loans</b> | <b>1.76%</b> | <b>1.94%</b> | <b>2.30%</b> | <b>2.27%</b> | <b>2.42%</b> |
|-------------------------------|--------------|--------------|--------------|--------------|--------------|

We had \$49.5 million in non-covered nonperforming loans, defined as nonaccrual loans and nonperforming TDRs, at September 30, 2013, or 1.51% of total non-covered loans. This compares to \$58.0 million in nonperforming loans at December 31, 2012 and \$66.0 million in nonperforming loans at September 30, 2012. Six customer relationships make up \$27.4 million, or 55.29%, of our nonperforming loans at September 30, 2013. Three of these customer relationships are commercial real estate developers (owner/non-owner occupied); and the primary collateral for these loans is commercial real estate properties. The other three customer relationships are in the dairy & livestock industry; and the collateral is primarily the dairy farm property and the dairy livestock. These six customer relationships have had total charge-offs of \$5.2 million and have \$2.6 million of related allowance at September 30, 2013.

Changes in economic and business conditions has had an impact on our market area and on our loan portfolio. We continually monitor these conditions in determining our estimates of needed reserves. However, we cannot predict the extent to which the deterioration in general economic conditions, real estate values, increases in general rates of interest, and changes in the financial conditions or business of a borrower may adversely affect a borrower's ability to pay. See Risk Management - Credit Risk contained in our Annual Report on Form 10-K for the year ended December 31, 2012.

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**Table of Contents*****Nonperforming Assets-Covered***

Loans acquired through the SJB acquisition are accounted for under ASC Topic 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality* ( ASC 310-30 ). Covered loans accounted for under ASC 310-30 are generally considered accruing and performing loans as the loans accrete interest income over the estimated life of the loan when cash flows are reasonably estimable. Accordingly, acquired impaired loans that are contractually past due are still considered to be accruing and performing loans. If the timing and amount of future cash flows is not reasonably estimable, the loans may be classified as nonperforming loans and interest income is not recognized until the timing and amount of future cash flows can be reasonably estimated. As of September 30, 2013, there were no covered loans considered as nonperforming as described above. There were two properties in covered OREO totaling \$906,000 as of September 30, 2013, compared to three properties totaling \$1.1 million as of December 31, 2012.

***Allowance for Loan losses***

The allowance for loan losses is established as management's estimate of probable losses inherent in the loan and lease receivables portfolio. The allowance is increased by the provision for losses and decreased by charge-offs when management believes the uncollectability of a loan is confirmed. Subsequent recoveries, if any, are credited to the allowance. The determination of the balance in the allowance for loan losses is based on an analysis of the loan and lease finance receivables portfolio using a systematic methodology and reflects an amount that, in management's judgment, is appropriate to provide for probable credit losses inherent in the portfolio, after giving consideration to the character of the loan portfolio, current economic conditions, past loan loss experience, and such other factors that would deserve current recognition in estimating inherent credit losses.

We maintain an allowance for inherent loan losses that is increased by a provision for loan losses charged against operating results. The allowance for loan losses is also increased by recoveries on loans previously charged off and reduced by actual loan losses charged to the allowance. The allowance for loan losses was \$80.7 million as of September 30, 2013. This represents a decrease of \$11.7 million, or 12.69%, compared to the allowance for loan losses of \$92.4 million as of December 31, 2012. We recorded a \$10.0 million loan loss provision recapture for the nine months ended September 30, 2013, compared to zero provision (or recapture of provision) for loan losses for the same period in 2012.

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The table below presents a comparison of net loan losses, the provision for loan losses, and the resulting allowance for loan losses for the nine months ended September 30, 2013 and 2012.

**Summary of Loan loss Experience***(Non-Covered Loans)*

|  | <b>As of and For the<br/>Nine Months Ended<br/>September 30,</b> |                  |
|--|--|------------------|
|  | <b>2013</b>  | <b>2012</b>      |
|  | <i>(Dollars in thousands)</i>                                    |                  |
| Allowance for loan losses at beginning of period         | \$ 92,441  | \$ 93,964        |
| Charge-offs:   |  |                  |
| Commercial and industrial                                | 2,339  | 977              |
| Commercial real estate                                   |  | 1,840            |
| Construction   |  |                  |
| SFR mortgage   | 252  | 642              |
| Dairy & livestock, and agribusiness                      |  | 1,150            |
| Consumer and other loans                                 | 108  | 154              |
| <b>Total charge-offs</b>                                 | <b>2,699</b>   | <b>4,763</b>     |
| Recoveries:  |  |                  |
| Commercial and industrial                                | 523  | 694              |
| Commercial real estate                                   | 100  | 481              |
| Construction   | 83   | 1,129            |
| SFR mortgage   | 133  | (108)            |
| Dairy & livestock, and agribusiness                      | 42   | 11               |
| Consumer and other loans                                 | 40   | 12               |
| <b>Total recoveries</b>                                  | <b>921</b>   | <b>2,219</b>     |
| Charge-offs, net of recoveries                           | 1,778  | 2,544            |
| Other reallocation (2)                                   |  | 647              |
| (Recapture of) provision for loan losses                 | (9,950)  |                  |
| <b>Allowance for loan losses at end of period</b>        | <b>\$ 80,713</b>   | <b>\$ 92,067</b> |
| Summary of reserve for unfunded commitments:             |  |                  |
| Reserve for unfunded commitments at beginning of period  | \$ 8,588   | \$ 9,588         |
| Provision for unfunded commitments                       | 500  |                  |
| <b>Reserve for unfunded commitments at end of period</b> | <b>\$ 9,088</b>  | <b>\$ 9,588</b>  |



|  |              |              |
|--|--------------|--------------|
| Reserve for unfunded commitments to total unfunded commitments | 1.41%        | 1.58%        |
| Amount of total loans at end of period (1)                     | \$ 3,281,352 | \$ 3,227,405 |
| Average total loans outstanding (1)                            | \$ 3,189,906 | \$ 3,194,409 |
| Net charge-offs to average total loans                         | 0.06%        | 0.08%        |
| Net charge-offs to total loans at end of period                | 0.05%        | 0.08%        |
| Allowance for loan losses to average total loans               | 2.53%        | 2.88%        |
| Allowance for loan losses to total loans at end of period      | 2.46%        | 2.85%        |
| Net charge-offs to allowance for loan losses                   | 2.20%        | 2.76%        |
| Net charge-offs to provision for loan losses                   | 17.87%       |              |

(1) Net of deferred loan origination fees.

(2) During the first nine months of 2012, there was \$647,000 in net recoveries for covered loans, resulting in a \$ 647,000 recapture of provision for loan losses on the covered SJB loans. An offsetting adjustment was recorded to the FDIC loss-sharing asset based on the appropriate asset based on the appropriate loss-sharing percentage.

**Specific allowance:** For impaired loans, we incorporate specific allowances based on loans individually evaluated utilizing one of three valuation methods, as prescribed under ASC 310-10. If the measure of the impaired loan is less than the recorded investment in the loan, the deficiency will be charged off against the ALLL or, alternatively, a specific allocation will be established and included in the overall ALLL balance. The specific allocation represents \$3.5 million (4.32%), \$2.3 million (2.52%) and \$2.0 million (2.18%) of the total allowance as of September 30, 2013, December 31, 2012 and September 30, 2012, respectively.

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**General allowance:** The loan portfolio collectively evaluated for impairment under ASC 450-20 is divided into classes of loan receivables between classified loans (including substandard and special mention loans) and unclassified loans, and then further disaggregated into loan segments by loan type with similar risk characteristics. The non-classified loans are divided into 37 segments, including 25 specific segments within the commercial real estate and construction loan portfolios split between owner and non-owner properties and based on property type (i.e. industrial, office, retail, etc.). The allowance is provided for each segment based upon that segment's average historical loss experience over a rolling three-year period, adjusted for current conditions based on our analysis of specific environmental or qualitative loss factors, as prescribed in the 2006 Interagency Policy Statement on ALLL, affecting the collectability of our loan portfolio that may cause actual loss rates to differ from historical loss experience.

In addition, recognizing the inherent imprecision in the estimation of these loss factors, we also incorporate an *unallocated reserve* that reflects management's best estimate of probable losses not otherwise captured by our qualitative loss factors or otherwise accounted for in our ALLL methodology. Management believes that appropriate drawdowns from usage of the unallocated reserve may include, but are not limited to, (i) consideration of conditions or factors that may not be easily allocated to a specific loan segment, (ii) addressing elevated risks from unique or unusual conditions of volatility and uncertainty affecting the collectability of our loan portfolio, (iii) supporting allocations resulting from refinements to our factors, and (iv) prudent releases of general reserves, if warranted and appropriate when current conditions show demonstrable improvement in credit quality for a sustained period.

Moreover, as conditions change, we may modify or refine our methodology to better reflect risk characteristics that currently impact underlying credit components and the collectability of the loan portfolio. Examples of such modifications or refinements impacting our ALLL in recent quarters include (i) addition of a qualitative factor on changes in the value of underlying collateral for collateral-dependent loans, based on continuing weakness in the values of commercial real estate in our primary lending markets, (ii) increasing the number of segments within the classified and criticized pools primarily to disaggregate our real estate portfolio between owner-occupied and non-owner occupied commercial real estate loans, as well as between residential and non-residential construction loans, and (iii) creating a specific allocated pool for our dairy and livestock loan segment to address perceived weaknesses in this segment due to phenomena such as highly volatile milk and feed prices, reduced levels of cow milk production, shorter cyclical periods between industry highs and lows, unstable values for herd liquidations, lack of adequate farm land to raise forage crops in certain geographical locations, and depleted resources available to certain dairy operators due to periodic industry stress factors.

During the third quarter of 2013, in light of continued improvement in certain underlying credit conditions that affect key segments (e.g. commercial real estate, commercial and industrial and dairy & livestock) within the Bank's loan portfolio, we reduced loss factors related to several of the qualitative factors including (i) changes in economic and business conditions, (ii) changes in volume and severity of past due loans and volume of non-accrual and classified loans, (iii) changes in the collateral value of collateral-dependent loans, and (iv) certain qualitative factors pertaining specifically to the dairy & livestock segment, which experienced improvement in both industry and borrower factors. The improvements noted included, but are not limited to, (i) better economic conditions and rising home values, improving consumer confidence and spending creating revenue growth generally for businesses we serve, (ii) improvement in cash flows of our business customers generally resulting in lower rates of loan delinquency and lower levels of classified loans for the Bank, (iii) improving rental rates, reduced vacancies, and better absorption rates for commercial real estate in real estate markets we serve resulting in rising collateral values for collateral-dependent loans, and (iv) improving conditions in the dairy & livestock segment, including higher milk prices and lower feed costs industry-wide that resulted in better operating results for our borrowers. The impact of these changes to our factors in addition to a significant decline in classified loans of \$40.3 million from June 30, 2013 which, based on our methodologies, reduced our allowance requirement by \$3.8 million. This compares to a recapture of \$6.2 million for the second quarter of 2013. Future adjustments will then, as now, be based on an evaluation of all relevant facts and

circumstances that we determine in our best judgment are necessary to reflect current conditions as they may impact overall loan loss rates and improve our ability to estimate losses inherent in the Bank's loan portfolio.

While we believe that the allowance at September 30, 2013, was appropriate to absorb losses from any known or inherent risks in the portfolio, no assurance can be given that economic conditions, interest rate fluctuations, conditions of our borrowers, or natural disasters, which adversely affect our service areas or other circumstances or conditions, including those defined above, will not be reflected in increased provisions for loan losses in the future.

**Table of Contents****Deposits**

The primary source of funds to support earning assets (loans and investments) is the generation of customer deposits.

Total deposits were \$4.90 billion at September 30, 2013. This represented an increase of \$121.5 million, or 2.55%, over total deposits of \$4.77 billion at December 31, 2012. The composition of deposits is as follows:

|                              | September 30, 2013            |        | December 31, 2012 |        |
|------------------------------|-------------------------------|--------|-------------------|--------|
|                              | <i>(Dollars in thousands)</i> |        |                   |        |
| Noninterest-bearing deposits |                               |        |                   |        |
| Demand deposits              | \$ 2,538,461                  | 51.8%  | \$ 2,420,993      | 50.7%  |
| Interest-bearing deposits    |                               |        |                   |        |
| Savings deposits             | 1,668,708                     | 34.1%  | 1,638,827         | 34.3%  |
| Time deposits                | 688,317                       | 14.1%  | 714,167           | 15.0%  |
| Total deposits               | \$ 4,895,486                  | 100.0% | \$ 4,773,987      | 100.0% |

The amount of noninterest-bearing demand deposits in relation to total deposits is an integral element in achieving a low cost of funds. Demand deposits totaled \$2.54 billion at September 30, 2013, representing an increase of \$117.5 million, or 4.85%, from demand deposits of \$2.42 billion at December 31, 2012. Noninterest-bearing demand deposits represented 51.85% of total deposits as of September 30, 2013, compared to 50.71% of total deposits as of December 31, 2012.

Savings deposits, which include savings, interest-bearing demand, and money market accounts, totaled \$1.67 billion at September 30, 2013, representing a decrease of \$29.9 million, or 1.82%, from savings deposits of \$1.64 billion at December 31, 2012.

Time deposits totaled \$688.3 million at September 30, 2013. This represented a decrease of \$25.9 million, or 3.62%, from total time deposits of \$714.2 billion at December 31, 2012.

**Borrowings**

In order to enhance the Bank's spread between its cost of funds and interest-earning assets, we first seek noninterest-bearing deposits (the lowest cost of funds to the Company). Next, we pursue growth in interest-bearing deposits, and finally, we supplement the growth in deposits with borrowed funds (borrowings and customer repurchase agreements). Average borrowed funds, as a percent of average total funding (total deposits plus borrowed funds) was 13.38% for the third quarter of 2013, compared to 14.89% for the third quarter of 2012.

At September 30, 2013, we had \$42.5 million in short-term borrowings. These borrowings were used to facilitate a portion of our investment purchases made in the third quarter of 2013. We had \$26.0 million in short-term borrowings at December 31, 2012.

At September 30, 2013, borrowed funds totaled \$807.5 million. This represented an increase of \$109.3 million, or 15.66%, from total borrowed funds of \$698.2 million at December 31, 2012.

In November 2006, we began a repurchase agreement product with our customers. This product, known as Citizens Sweep Manager, sells our investment securities overnight to our customers under an agreement to repurchase them the next day at a price which reflects the market value of the use of funds by the Bank for the period concerned. These repurchase agreements are signed with customers who want to invest their excess deposits, above a pre-determined balance in a demand deposit account, in order to earn interest. As of September 30, 2013 and December 31, 2012, total customer repurchases were \$565.9 million and \$473.2 million, respectively, with weighted average interest rates of 0.29% and 0.28%, respectively.

We entered into borrowing agreements with the FHLB. We had outstanding balances of \$199.1 million and \$198.9 million under these agreements at September 30, 2013 and December 31, 2012, respectively. The interest rate was 4.52% at September 30, 2013 and December 31, 2012. The FHLB holds certain investment securities and loans as collateral available for borrowings.

At September 30, 2013, \$1.99 billion of loans and \$2.61 billion of investment securities, at carrying value, were pledged to secure public deposits, short and long-term borrowings, and for other purposes as required or permitted by law.

**Table of Contents****Aggregate Contractual Obligations**

The following table summarizes our contractual commitments as of September 30, 2013:

|                                    | Total        | Maturity by Period       |                                    |  |                       |
|------------------------------------|--------------|--------------------------|------------------------------------|--|-----------------------|
|                                    |              | Less Than<br>One<br>Year | One Year<br>Through<br>Three Years | Four Years<br>Through<br>Five<br>Years | Over<br>Five<br>Years |
| <i>(Dollars in thousands)</i>      |              |                          |                                    |  |                       |
| Deposits (1)                       | \$ 4,895,486 | \$ 4,878,385             | \$ 13,001                          | \$ 379                                 | \$ 3,721              |
| Customer repurchase agreements (1) | 565,883      | 565,883                  |                                    |  |                       |
| FHLB advances (1)                  | 199,138      |                          |                                    | 199,138                                |                       |
| Junior subordinated debentures (1) | 25,774       |                          |                                    |  | 25,774                |
| Deferred compensation              | 9,316        | 873                      | 1,484                              | 749                                    | 6,210                 |
| Operating leases                   | 21,235       | 4,839                    | 8,612                              | 5,361                                  | 2,423                 |
| Advertising agreements             | 4,750        | 1,550                    | 1,600                              | 1,600                                  |                       |
| Total                              | \$ 5,721,582 | \$ 5,451,530             | \$ 24,697                          | \$ 207,227                             | \$ 38,128             |

(1) Amounts exclude accrued interest.

Deposits represent noninterest bearing, money market, savings, NOW, certificates of deposits, brokered and all other deposits held by the Company.

Customer repurchase agreements represent excess amounts swept from customer demand deposit accounts, which mature the following business day and are collateralized by investment securities. These amounts are due to customers.

FHLB advances represent the amount that is due to the FHLB. We have one advance with a fixed maturity date of November 28, 2016.

Junior subordinated debentures represent the amounts that are due from the Company to CVB Statutory Trust III. The debentures have the same maturity as the Trust Preferred Securities. CVB Statutory Trust III matures in 2036, and became callable in whole or in part in March 2011.

Deferred compensation represents the amounts that are due to former employees based on salary continuation agreements as a result of acquisitions and amounts due to current employees under our deferred compensation plans.

Operating leases represent the total minimum lease payments due under non-cancelable operating leases.

Advertising agreements represent the amounts that are due on various agreements that provide advertising benefits to the Company.

**Off-Balance Sheet Arrangements**

The following table summarizes the off-balance sheet arrangements at September 30, 2013:

|  | <b>Total</b>      | <b>Maturity by Period</b> |                                |                                 |                         |
|--|-------------------|---------------------------|--------------------------------|---------------------------------|-------------------------|
|  |                   | <b>Less Than One Year</b> | <b>One Year to Three Years</b> | <b>Four Years to Five Years</b> | <b>After Five Years</b> |
| <i>(Dollars in thousands)</i>            |                   |                           |                                |                                 |                         |
| <b>Commitment to extend credit:</b>      |                   |                           |                                |                                 |                         |
| Commercial and Industrial                | \$ 312,333        | \$ 258,231                | \$ 46,637                      | \$ 5,102                        | \$ 2,363                |
| <b>Real estate:</b>                      |                   |                           |                                |                                 |                         |
| Commercial real estate                   | 49,295            | 26,210                    | 8,575                          | 11,041                          | 3,469                   |
| Construction                             | 19,468            | 16,206                    | 3,262                          |                                 |                         |
| Dairy & livestock and agribusiness (1)   | 151,766           | 111,490                   | 40,276                         |                                 |                         |
| Consumer and other loans                 | 64,606            | 6,273                     | 3,673                          | 5,513                           | 49,147                  |
| <b>Total Commitment to extend credit</b> | <b>597,468</b>    | <b>418,410</b>            | <b>102,423</b>                 | <b>21,656</b>                   | <b>54,979</b>           |
| Obligations under letters of credit      | 38,456            | 5,496                     | 32,960                         |                                 |                         |
| <b>Total</b>                             | <b>\$ 635,924</b> | <b>\$ 423,906</b>         | <b>\$ 135,383</b>              | <b>\$ 21,656</b>                | <b>\$ 54,979</b>        |

(1) Total commitment to extend credit to agribusiness was \$ 20.6 million at September 30, 2013.

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As of September 30, 2013, we had commitments to extend credit of approximately \$597.5 million, and obligations under letters of credit of \$38.5 million. Commitments to extend credit are agreements to lend to customers, provided there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Commitments are generally variable rate, and many of these commitments are expected to expire without being drawn upon. As such, the total commitment amounts do not necessarily represent future cash requirements. We use the same credit underwriting policies in granting or accepting such commitments or contingent obligations as we do for on-balance sheet instruments, which consist of evaluating customers' creditworthiness individually. As a result of a \$45.9 million quarter-over quarter increase in unfunded loan commitments, we increased our reserve for unfunded commitments by \$500,000 for the third quarter of 2013. The Company had a reserve for unfunded commitments of \$9.1 million as of September 30, 2013 and \$8.6 million as of December 31, 2012 included in other liabilities.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the financial performance of a customer to a third party. Those guarantees are primarily issued to support private borrowing or purchase arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. When deemed necessary, we hold appropriate collateral supporting those commitments. We do not anticipate any material losses as a result of these transactions.

***Capital Resources***

Historically, our primary source of capital has been the retention of operating earnings. In order to ensure adequate levels of capital, we conduct an ongoing assessment of projected sources, needs and uses of capital in conjunction with projected increases in assets and the level of risk. As part of this ongoing assessment, the Board of Directors reviews the various components of capital.

The Company's equity capital was \$768.2 million at September 30, 2013. This represented an increase of \$5.3 million, or 0.69%, from equity capital of \$763.0 million at December 31, 2012. The increase during the first nine months of 2013 resulted primarily from \$70.3 million in net earnings and \$3.8 million for shares issued pursuant to our stock-based compensation plan, partially offset by a decrease of \$39.0 million in other comprehensive income, net of tax, resulting from the net change in fair value of our investment securities portfolio and \$29.9 million of common stock dividends declared.

The Company's 2012 Annual Report on Form 10-K (Management's Discussion and Analysis and Note 20 of the consolidated financial statements) describes the regulatory capital requirements of the Company and the Bank.

The Bank and the Company are required to meet risk-based capital standards set by their respective regulatory authorities. The risk-based capital standards require the achievement of a minimum ratio of total capital to risk-weighted assets of 8.0% (of which at least 4.0% must be Tier 1 capital). In addition, the regulatory authorities require the highest rated institutions to maintain a minimum leverage ratio of 4.0%. To be considered well-capitalized for bank regulatory purposes, the Bank and the Company are required to have a Tier 1 risk-based capital ratio equal to or greater than 6%, a total risk-based capital ratio equal to or greater than 10% and a Tier 1 leverage ratio equal to or greater than 5%. At September 30, 2013, the Bank and the Company exceeded the minimum risk-based capital ratios and leverage ratios required to be considered well-capitalized for regulatory purposes.

During the first nine months of 2013, the Board of Directors of the Company declared a quarterly common stock cash dividend of \$0.285 per share. Dividends are payable at the discretion of the Board of Directors and there can be no assurance that the Board of Directors will continue to pay dividends at the same rate, or at all, in the future. CVB's ability to pay cash dividends to its shareholders is subject to restrictions under federal and California law, including



restrictions imposed by the FRB and covenants set forth in various agreements we are a party to including covenants set forth in our junior subordinated debentures.

In July 2008, our Board of Directors authorized the repurchase of up to 10,000,000 shares of our common stock. During the first nine months of 2013, we repurchased zero of our common stock outstanding. As of September 30, 2013, we have 7,765,171 shares of our common stock remaining that are eligible for repurchase.

The table below presents the Company's and the Bank's risk-based and leverage capital ratios as of September 30, 2013, and December 31, 2012.

| Capital Ratios                  | Adequately<br>Capitalized<br>Ratios | Well<br>Capitalized<br>Ratios | September 30,<br>2013     |                              | December 31,<br>2012      |                              |
|---------------------------------|-------------------------------------|-------------------------------|---------------------------|------------------------------|---------------------------|------------------------------|
|                                 |                                     |                               | CVB<br>Financial<br>Corp. | Citizens<br>Business<br>Bank | CVB<br>Financial<br>Corp. | Citizens<br>Business<br>Bank |
| Tier 1 leverage capital ratio   | 4.00%                               | 5.00%                         | 11.44%                    | 11.30%                       | 11.50%                    | 11.21%                       |
| Tier 1 risk-based capital ratio | 4.00%                               | 6.00%                         | 17.87%                    | 17.66%                       | 18.23%                    | 17.77%                       |
| Total risk-based capital ratio  | 8.00%                               | 10.00%                        | 19.13%                    | 18.92%                       | 19.49%                    | 19.03%                       |

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As a result of recently adopted federal regulatory changes to capital requirements (Basel III), which will become effective for us commencing in 2015, our board of directors, in consultation with management, will continue to assess the adequacy and components of our capital to ensure that we meet all required regulatory standards.

**ASSET/LIABILITY AND MARKET RISK MANAGEMENT**

***Liquidity and Cash Flow***

In general, liquidity risk is managed daily by controlling the level of fed funds and the use of funds provided by the cash flow from the investment portfolio, loan demand and deposit fluctuations. To meet unexpected demands, lines of credit are maintained with correspondent banks, the Federal Home Loan Bank and the FRB. The sale of bonds maturing in the near future can also serve as a contingent source of funds. Increases in deposit rates are considered a last resort as a means of raising funds to increase liquidity.

Since the primary sources and uses of funds for the Company are loans and deposits, the relationship between gross loans and total deposits provides a useful measure of the Bank's liquidity. Typically, the closer the ratio of loans to deposits is to 100%, the more reliant we are on loan portfolio interest and principal payments to provide for short-term liquidity needs. Since repayment of loans tends to be less predictable than the maturity of investments and other liquid resources, the higher the loans to deposit ratio the less liquid are the Company's assets. For the first nine months of 2013, the loan to deposit ratio averaged 71.01% compared to an average ratio of 73.22% for the same period in 2012. The ratio of loans to deposits and customer repurchases averaged 63.91% for the first nine months of 2013 and 66.17% for the same period in 2012.

CVB Financial Corp. ( CVB ) is a company separate and apart from the Bank that must provide for its own liquidity and must service its own obligations. Substantially all of CVB's revenues are obtained from dividends declared and paid by the Bank to CVB. There are statutory and regulatory provisions that could limit the ability of the Bank to pay dividends to CVB. In addition, our regulators could limit the ability of the Bank or the CVB to pay dividends or make other distributions.

Under applicable California law, the Bank cannot make any distribution (including a cash dividend) to its shareholder in an amount which exceeds the lesser of: (i) the retained earnings of the Bank or (ii) the net income of the Bank for its last three fiscal years, less the amount of any distributions made by the Bank to its shareholder during such period. Notwithstanding the foregoing, with the prior approval of the California Commissioner of Financial Institutions, the Bank may make a distribution (including a cash dividend) to CVB in an amount not exceeding the greater of: (i) the retained earnings of the Bank; (ii) the net income of the Bank for its last fiscal year; or (iii) the net income of the Bank for its current fiscal year.

At September 30, 2013, approximately \$34.3 million of the Bank's equity was unrestricted and available to be paid as dividends to CVB. Management of the Company believes that such restrictions will not have any current impact on the ability of CVB to meet its ongoing cash obligations. As of September 30, 2013, neither the Bank nor CVB had any material commitments for capital expenditures.

For the Bank, sources of funds normally include principal payments on loans and investments, growth in deposits, FHLB advances, and other borrowed funds. Uses of funds include withdrawal of deposits, interest paid on deposits, increased loan balances, purchases, and noninterest expenses.

Net cash provided by operating activities totaled \$72.8 million for the first nine months of 2013, compared to \$115.3 million for the same period last year. The decrease in cash provided by operating activities was primarily attributed to

an increase in income taxes paid as well as decreases in interest and dividends received and proceeds from FDIC loss share agreement, partially offset by decreases in interest payments, and vendor and employee payments.

Net cash used in investing activities totaled \$212.2 million for the first nine months of 2013, compared to \$6.2 million for the first nine months of 2012. The cash used in investing activities was primarily the result of an increase in purchases of investment securities, a decrease in proceeds from repayment of investment securities, and a decrease in loan and lease finance receivables, partially offset by an increase in proceeds from sale of investment securities during the first nine months of 2013.

Net cash provided by financing activities totaled \$172.4 million for the first nine months of 2013, compared to net cash used in financing activities of \$206.2 million for the same period last year. The cash provided by financing activities during the first nine months of 2013 was primarily due to deposits, customer repurchase agreements, and other borrowings, partially offset by \$41.2 million for repayment of junior subordinated debentures in 2013. The cash used in financing activities during the first nine months of 2012 was primarily due to the redemption of \$250.0 million of FHLB advances.

At September 30, 2013, cash and cash equivalents totaled \$131.4 million. This represented a decrease of \$116.7 million, or 47.04%, from \$248.2 million at September 30, 2012 and an increase of \$33.0 million, or 33.54%, from \$98.4 million at December 31, 2012.

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**Table of Contents*****Interest Rate Sensitivity Management***

During periods of changing interest rates, the ability to re-price interest-earning assets and interest-bearing liabilities can influence net interest income, the net interest margin, and consequently, our earnings. Interest rate risk is managed by attempting to control the spread between rates earned on interest-earning assets and the rates paid on interest-bearing liabilities within the constraints imposed by market competition in our service area. Short-term re-pricing risk is minimized by controlling the level of floating rate loans and maintaining a downward sloping ladder of bond payments and maturities. Basis risk is managed by the timing and magnitude of changes to interest-bearing deposit rates. Yield curve risk is reduced by keeping the duration of the loan and bond portfolios relatively short. Options risk in the bond portfolio is monitored monthly and actions are recommended when appropriate.

We monitor the interest rate sensitivity risk to earnings from potential changes in interest rates using various methods, including a maturity/re-pricing gap analysis. This analysis measures, at specific time intervals, the differences between earning assets and interest-bearing liabilities for which re-pricing opportunities will occur. A positive difference, or gap, indicates that earning assets will re-price faster than interest-bearing liabilities. This will generally produce a greater net interest margin during periods of rising interest rates, and a lower net interest margin during periods of declining interest rates. Conversely, a negative gap will generally produce a lower net interest margin during periods of rising interest rates and a greater net interest margin during periods of decreasing interest rates. In managing risks associated with rising interest rates, we utilize interest rate derivative contracts on certain loans and borrowed funds.

The interest rates paid on deposit accounts do not always move in unison with the rates charged on loans. In addition, the magnitude of changes in the rates charged on loans is not always proportionate to the magnitude of changes in the rate paid on deposits. Consequently, changes in interest rates do not necessarily result in an increase or decrease in the net interest margin solely as a result of the differences between re-pricing opportunities of earning assets or interest-bearing liabilities. In general, whether we report a positive gap in the short-term period or negative gap in the long-term period does not necessarily indicate that, if interest rates decreased, net interest income would increase, or if interest rates increased, net interest income would decrease.

Approximately \$1.68 billion, or 64%, of the total investment portfolio at September 30, 2013 consisted of securities backed by mortgages. The final maturity of these securities can be affected by the speed at which the underlying mortgages repay. Mortgages tend to repay faster as interest rates fall, and slower as interest rates rise. As a result, we may be subject to a prepayment risk resulting from greater funds available for reinvestment at a time when available yields are lower. Conversely, we may be subject to extension risk resulting, as lesser amounts would be available for reinvestment at a time when available yields are higher. Prepayment risk includes the risk associated with the payment of an investment's principal faster than originally intended. Extension risk is the risk associated with the payment of an investment's principal over a longer time period than originally anticipated. In addition, there can be greater risk of price volatility for mortgage-backed securities as a result of anticipated prepayment or extension risk.

We utilize the results of a simulation model to quantify the estimated exposure of net interest income to sustained interest rate changes. The sensitivity of our net interest income is measured over a rolling two-year horizon.

The simulation model estimates the impact of changing interest rates on interest income from all interest-earning assets and interest expense paid on all interest-bearing liabilities reflected on our balance sheet. This sensitivity analysis is compared to policy limits, which specify a maximum tolerance level for net interest income exposure over a one-year horizon assuming no balance sheet growth, given a 200 basis point upward and a 100 basis point downward shift in interest rates. A parallel and pro rata shift in rates over a 12-month period is assumed.

The following depicts the Company's net interest income sensitivity analysis as of September 30, 2013:

|                        | Estimated Net<br>Interest |
|------------------------|---------------------------|
| Simulated Rate Changes | Income<br>Sensitivity (1) |
| + 200 basis points     | (1.34%)                   |
| 100 basis points       | (0.28%)                   |

(1) Changes from the base case for a 12-month period.

Based on our current models, we believe that the interest rate risk profile of the balance sheet is well matched over a one year horizon and is slightly asset-sensitive over a two year horizon. The estimated sensitivity does not necessarily represent a forecast and the results may not be indicative of actual changes to our net interest income. These estimates are based upon a number of assumptions including: the nature and timing of interest rate levels including yield curve shape, prepayments on loans and securities, pricing strategies on loans and deposits, and replacement of asset and liability cash flows. While the assumptions used are based on current economic and local market conditions, there is no assurance as to the predictive nature of these conditions including how customer preferences or competitor influences might change.

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**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

For quantitative and qualitative disclosures about market risks in our portfolio, see "Asset/Liability Management and Interest Rate Sensitivity Management" included in Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations presented elsewhere in this report. This analysis should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2012. Our analysis of market risk and market-sensitive financial information contain forward looking statements and is subject to the disclosure at the beginning of Part I regarding such forward-looking information.

**ITEM 4. CONTROLS AND PROCEDURES**

As of the end of the period covered by this report, we carried out an evaluation of the effectiveness of the Company's disclosure controls and procedures under the supervision and with the participation of the Chief Executive Officer, the Chief Financial Officer and other senior management of the Company. Based on the foregoing, the Company's Chief Executive Officer and the Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of the end of the period covered by this report.

During our most recent fiscal quarter, there have been no changes in our internal control over financial reporting that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

**PART II - OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

Certain lawsuits and claims arising in the ordinary course of business have been filed or are pending against us or our affiliates. Where appropriate, we establish reserves in accordance with FASB guidance over contingencies (ASC 450). The outcome of litigation and other legal and regulatory matters is inherently uncertain, however, and it is possible that one or more of the legal or regulatory matters currently pending or threatened could have a material adverse effect on our liquidity, consolidated financial position, and/or results of operations. As of September 30, 2013, the Company does not have any litigation reserves.

The Company is involved in the following significant legal actions and complaints.

On July 26, 2010, we received a subpoena from the Los Angeles office of the SEC regarding the Company's allowance for loan loss methodology, loan underwriting guidelines, methodology for grading loans, and the process for making provisions for loan losses. In addition, the subpoena requested information regarding certain presentations Company officers have given or conferences Company officers have attended with analysts, brokers, investors or prospective investors. We have fully cooperated with the SEC in its investigation, and we will continue to do so to the extent any further information is requested. We cannot predict the timing or outcome of the SEC investigation.

In the wake of the Company's disclosure of the SEC investigation, on August 23, 2010, a purported shareholder class action complaint was filed against the Company, in an action captioned *Lloyd v. CVB Financial Corp., et al.*, Case No. CV 10-06256-MMM, in the United States District Court for the Central District of California. Along with the Company, Christopher D. Myers (President and Chief Executive Officer) and Edward J. Biebrich, Jr. (our former Chief Financial Officer) were also named as defendants. On September 14, 2010, a second purported shareholder class action complaint was filed against the Company, in an action originally captioned *Englund v. CVB Financial Corp., et al.*, Case No. CV 10-06815-RGK, in the United States District Court for the Central District of California. The

Englund complaint named the same defendants as the Lloyd complaint and made allegations substantially similar to those included in the Lloyd complaint. On January 21, 2011, the Court consolidated the two actions for all purposes under the Lloyd action, now captioned as Case No. CV 10-06256-MMM (PJWx). That same day, the Court also appointed the Jacksonville Police and Fire Pension Fund (the Jacksonville Fund ) as lead plaintiff in the consolidated action and approved the Jacksonville Fund's selection of lead counsel for the plaintiffs in the consolidated action. On March 7, 2011, the Jacksonville Fund filed a consolidated complaint naming the same defendants and alleging violations by all defendants of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder and violations by the individual defendants of Section 20(a) of the Exchange Act. Specifically, the complaint alleges that defendants misrepresented and failed to disclose conditions adversely affecting the Company throughout the purported class period, which is alleged to be between October 21, 2009 and August 9, 2010. The consolidated complaint sought compensatory damages and other relief in favor of the purported class.

Following the filing by each side of various motions and briefs and a hearing on August 29, 2011, the District Court issued a ruling on January 12, 2012, granting defendants' motion to dismiss the consolidated complaint, but the ruling provided the plaintiffs with leave to file an amended complaint within 45 days of the date of the order. On February 27, 2012, the plaintiffs filed a first

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amended complaint against the same defendants, and following filings by both sides and another hearing on June 4, 2012, the District Court issued a ruling on August 21, 2012, granting defendants' motion to dismiss the first amended complaint, but providing the plaintiffs with leave to file another amended complaint within 30 days of the ruling. On September 20, 2012, the plaintiffs filed a second amended complaint against the same defendants, the Company filed its third motion to dismiss on October 25, 2012, and following another hearing on February 25, 2013, the District Court issued an order dismissing the plaintiffs' complaint for the third time on May 9, 2013. Although the District Court's most recent order of dismissal provided the plaintiffs with leave to file a third amended and restated complaint within 30 days of the issuance of the order, on June 3, 2013, counsel for the plaintiffs instead filed a Notice of Intent Not to File an Amended Complaint, along with a request that the District Court convert its order to a dismissal with prejudice. The Company believes the plaintiffs decided to take this action because they preferred to proceed directly to appeal from the Court's third order of dismissal, rather than to file a fourth version of their complaint. On September 27, 2013, the District Court issued its order dismissing the plaintiffs' second amended complaint with prejudice, and the plaintiffs filed their notice of appeal with the Ninth Circuit Court of Appeals subsequent to the end of the third quarter of 2013, on October 24, 2013. The Company intends to continue to vigorously contest the plaintiff's allegations in this case.

On February 28, 2011, a purported and related shareholder derivative complaint was filed in an action captioned Sanderson v. Borba, et al., Case No. CIVRS1102119, in California State Superior Court in San Bernardino County. The complaint names as defendants the members of our board of directors and also refers to unnamed defendants allegedly responsible for the conduct alleged. The Company is included as a nominal defendant. The complaint alleges breaches of fiduciary duties, abuse of control, gross mismanagement and corporate waste. Specifically, the complaint alleges, among other things, that defendants engaged in accounting manipulations in order to falsely portray the Company's financial results in connection with its commercial real estate portfolio. Plaintiff seeks compensatory and exemplary damages to be paid by the defendants and awarded to the Company, as well as other relief. On June 20, 2011, defendants filed a demurrer requesting dismissal of the derivative complaint. Following the filing by each side of additional motions, the parties have subsequently filed repeated notices to postpone the Court's hearing on the defendants' demurrer, pending resolution of the federal securities shareholder class action complaint. On July 30, 2013, the Court signed a Minute Order agreeing to the parties' stipulation to further extend the postponement of the derivative action hearing, at least to the date of any ruling by the Ninth Circuit Court of Appeals in connection with any potential appeal in the federal class action securities case, subject to brief status conferences every six months or so, with the next status update scheduled for March 11, 2014.

Because the outcome of these proceedings is uncertain, we cannot predict any range of loss or even if any loss is probable related to the actions described above.

**ITEM 1A. RISK FACTORS**

There have been no material changes to the risk factors as previously disclosed in Item 1A. to Part I of our Annual Report on Form 10-K for the year ended December 31, 2012. The materiality of any risks and uncertainties identified in our Forward Looking Statements contained in this report together with those previously disclosed in the Form 10-K and any subsequent Form 10-Q or those that are presently unforeseen could result in significant adverse effects on our financial condition, results of operations and cash flows. See Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations - General in this Quarterly Report on Form 10-Q.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**



On July 16, 2008, our Board of Directors approved a program to repurchase up to 10,000,000 shares of our common stock (such number will not be adjusted for stock splits, stock dividends, and the like) in the open market or in privately negotiated transactions, at times and at prices considered appropriate by us, depending upon prevailing market conditions and other corporate and legal considerations. There is no expiration date for our current stock repurchase program. There were no issuer repurchases of the Company's common stock as part of its repurchase program for the nine months ended September 30, 2013. As of September 30, 2013, there were 7,765,171 shares remaining to be purchased.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

Not Applicable

**ITEM 4. MINE SAFETY DISCLOSURES**

Not Applicable

**ITEM 5. OTHER INFORMATION**

None

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| Exhibit No. | Description of Exhibits   |
|-------------|---|
| 31.1        | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2        | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| *32.1       | Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| *32.2       | Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101.INS     | XBRL Instance Document  |
| 101.SCH     | XBRL Taxonomy Extension Schema Document   |
| 101.CAL     | XBRL Taxonomy Extension Calculation Linkbase Document   |
| 101.DEF     | XBRL Taxonomy Extension Definition Linkbase Document  |
| 101.LAB     | XBRL Taxonomy Extension Label Linkbase Document   |
| 101.PRE     | XBRL Taxonomy Extension Presentation Linkbase Document  |

\* Furnished, not filed to the extent set forth in Regulation S-K.

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**CVB FINANCIAL CORP.**  
(Registrant)

Date: November 12, 2013

/s/ Richard C. Thomas  
Duly Authorized Officer and  
Chief Financial Officer