

COLUMBIA BANKING SYSTEM INC

Form 10-K

February 29, 2012

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT  
OF 1934

For the fiscal year ended December 31, 2011 or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE  
ACT OF 1934

Commission File Number 0-20288

COLUMBIA BANKING SYSTEM, INC.

(Exact name of registrant as specified in its charter)

Washington

91-1422237

(State or other jurisdiction of  
incorporation or organization)

(I.R.S. Employer  
Identification Number)

1301 "A" Street

Tacoma, Washington 98402

(Address of principal executive offices) (Zip code)

Registrant's Telephone Number, Including Area Code: (253) 305-1900

Securities Registered Pursuant to Section 12(b) of the Act:

Common Stock, No Par Value

(Title of class)

Securities Registered Pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (17 C.F.R. 229.405) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large Accelerated Filer  Accelerated Filer  Non-accelerated Filer  Smaller Reporting Company

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

The aggregate market value of Common Stock held by non-affiliates of the registrant at June 30, 2011 was \$667,249,601 based on the closing sale price of the Common Stock on that date.

The number of shares of registrant's Common Stock outstanding at January 31, 2012 was 39,522,884.

**DOCUMENTS INCORPORATED BY REFERENCE:**

Portions of the Registrant's definitive 2012 Annual Meeting Proxy Statement.

Part III

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 FORM 10-K ANNUAL REPORT  
 DECEMBER 31, 2011

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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This annual report on Form 10-K may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include, but are not limited to, statements about our plans, objectives, expectations and intentions that are not historical facts, and other statements identified by words such as “expects,” “anticipates,” “intends,” “plans,” “believes,” “should,” “projects,” “seeks,” “estimates” or words of similar meaning. These forward-looking statements are based on current beliefs and expectations of management and are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control. In addition, these forward-looking statements are subject to assumptions with respect to future business strategies and decisions that are subject to change. In addition to the factors set forth in the sections titled “Risk Factors,” “Business” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in this Form 10-K, the following factors, among others, could cause actual results to differ materially from the anticipated results:

- local and national economic conditions could be less favorable than expected or could have a more direct and pronounced effect on us than expected and adversely affect our ability to continue internal growth at historical rates and maintain the quality of our earning assets;
- the local housing/real estate markets where we operate and make loans could continue to decline;
- the risks presented by a continued economic recession, or sluggish recovery, which could adversely affect credit quality, collateral values, including real estate collateral, investment values, liquidity and loan originations and loan portfolio delinquency rates;
- the efficiencies and enhanced financial and operating performance we expect to realize from investments in personnel, acquisitions and infrastructure could not be realized;
- interest rate changes could significantly reduce net interest income and negatively affect funding sources;
- projected business increases following strategic expansion or opening of new branches could be lower than expected;
- changes in the scope and cost of FDIC insurance and other coverages;
- changes in accounting principles, policies, and guidelines applicable to bank holding companies and banking;
- competition among financial institutions could increase significantly;
- the goodwill we have recorded in connection with acquisitions could become impaired, which may have an adverse impact on our earnings and capital;
- the reputation of the financial services industry could deteriorate, which could adversely affect our ability to access markets for funding and to acquire and retain customers;
- the terms and costs of the numerous actions taken by the Federal Reserve, the U.S. Congress, the Treasury, the FDIC, the SEC and others in response to the liquidity and credit crisis, or the failure of these actions to help stabilize the financial markets, asset prices, market liquidity, or worsening of current financial market and economic conditions could materially and adversely affect our business, financial condition, results of operations, and the trading price of our common stock;
- our ability to effectively manage credit risk, interest rate risk, market risk, operational risk, legal risk, liquidity risk and regulatory and compliance risk; and
- our profitability measures could be adversely affected if we are unable to effectively deploy recently raised capital.

You should take into account that forward-looking statements speak only as of the date of this report. Given the described uncertainties and risks, we cannot guarantee our future performance or results of operations and you should not place undue reliance on these forward-looking statements. We undertake no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required under federal securities laws.

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PART I

ITEM 1. BUSINESS

General

Columbia Banking System, Inc. (referred to in this report as “we,” “our,” and “the Company”) is a registered bank holding company whose wholly owned banking subsidiary, Columbia State Bank (“Columbia Bank” or “the Bank”) also does business under the Bank of Astoria name and conducts full-service commercial banking business in the states of Washington and Oregon. Headquartered in Tacoma, Washington, we provide a full range of banking services to small and medium-sized businesses, professionals and individuals.

Columbia Bank was established in 1993 to take advantage of commercial banking business opportunities in our principal market area. The opportunities to capture commercial banking market share were due to increased consolidations of banks, primarily through acquisitions by out-of-state bank holding companies, which created dislocation of customers.

At December 31, 2011 Columbia Bank had 102 branch locations in Washington and Oregon. Included in these branch locations are six Columbia Bank branches doing business in Oregon under the Bank of Astoria name in Astoria, Warrenton, Seaside and Cannon Beach in Clatsop County and in Manzanita and Tillamook in Tillamook County. Substantially all of Columbia Bank’s loans, loan commitments and core deposits are within its service areas. Columbia Bank is a Washington state-chartered commercial bank, the deposits of which are insured in whole or in part by the Federal Deposit Insurance Corporation (“FDIC”). Columbia Bank is subject to regulation by the FDIC and the Washington State Department of Financial Institutions Division of Banks. Although Columbia Bank is not a member of the Federal Reserve System, the Board of Governors of the Federal Reserve System has certain supervisory authority over the Company, which can also affect Columbia Bank.

Business Overview

Our goal is to be a leading Pacific Northwest regional community banking company while consistently increasing shareholder value. We continue to build on our reputation for excellent customer service in order to be recognized as the bank of choice for retail deposit customers, small to medium-sized businesses and affluent households in all markets we serve.

We have established a network of 102 branches in Washington and Oregon as of December 31, 2011 from which we intend to grow market share. We operate 62 branches in western Washington, 15 branches in eastern Washington, 15 branches in western Oregon, and 10 branches in eastern Oregon. Washington counties include: Adams, Asotin, Benton, Clallam, Clark, Cowlitz, Franklin, Jefferson, King, Kitsap, Klickitat, Mason, Pierce, Snohomish, Skagit, Spokane, Thurston, Walla Walla, Whatcom, Whitman and Yakima. Oregon counties include Clackamas, Clatsop, Deschutes, Hood River, Jefferson, Marion, Multnomah, Tillamook, Umatilla, Wasco and Yamhill.

In order to fund our lending activities and to allow for increased contact with customers, we utilize a branch system to better serve both retail and business depositors. We believe this approach will enable us to expand lending activities while attracting a stable core deposit base. To support our strategy of market penetration and increased profitability while continuing our personalized banking approach, we have invested in experienced banking and administrative personnel and have incurred related costs in the creation of our branch network.

Business Strategy

Our business strategy is to provide our customers with the financial sophistication and product depth of a regional banking company while retaining the appeal and service level of a community bank. We continually evaluate our existing business processes while focusing on maintaining asset quality and balanced loan and deposit portfolios, building our strong core deposit base, expanding total revenue and controlling expenses in an effort to increase our return on average equity and gain operational efficiencies. We believe that, as a result of our strong commitment to highly personalized, relationship-oriented customer service, our varied products, our strategic branch locations and the long-standing community presence of our managers, banking officers and branch personnel, we are well positioned to attract and retain new customers and to increase our market share of loans, deposits, investments, and other financial services. We are committed to increasing market share in the communities we serve by continuing to leverage our existing branch network, adding new branch locations and considering business combinations that are consistent with

our expansion strategy throughout the Pacific Northwest.

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Products & Services

We place the highest priority on customer service and assist our customers in making informed decisions when selecting from the products and services we offer. We continuously review our product and service offerings to ensure that we provide our customers with the tools to meet their financial needs. A more complete listing of all the services and products available to our customers can be found on our website: [www.columbiabank.com](http://www.columbiabank.com). Some of the core products and services we offer include:

Personal Banking

- Checking and Saving Accounts
- Online Banking
- Electronic Bill Pay
- Consumer Lending
- Residential Lending
- VISA® Card Services
- Investment Services through CB Financial Services
- Private Banking
- Trust Services

Business Banking

- Checking & Saving Accounts
- Online Banking
- Electronic Bill Pay
- Remote Deposit Capture
- Cash Management
- Commercial & Industrial Lending
- Real Estate and Real Estate Construction Lending
- Equipment Finance
- Small Business Services
- VISA® Card Services
- Investment Services through CB Financial Services
- International Banking
- Merchant Card Services
- Professional Banking

Personal Banking: We offer our personal banking customers an assortment of account products including noninterest and interest-bearing checking, savings, money market and certificate of deposit accounts. Overdraft protection is also available with direct links to the customer’s checking account. Our online banking service, Columbia Online™, provides our personal banking customers with the ability to safely and securely conduct their banking business 24 hours a day, 7 days a week. Personal banking customers are also provided with a variety of borrowing products including fixed and variable rate home equity loans and lines of credit, home mortgages for purchases and refinances, personal loans, and other consumer loans. Eligible personal banking customers with checking accounts are provided a Visa® Debit Card which can be used both to make purchases and as an ATM card. A variety of Visa® Credit Cards are also available to eligible personal banking customers.

Columbia Private Banking offers affluent clientele and their businesses complex financial solutions, such as deposit and cash management services, credit services, and wealth management strategies. Each private banker provides advisory services<sup>(2)</sup> and coordinates a relationship team of experienced financial professionals to meet the unique needs of each discerning customer.

Through CB Financial Services<sup>(1)</sup>, customers are provided with a full range of investment options including mutual funds, stocks, bonds, retirement accounts, annuities, tax-favored investments, US Government securities as well as long-term care and life insurance policies. Qualified investment professionals are available to provide advisory services<sup>(2)</sup> and assist customers with retirement, education and other financial planning activities.

Business Banking: We offer our business banking customers the foundation of a variety of checking, savings, interest bearing money market and certificate of deposit accounts to satisfy all their banking needs. In addition to these core banking products we provide a breadth of services to support the complete financial needs of small and middle market businesses including Cash Management, Professional Banking, International Banking, VISA Credit Cards, Merchant Services and Commercial Lending.

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(1) Securities and insurance products are offered through PrimeVest Financial Services, Inc., an independent, registered broker/dealer. Member FINRA/SIPC. CB Financial Services is a marketing name for PrimeVest. \* Investment products are Not FDIC insured \* No bank guarantee \* Not a deposit \* Not insured by any federal

government agency \* May lose value.

- (2) Advisory services may only be offered by Investment Adviser Representatives in connection with an appropriate PrimeVest Advisory Services Agreement and disclosure brochure as provided.

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### Cash Management

Columbia State Bank's diversified Cash Management Programs are tailored to meet specific banking needs of each individual business. We combine technology with integrated operations and local expertise for safe, powerful, flexible solutions. Columbia customers, of all sizes, choose from a full range of transaction and Cash Management tools to gain more control over and make more from their money. Services include Commercial Online Banking, Positive Pay fraud protection, Automated Clearing House (ACH) payments, Remote Deposit Capture, and Merchant Services. Our Cash Management professionals work with businesses to find the best combination of services to meet their needs. This customized, modular approach ensures their business banking operations are cost-effective now, with flexibility for future growth.

### Professional Banking

Columbia Professional Bankers are uniquely qualified to help medical and dental professionals acquire, build and grow their practice. We offer tailored banking and investment solutions<sup>(1)</sup> delivered by experienced bankers with the industry knowledge necessary to meet their business's unique needs. No matter what the needs are now or in the years to come, we guide professionals through all their financial options to make their banking as easy and personal as possible.

### International Banking

Columbia Bank's International services division offers a range of financial services to help forward-thinking independent businesses explore global markets and conduct international trade smoothly and expediently. We're proud to provide small and mid-size business with the same caliber of expertise and personalized service that national banks usually limit to large businesses.

Our experience with foreign currency exchange, letters of credit, foreign collections and trade finance services can help independent companies open the door to new markets and suppliers overseas. Put simply, the wealth of opportunities that international trade offers growing businesses can have a significant impact on both long-term growth and their bottom line.

### Commercial Lending

We offer a variety of loan products tailored to meet the various needs of business banking customers. Commercial loan products include accounts receivable and inventory financing as well as Small Business Administration ("SBA") financing. We also offer commercial real estate loan products for construction and development or permanent financing. Real estate lending activities have been focused on construction and permanent loans for both owner occupants and investor oriented real estate properties. In addition, the Bank has pursued construction and first mortgages on owner occupied, one- to four-family residential properties. Commercial banking has been directed toward meeting the credit and related deposit needs of various sized businesses and professional practice organizations operating in our primary market areas.

### CB Financial Services

Through CB Financial Services<sup>(1)</sup>, customers are provided with an array of investment options and all the tools and resources necessary to assist them in reaching their investment goals. Some of the investment solutions available to customers include 401(k), Simple IRA, Simple Employee Pensions, Buy-Sell Agreements, Key-Man Insurance, Business Succession Planning and personal investments.

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Securities and insurance products are offered through PrimeVest Financial Services, Inc., an independent, registered broker/dealer. Member FINRA/SIPC. CB Financial Services is a marketing name for PrimeVest. \*  
(1) Investment products are Not FDIC insured \* No bank guarantee \* Not a deposit \* Not insured by any federal government agency \* May lose value.



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### Business VISA® Credit and Debit Cards

We offer our business banking customers a selection of Visa® Cards including the Business Debit Card that works like a check wherever Visa® is accepted. We partner with First National Bank of Omaha to offer Visa® Credit Cards such as the Corporate Card which can be used all over the world as well as the Business Edition® and Business Edition Plus® that earns reward points with every purchase.

### Merchant Card Services

Business clients that utilize Columbia's Merchant Card Services have the ability to accept Visa®, MasterCard® and Discover® sales drafts for deposit directly into their business checking account. Merchants are provided with a comprehensive accounting system tailored to meet each merchant's needs, which includes month-to-date credit card deposit information on a transaction statement. Internet access is available to view merchant reports that allow business customers to review merchant statements, authorized, captured, cleared and settled transactions.

### Competition

Our industry remains highly competitive in spite of challenging economic conditions. Several other financial institutions with greater resources compete for banking business in our market areas. Among the advantages of some of these institutions are their ability to make larger loans, finance extensive advertising and promotion campaigns, access international financial markets and allocate their investment assets to regions of highest yield and demand. In addition to competition from other banking institutions, we continue to experience competition from non-banking companies such as credit unions, brokerage houses and other financial services companies. We compete for deposits, loans, and other financial services by offering our customers similar breadth of products as our larger competitors while delivering a more personalized service level with faster transaction turnaround time.

### Market Areas

Washington: Approximately 30% of our total branches within Washington are located in Pierce County, with an estimated 2011 population of 815,000 residents. At June 30, 2011 our Pierce County branch locations' share of the county's total deposit market was 18%<sup>(1)</sup>, ranking first among our competition. Also located in Pierce County is our Company headquarters in the city of Tacoma and one nearby operational facility. Some of the most significant contributors to the Pierce County economy are the Port of Tacoma, whose activities are related to more than 40,000 jobs in the county, and well over 100,000 in the state of Washington, Joint Base Lewis-McChord which accounts for nearly 20% of the County's total employment, and the manufacturing industry which supplies the Boeing Company. We operate thirteen branch locations in King County, including Seattle, Bellevue and Redmond. King County, which is Washington's most highly populated county at close to 2 million residents, is a market that has significant growth potential for our Company and will play a key role in our expansion strategy in the future. At June 30, 2011 we ranked 13<sup>th</sup> in our share of the King County deposit market or approximately 1%<sup>(1)</sup>; however, we continue to make inroads within this market through the strategic expansion of our banking team. The north King County economy is primarily made up of the aerospace, construction, computer software and biotechnology industries. South King County, with its close proximity to Pierce County, is considered a natural extension of our primary market area. The economy of south King County is primarily comprised of residential communities supported by light industrial, retail, aerospace and distributing and warehousing industries.

Some other market areas served by the Company include Cowlitz County where we rank first, or 9%<sup>(1)</sup>, in deposit market share, operating two branch locations; and Kitsap County, where we operate 6 branches with 8%<sup>(1)</sup> of the deposit market share. We also have locations in Adams, Clallam, Clark, Jefferson, Klickitat, Spokane, Thurston, Whitman and Yakima counties where we operate two branch offices in each county, and Asotin, Benton, Franklin, Grant, Mason, Snohomish, Skagit, Walla Walla and Whatcom Counties where we operate one branch in each county. Oregon: With the acquisition of Columbia River Bank in January 2010, we significantly expanded our market area in western Oregon, and entered the eastern Oregon market area, bringing our total to 25 branch locations in the state. Oregon counties include Clackamas, Clatsop, Deschutes, Hood River, Jefferson, Marion, Multnomah, Tillamook, Umatilla, Wasco and Yamhill. Columbia ranks fifteenth<sup>(1)</sup> in total deposit market share in Oregon. We are first<sup>(1)</sup> in deposit market share in Hood River, Jefferson, and Wasco counties, and second or 28%<sup>(1)</sup> of the deposit market share in Clatsop county. Oregon market areas provide a significant opportunity for expansion in the future.

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Source: FDIC Annual Summary of Deposit Report as of June 30, 2011.

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### Employees

As of December 31, 2011 the Company and its banking subsidiary employed approximately 1,256 full-time equivalent employees, significantly up from the 1,092 at December 31, 2010. We value our employees and pride ourselves on providing a professional work environment accompanied by comprehensive benefit programs. We are committed to providing flexible and value-added benefits to our employees through a “Total Compensation Philosophy” which incorporates all compensation and benefits. Our continued commitment to employees contributed to Columbia Bank being again awarded one of Seattle Business Magazine’s 100 Best Companies to Work For 2011 and designated one of the Puget Sound Business Journal’s “Washington’s Best Workplaces 2011”.

### Available Information

We file annual reports on Form 10-K, quarterly reports on Form 10-Q, periodic reports on Form 8-K, proxy statements and other information with the United States Securities and Exchange Commission (“SEC”). The public may obtain copies of these reports and any amendments at the SEC’s Internet site, [www.sec.gov](http://www.sec.gov).

Additionally, reports filed with the SEC can be obtained through our website at [www.columbiabank.com](http://www.columbiabank.com). These reports are available through our website as soon as reasonably practicable after they are filed electronically with the SEC. Information contained on our website is not intended to be incorporated by reference into this report.

### Supervision and Regulation

The following discussion provides an overview of certain elements of the extensive regulatory framework applicable to the Company and Columbia State Bank, which operates under the names Columbia State Bank in Washington, and Columbia State Bank and Bank of Astoria in Oregon (collectively, referred to herein as “Columbia Bank”). This regulatory framework is primarily designed for the protection of depositors, federal deposit insurance funds and the banking system as a whole, rather than specifically for the protection of shareholders. Due to the breadth and growth of this regulatory framework, our costs of compliance continue to increase in order to monitor and satisfy these requirements.

To the extent that this section describes statutory and regulatory provisions, it is qualified by reference to those provisions. These statutes and regulations, as well as related policies, are subject to change by Congress, state legislatures and federal and state regulators. Changes in statutes, regulations or regulatory policies applicable to us, including the interpretation or implementation thereof, could have a material effect on our business or operations. In light of the recent financial crisis, numerous changes to the statutes, regulations or regulatory policies applicable to us have been made or proposed. The full extent to which these changes will impact our business is not yet known. However, our continued efforts to monitor and comply with new regulatory requirements add to the complexity and cost of our business.

### Federal Bank Holding Company Regulation

**General.** The Company is a bank holding company as defined in the Bank Holding Company Act of 1956, as amended (“BHCA”), and is therefore subject to regulation, supervision and examination by the Federal Reserve. In general, the BHCA limits the business of bank holding companies to owning or controlling banks and engaging in other activities closely related to banking. The Company must file reports with and provide the Federal Reserve such additional information as it may require. Under the Financial Services Modernization Act of 1999, a bank holding company may apply to the Federal Reserve to become a financial holding company, and thereby engage (directly or through a subsidiary) in certain expanded activities deemed financial in nature, such as securities and insurance underwriting.

**Holding Company Bank Ownership.** The BHCA requires every bank holding company to obtain the prior approval of the Federal Reserve before (i) acquiring, directly or indirectly, ownership or control of any voting shares of another bank or bank holding company if, after such acquisition, it would own or control more than 5% of such shares; (ii) acquiring all or substantially all of the assets of another bank or bank holding company; or (iii) merging or consolidating with another bank holding company.

**Holding Company Control of Nonbanks.** With some exceptions, the BHCA also prohibits a bank holding company from acquiring or retaining direct or indirect ownership or control of more than 5% of the voting shares of any company which is not a bank or bank holding company, or from engaging directly or indirectly in activities other than those of banking, managing or controlling banks, or providing services for its subsidiaries. The principal exceptions to these prohibitions involve certain non-bank activities that, by statute or by Federal Reserve regulation or order, have

been identified as activities closely related to the business of banking or of managing or controlling banks.

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**Transactions with Affiliates.** Subsidiary banks of a bank holding company are subject to restrictions imposed by the Federal Reserve Act on extensions of credit to the holding company or its subsidiaries, on investments in their securities and on the use of their securities as collateral for loans to any borrower. These regulations and restrictions may limit the Company's ability to obtain funds from Columbia Bank for its cash needs, including funds for payment of dividends, interest and operational expenses.

**Tying Arrangements.** We are prohibited from engaging in certain tie-in arrangements in connection with any extension of credit, sale or lease of property or furnishing of services. For example, with certain exceptions, neither the Company nor its subsidiaries may condition an extension of credit to a customer on either (i) a requirement that the customer obtain additional services provided by us; or (ii) an agreement by the customer to refrain from obtaining other services from a competitor.

**Support of Subsidiary Banks.** Under Federal Reserve policy and the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), the Company is expected to act as a source of financial and managerial strength to Columbia Bank. This means that the Company is required to commit, as necessary, resources to support Columbia Bank. Any capital loans a bank holding company makes to its subsidiary banks are subordinate to deposits and to certain other indebtedness of those subsidiary banks.

**State Law Restrictions.** As a Washington corporation, the Company is subject to certain limitations and restrictions under applicable Washington corporate law. For example, state law restrictions in Washington include limitations and restrictions relating to indemnification of directors, distributions to shareholders, transactions involving directors, officers or interested shareholders, maintenance of books, records, and minutes, and observance of certain corporate formalities.

### **Federal and State Regulation of Columbia Bank**

**General.** The deposits of Columbia Bank, a Washington chartered commercial bank with branches in Washington and Oregon, are insured by the FDIC. As a result, Columbia Bank is subject to supervision and regulation by the Washington Department of Financial Institutions, Division of Banks and the FDIC. With respect to branches of Columbia Bank in Oregon, the Bank is also subject to supervision and regulation by the Oregon Department of Consumer and Business Services, as well as the FDIC. These agencies have the authority to prohibit banks from engaging in what they believe constitute unsafe or unsound banking practices.

**Consumer Protection.** The Bank is subject to a variety of federal and state consumer protection laws and regulations that govern its relationship with consumers including laws and regulations that impose certain disclosure requirements and regulate the manner in which we take deposits, make and collect loans, and provide other services. Failure to comply with these laws and regulations may subject the Bank to various penalties, including but not limited to, enforcement actions, injunctions, fines, civil liability, criminal penalties, punitive damages, and the loss of certain contractual rights.

**Community Reinvestment.** The Community Reinvestment Act ("CRA") of 1977 requires that, in connection with examinations of financial institutions within their jurisdiction, the Federal Reserve or the FDIC evaluate the record of the financial institution in meeting the credit needs of its local communities, including low and moderate-income neighborhoods, consistent with the safe and sound operation of the institution. A bank's community reinvestment record is also considered by the applicable banking agencies in evaluating mergers, acquisitions and applications to open a branch or facility.

**Insider Credit Transactions.** Banks are also subject to certain restrictions imposed by the Federal Reserve Act on extensions of credit to executive officers, directors, principal shareholders or any related interests of such persons. Extensions of credit (i) must be made on substantially the same terms, including interest rates and collateral, and follow credit underwriting procedures that are at least as stringent as those prevailing at the time for comparable transactions with persons not related to the lending bank; and (ii) must not involve more than the normal risk of repayment or present other unfavorable features. Banks are also subject to certain lending limits and restrictions on overdrafts to insiders. A violation of these restrictions may result in the assessment of substantial civil monetary penalties, regulatory enforcement actions, and other regulatory sanctions.

**Regulation of Management.** Federal law (i) sets forth circumstances under which officers or directors of a bank may be removed by the institution's federal supervisory agency; (ii) places restraints on lending by a bank to its executive

officers, directors, principal shareholders, and their related interests; and (iii) generally prohibits management personnel of a bank from serving as directors or in other management positions of another financial institution whose assets exceed a specified amount or which has an office within a specified geographic area.

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**Safety and Soundness Standards.** Certain non-capital safety and soundness standards are also imposed upon banks. These standards cover internal controls, information systems and internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation, fees and benefits, such other operational and managerial standards as the agency determines to be appropriate, and standards for asset quality, earnings and stock valuation. An institution that fails to meet these standards may be subject to regulatory sanctions.

### **Interstate Banking and Branching**

The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (“Interstate Act”) together with the Dodd-Frank Act relaxed prior interstate branching restrictions under federal law by permitting, subject to regulatory approval, state and federally chartered commercial banks to establish branches in states where the laws permit banks chartered in such states to establish branches. The Interstate Act requires regulators to consult with community organizations before permitting an interstate institution to close a branch in a low-income area. Federal banking agency regulations prohibit banks from using their interstate branches primarily for deposit production and the federal banking agencies have implemented a loan-to-deposit ratio screen to ensure compliance with this prohibition.

### **Dividends**

The principal source of the Company's cash is from dividends received from Columbia Bank, which are subject to government regulation and limitations. Regulatory authorities may prohibit banks and bank holding companies from paying dividends in a manner that would constitute an unsafe or unsound banking practice or would reduce the amount of its capital below that necessary to meet minimum applicable regulatory capital requirements. Washington law also limits a bank's ability to pay dividends that are greater than the bank's retained earnings without approval of the applicable banking agency. Additionally, current guidance from the Federal Reserve provides, among other things, that dividends per share on the Company's common stock generally should not exceed earnings per share, measured over the previous four fiscal quarters.

### **Capital Adequacy**

**Regulatory Capital Guidelines.** Federal bank regulatory agencies use capital adequacy guidelines in the examination and regulation of bank holding companies and banks. The guidelines are “risk-based,” meaning that they are designed to make capital requirements more sensitive to differences in risk profiles among banks and bank holding companies.

**Tier I and Tier II Capital.** Under the guidelines, an institution's capital is divided into two broad categories, Tier I capital and Tier II capital. Tier I capital generally consists of common stockholders' equity (including surplus and undivided profits), qualifying non-cumulative perpetual preferred stock, and qualified minority interests in the equity accounts of consolidated subsidiaries. Tier I capital generally excludes goodwill and intangible assets, net unrealized gains and losses on available for sale securities and accumulated net gains and losses on cash flow hedges. Tier II capital generally consists of the allowance for loan losses, hybrid capital instruments and qualifying subordinated debt. The sum of Tier I capital and Tier II capital represents an institution's total capital. The guidelines require that at least 50% of an institution's total capital consist of Tier I capital.

**Risk-based Capital Ratios.** The adequacy of an institution's capital is gauged primarily with reference to the institution's risk-weighted assets. The guidelines assign risk weightings to an institution's assets in an effort to quantify the relative risk of each asset and to determine the minimum capital required to support that risk. An institution's risk-weighted assets are then compared with its Tier I capital and total capital to arrive at a Tier I risk-based ratio and a total risk-based ratio, respectively. The guidelines provide that an institution must have a minimum Tier I risk-based ratio of 4% and a minimum total risk-based ratio of 8%.

**Leverage Ratio.** The guidelines also employ a leverage ratio, which is Tier I capital as a percentage of average total assets, less intangibles. The principal objective of the leverage ratio is to constrain the maximum degree to which a bank holding company may leverage its equity capital base. The minimum leverage ratio is 3%; however, for all but the most highly rated bank holding companies and for bank holding companies seeking to expand, regulators expect an additional cushion of at least 1% to 2%.

**Prompt Corrective Action.** Under the guidelines, an institution is assigned to one of five capital categories depending on its total risk-based capital ratio, Tier I risk-based capital ratio, and leverage ratio, together with certain subjective factors. The categories range from “well capitalized” to “critically undercapitalized.” Institutions that are “undercapitalized” or lower are subject to certain mandatory supervisory corrective actions. At each successively lower capital category,

an insured bank is subject to increased restrictions on its operations. During these challenging economic times, the federal banking regulators have actively enforced these provisions.

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### Regulatory Oversight and Examination

The Federal Reserve conducts periodic inspections of bank holding companies, which are performed both onsite and offsite. The supervisory objectives of the inspection program are to ascertain whether the financial strength of the bank holding company is being maintained on an ongoing basis and to determine the effects or consequences of transactions between a holding company or its non-banking subsidiaries and its subsidiary banks. For holding companies under \$10 billion in assets, the inspection type and frequency varies depending on asset size, complexity of the organization, and the holding company's rating at its last inspection.

Banks are subject to periodic examinations by their primary regulators. Bank examinations have evolved from reliance on transaction testing in assessing a bank's condition to a risk-focused approach. These examinations are extensive and cover the entire breadth of operations of the bank. Generally, safety and soundness examinations occur on an 18-month cycle for banks under \$500 million in total assets that are well capitalized and without regulatory issues, and 12-months otherwise. Examinations alternate between the federal and state bank regulatory agency or may occur on a combined schedule. The frequency of consumer compliance and CRA examinations is linked to the size of the institution and its compliance and CRA ratings at its most recent examinations. However, the examination authority of the Federal Reserve and the FDIC allows them to examine supervised banks as frequently as deemed necessary based on the condition of the bank or as a result of certain triggering events.

### Corporate Governance and Accounting

Sarbanes-Oxley Act of 2002. The Sarbanes-Oxley Act of 2002 (the "Act") addresses, among other things, corporate governance, auditing and accounting, enhanced and timely disclosure of corporate information, and penalties for non-compliance. Generally, the Act (i) requires chief executive officers and chief financial officers to certify to the accuracy of periodic reports filed with the SEC; (ii) imposes specific and enhanced corporate disclosure requirements; (iii) accelerates the time frame for reporting of insider transactions and periodic disclosures by public companies; (iv) requires companies to adopt and disclose information about corporate governance practices, including whether or not they have adopted a code of ethics for senior financial officers and whether the audit committee includes at least one "audit committee financial expert;" and (v) requires the SEC, based on certain enumerated factors, to regularly and systematically review corporate filings.

### Anti-terrorism

USA Patriot Act of 2001. The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, intended to combat terrorism, was renewed with certain amendments in 2006 (the "Patriot Act"). The Patriot Act, in relevant part, (i) prohibits banks from providing correspondent accounts directly to foreign shell banks; (ii) imposes due diligence requirements on banks opening or holding accounts for foreign financial institutions or wealthy foreign individuals; (iii) requires financial institutions to establish an anti-money-laundering compliance program; and (iv) eliminates civil liability for persons who file suspicious activity reports. The Act also includes provisions providing the government with power to investigate terrorism, including expanded government access to bank account records.

### Financial Services Modernization

Gramm-Leach-Bliley Act of 1999. The Gramm-Leach-Bliley Financial Services Modernization Act of 1999 brought about significant changes to the laws affecting banks and bank holding companies. Generally, the Act (i) repeals historical restrictions on preventing banks from affiliating with securities firms; (ii) provides a uniform framework for the activities of banks, savings institutions and their holding companies; (iii) broadens the activities that may be conducted by national banks and banking subsidiaries of bank holding companies; (iv) provides an enhanced framework for protecting the privacy of consumer information and requires notification to consumers of bank privacy policies; and (v) addresses a variety of other legal and regulatory issues affecting both day-to-day operations and long-term activities of financial institutions. Bank holding companies that qualify and elect to become financial holding companies can engage in a wider variety of financial activities than permitted under previous law, particularly with respect to insurance and securities underwriting activities.

### The Emergency Economic Stabilization Act of 2008

Emergency Economic Stabilization Act of 2008. In response to market turmoil and financial crises affecting the overall banking system and financial markets in the United States, the Emergency Economic Stabilization Act of 2008

(“EESA”) was enacted on October 3, 2008. EESA provides the United States Department of the Treasury (the “Treasury”) with broad authority to implement certain actions intended to help restore stability and liquidity to the U.S. financial markets.

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Troubled Asset Relief Program. Under the EESA, the Treasury has authority, among other things, to purchase up to \$700 billion in mortgage loans, mortgage-related securities and certain other financial instruments, including debt and equity securities issued by financial institutions pursuant to the Troubled Asset Relief Program (“TARP”). The purpose of TARP is to restore confidence and stability to the U.S. banking system and to encourage financial institutions to increase lending to customers and to each other. Pursuant to the EESA, the Treasury was initially authorized to use \$350 billion for TARP. Of this amount, the Treasury allocated \$250 billion to the TARP Capital Purchase Program (“CPP”), which funds were used to purchase preferred stock from qualifying financial institutions. The Company applied for and received approximately \$76 million in the CPP. Due to its capital position, on August 11, 2010, the Company redeemed all of its 76,898 outstanding shares of preferred stock, originally issued to the Treasury for a total redemption price of \$77.8 million, consisting of \$76.9 million in principal and \$918,504 in accrued and unpaid dividends. On September 1, 2010, the Company repurchased the common stock warrant issued to the Treasury for \$3.3 million. The warrant repurchase, together with the Company's redemption in August 2010 of the entire amount of the preferred stock, represents full repayment of all TARP obligations and cancellation of all equity interests in the Company held by the Treasury.

Temporary Liquidity Guarantee Program. Another program established pursuant to the EESA is the Temporary Liquidity Guarantee Program (“TLGP”), which (i) removed the limit on FDIC deposit insurance coverage for non-interest bearing transaction accounts through December 31, 2009, and (ii) provided FDIC backing for certain types of senior unsecured debt issued from October 14, 2008 through June 30, 2009. The end-date for issuing senior unsecured debt was later extended to October 31, 2009 and the FDIC also extended the Transaction Account Guarantee portion of the TLGP through December 31, 2010. In November 2010, the FDIC issued a final rule to implement provisions of the Dodd-Frank Act that provides for temporary unlimited coverage for non-interest-bearing transaction accounts. The separate coverage for non-interest-bearing transaction accounts became effective on December 31, 2010 and terminates on December 31, 2012.

#### Deposit Insurance

The Bank's deposits are insured under the Federal Deposit Insurance Act, up to the maximum applicable limits and are subject to deposit insurance assessments designed to tie what banks pay for deposit insurance more closely to the risks they pose. The Bank has prepaid its quarterly deposit insurance assessments for 2012 pursuant to applicable FDIC regulations. In February 2011, the FDIC approved new rules to, among other things, change the assessment base from one based on domestic deposits (as it has been since 1935) to one based on assets (average consolidated total assets minus average tangible equity). Since the new assessment base is larger than the base used under prior regulations, the rules also lower assessment rates, so that the total amount of revenue collected by the FDIC from the industry is not significantly altered. The rules also revise the deposit insurance assessment system for large financial institutions, defined as institutions with at least \$10 billion in assets. The rules revise the assessment rate schedule, effective April 1, 2011, and adopt additional rate schedules that will go into effect when the Deposit Insurance Fund reserve ratio reaches various milestones. The Dodd-Frank Act requires the FDIC to increase the reserve ratio of the Deposit Insurance Fund from 1.15% to 1.35% of insured deposits by 2020 and eliminates the requirement that the FDIC pay dividends to insured depository institutions when the reserve ratio exceeds certain thresholds.

Insurance of Deposit Accounts. The EESA included a provision for a temporary increase from \$100,000 to \$250,000 per depositor in deposit insurance effective October 3, 2008 through December 31, 2010. On May 20, 2009, the temporary increase was extended through December 31, 2013. The Dodd-Frank Act permanently raises the current standard maximum deposit insurance amount to \$250,000. The FDIC insurance coverage limit applies per depositor, per insured depository institution for each account ownership category. EESA also temporarily raised the limit on federal deposit insurance coverage to an unlimited amount for non-interest or low-interest bearing demand deposits. Pursuant to the Dodd-Frank Act, unlimited coverage for non-interest transaction accounts will continue until December 31, 2012.

#### Recent Legislation

Dodd-Frank Wall Street Reform and Consumer Protection Act. As a result of the recent financial crises, on July 21, 2010 the Dodd-Frank Act was signed into law. The Dodd-Frank Act is expected to have a broad impact on the financial services industry, including significant regulatory and compliance changes and changes to corporate

governance matters affecting public companies. Not all of the regulations implementing these changes have been promulgated. As a result, we cannot determine the full impact on our business and operations at this time. However, the Dodd-Frank Act is expected to have a significant impact on our business operations as its provisions take effect. Some of the provisions of the Dodd-Frank Act that may impact our business are summarized below.

**Holding Company Capital Requirements.** Under the Dodd-Frank Act, trust preferred securities will be excluded from the Tier 1 capital of a bank holding company between \$500 million and \$15 billion in assets unless such securities were issued prior to May 19, 2010.

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**Corporate Governance.** The Dodd-Frank Act requires publicly traded companies to provide their shareholders with (i) a non-binding shareholder vote on executive compensation, (ii) a non-binding shareholder vote on the frequency of such vote, (iii) disclosure of “golden parachute” arrangements in connection with specified change in control transactions, and (iv) a non-binding shareholder vote on golden parachute arrangements in connection with these change in control transactions. Except with respect to “smaller reporting companies” and participants in the CPP, the new rules applied to proxy statements relating to annual meetings of shareholders held after January 20, 2011. “Smaller reporting companies,” those with a public float of less than \$75 million, are required to include the non-binding shareholder votes on executive compensation and the frequency thereof in proxy statements relating to annual meetings occurring on or after January 21, 2013.

**Prohibition Against Charter Conversions of Troubled Institutions.** The Dodd-Frank Act generally prohibits a depository institution from converting from a state to federal charter, or vice versa, while it is the subject to an enforcement action unless the bank seeks prior approval from its regulator and complies with specified procedures to ensure compliance with the enforcement action.

**Debit Card Interchange Fees.** The Dodd-Frank Act requires the amount of any interchange fee charged by a debit card issuer with respect to a debit card transaction to be reasonable and proportional to the cost incurred by the issuer.

While the restrictions on interchange fees do not apply to banks that, together with their affiliates, have assets of less than \$10 billion, the rule could affect the competitiveness of debit cards issued by smaller banks.

**Consumer Financial Protection Bureau.** The Dodd-Frank Act creates a new, independent federal agency called the Consumer Financial Protection Bureau (“CFPB”) within the Federal Reserve Board. The CFPB has broad rulemaking, supervision and enforcement authority for a wide range of consumer protection laws applicable to banks and thrifts with greater than \$10 billion in assets. Smaller institutions are subject to certain rules promulgated by the CFPB but will continue to be examined and supervised by their federal banking regulators for compliance purposes.

**Repeal of Demand Deposit Interest Prohibition.** The Dodd-Frank Act repeals the federal prohibitions on the payment of interest on demand deposits, thereby permitting depository institutions to pay interest on business transaction and other accounts.

**American Recovery and Reinvestment Act of 2009.** On February 17, 2009 the American Recovery and Reinvestment Act of 2009 (“ARRA”) was signed into law. ARRA was intended to help stimulate the economy through a combination of tax cuts and spending provisions applicable to a broad range of areas with an estimated cost of about \$780 billion. Among other things, ARRA authorized the U.S. Small Business Administration (“SBA”) to increase the level of the SBA's guaranty for eligible loans to 90 percent. The increased guaranty percentage continued until available funding was exhausted on January 3, 2011. ARRA also made temporary changes, which expired on December 31, 2010, to federal law that expanded the capability of banks to purchase tax-exempt debt.

**Overdrafts.** On November 17, 2009, the Board of Governors of the Federal Reserve System promulgated the Electronic Fund Transfer rule with an effective date of January 19, 2010 and a mandatory compliance date of July 1, 2010. The rule, which applies to all FDIC-regulated institutions, prohibits financial institutions from assessing an overdraft fee for paying automated teller machine (ATM) and one-time point-of-sale debit card transactions, unless the customer affirmatively opts in to the overdraft service for those types of transactions. The opt-in provision establishes requirements for clear disclosure of fees and terms of overdraft services for ATM and one-time debit card transactions.

### Proposed Legislation

**General.** Proposed legislation is introduced in almost every legislative session. Certain of such legislation could dramatically affect the regulation of the banking industry. We cannot predict if any such legislation will be adopted or if it is adopted how it would affect the business of Columbia Bank or the Company. Past history has demonstrated that new legislation or changes to existing laws or regulations usually results in a greater compliance burden and therefore generally increases the cost of doing business.

**Possible Changes to Capital Requirements Resulting from Basel III.** Basel III updates and revises significantly the current international bank capital accords (so-called “Basel I” and “Basel II”). Basel III is intended to be implemented by participating countries for large, internationally active banks. However, standards consistent with Basel III will be formally implemented in the United States through a series of regulations, some of which may apply to other banks.

Among other things, Basel III creates “Tier 1 common equity,” a new measure of regulatory capital closer to pure tangible common equity than the present Tier 1 definition. Basel III also increases minimum capital ratios. For the new concept of Tier 1 common equity, the minimum ratio is 4.5 percent of risk weighted assets. For Tier 1 and total capital the Basel III minimums are 6 percent and 8 percent respectively. Capital buffers comprising common equity equal to 2.5 percent of risk-weighted assets are added to each of these minimums to enable banks to absorb losses during a stressed period while remaining above their



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regulatory minimum ratios. The Company cannot predict the extent to which Basel III will be adopted or, if adopted, how it will apply to us.

Effects of Government Monetary Policy

Our earnings and growth are affected not only by general economic conditions, but also by the fiscal and monetary policies of the federal government, particularly the Federal Reserve. The Federal Reserve implements national monetary policy for such purposes as curbing inflation and combating recession, but its open market operations in U.S. government securities, control of the discount rate applicable to borrowings from the Federal Reserve, and establishment of reserve requirements against certain deposits, influence the growth of bank loans, investments and deposits, and also affect interest rates charged on loans or paid on deposits. The nature and impact of future changes in monetary policies and their impact on us cannot be predicted with certainty.

ITEM 1A. RISK FACTORS

Our business exposes us to certain risks. The following is a discussion of what we currently believe are the most significant risks and uncertainties that may affect our business, financial condition and future results.

A protracted slow or fragile economic recovery could adversely affect our future results of operations or market price of our stock.

The national and global economy and the financial services sector in particular continue to face significant challenges. We cannot accurately predict how quickly or strongly the economy will recover from the recent recession, which has adversely impacted the markets we serve. The U.S. economy has also experienced substantial volatility in the financial markets. Any further deterioration in the economies of the nation as a whole or in our markets would have an adverse effect, which could be material, on our business, financial condition, results of operations and prospects, and could also cause the market price of our stock to decline. While it is impossible to predict how long adverse economic conditions may exist, a slow or fragile recovery could continue to present risks for some time for the industry and our company.

Economic conditions in the market areas we serve may continue to adversely impact our earnings and could increase our credit risk associated with our loan portfolio and the value of our investment portfolio.

Substantially all of our loans are to businesses and individuals in Washington and Oregon, and a continuing decline in the economies of these market areas could have a material adverse effect on our business, financial condition, results of operations and prospects. Housing prices have declined and unemployment is a continued concern in both Washington and Oregon. A further deterioration in the market areas we serve could result in the following consequences, any of which could have an adverse impact, which could be material, on our business, financial condition, results of operations and prospects:

- commercial and consumer loan delinquencies may increase;
- problem assets and foreclosures may increase;
- collateral for loans made may decline further in value, in turn reducing customers' borrowing power, reducing the value of assets and collateral associated with existing loans;
- certain securities within our investment portfolio could become other than temporarily impaired, requiring a write-down through earnings to fair value, thereby reducing equity;
- low cost or non-interest bearing deposits may decrease; and
- demand for our loan and other products and services may decrease.

Our loan portfolio mix, which has a concentration of loans secured by real estate, could result in increased credit risk in a challenging economy.

Our loan portfolio is concentrated in commercial real estate and commercial business loans. These types of loans generally are viewed as having more risk of default than residential real estate loans or certain other types of loans or investments. In fact, the FDIC has issued pronouncements alerting banks of its concern about heavy loan concentrations. Because our loan portfolio contains commercial real estate and commercial business loans with relatively large balances, the deterioration of one or a few of these loans may cause a significant increase in our non-performing loans. An increase in non-performing loans could result in a loss of earnings from these loans, an increase in the provision for loan losses, or an increase in loan charge-offs, any of which could have a material adverse impact on our results of operations and financial condition.

A further downturn in the economies or real estate values in the markets we serve could have a material adverse effect on both borrowers' ability to repay their loans and the value of the real property securing such loans. Our ability to recover on defaulted loans would then be diminished, and we would be more likely to suffer losses on defaulted loans.

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Our Allowance for Loan and Lease Losses (“ALLL”) may not be adequate to cover future loan losses, which could adversely affect earnings.

We maintain an ALLL in an amount that we believe is adequate to provide for losses inherent in our loan portfolio. While we strive to carefully monitor credit quality and to identify loans that may become non-performing, at any time there are loans in the portfolio that could result in losses, but that have not been identified as non-performing or potential problem loans. We cannot be sure that we will be able to identify deteriorating loans before they become non-performing assets, or that we will be able to limit losses on those loans that have been identified. Additionally, the process for determining the ALLL requires different, subjective and complex judgments about the future impact from current economic conditions that might impair the ability of borrowers to repay their loans. As a result, future significant increases to the ALLL may be necessary.

Future increases to the ALLL may be required based on changes in the composition of the loans comprising the portfolio, deteriorating values in underlying collateral (most of which consists of real estate) and changes in the financial condition of borrowers, such as may result from changes in economic conditions, or as a result of actual future events differing from assumptions used by management in determining the ALLL. Additionally, banking regulators, as an integral part of their supervisory function, periodically review our ALLL. These regulatory agencies may require us to increase the ALLL. Any increase in the ALLL would have an adverse effect, which could be material, on our financial condition and results of operations.

Nonperforming assets take significant time to resolve and adversely affect our results of operations and financial condition.

Our nonperforming assets adversely affect our net income in various ways. Until economic and market conditions improve to pre-recession levels, we expect to continue to incur additional losses relating to elevated levels of nonperforming loans. We do not record interest income on nonaccrual loans, thereby adversely affecting our income, and increasing loan administration costs. Assets acquired by foreclosure or similar proceedings are recorded at the lower of carrying value or fair value less estimated costs to sell. The valuation of these foreclosed assets is periodically updated and resulting losses, if any, are charged to earnings in the period in which they are identified. An increase in the level of nonperforming assets also increases our risk profile and may impact the capital levels our regulators believe is appropriate in light of such risks. We utilize various techniques such as loan sales, workouts, and restructurings to manage our problem assets. Decreases in the value of these problem assets, the underlying collateral, or in the borrowers’ performance or financial condition, could adversely affect our business, results of operations and financial condition. In addition, the resolution of nonperforming assets requires significant commitments of time from management and staff, which can be detrimental to performance of their other responsibilities. We may experience further increases in nonperforming loans in the future.

Our acquisitions and the integration of acquired businesses may not result in all of the benefits anticipated, and future acquisitions may be dilutive to current shareholders.

We have in the past and may in the future seek to grow our business by acquiring other businesses. Our acquisitions may not have the anticipated positive results, including results relating to: correctly assessing the asset quality of the assets being acquired; the total cost of integration including management attention and resources; the time required to complete the integration successfully; the amount of longer-term cost savings; being able to profitably deploy funds acquired in an acquisition; or the overall performance of the combined entity.

We also may encounter difficulties in obtaining required regulatory approvals and unexpected contingent liabilities can arise from the businesses we acquire. Integration of an acquired business can be complex and costly, sometimes including combining relevant accounting and data processing systems and management controls, as well as managing relevant relationships with employees, clients, suppliers and other business partners. Integration efforts could divert management attention and resources, which could adversely affect our operations or results.

Given the continued market volatility and uncertainty, notwithstanding our loss-sharing arrangements with the FDIC, we may continue to experience increased credit costs or need to take additional markdowns and allowances for loan losses on the assets and loans acquired that could adversely affect our financial condition and results of operations in the future.

We may also experience difficulties in complying with the technical requirements of our loss-sharing agreements with the FDIC, which could result in some assets which we acquire in FDIC-assisted transactions losing their coverage under such agreements. As our integration efforts continue in connection with these transactions, other unanticipated costs, including the diversion of personnel, or losses, may be incurred.

Acquisitions may also result in business disruptions that cause us to lose customers or cause customers to remove their accounts from us and move their business to competing financial institutions. It is possible that the integration process related

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to acquisitions could result in the disruption of our ongoing businesses or inconsistencies in standards, controls, procedures and policies that could adversely affect our ability to maintain relationships with clients, customers, depositors and employees. The loss of key employees in connection with an acquisition could adversely affect our ability to successfully conduct our business.

We may engage in future acquisitions involving the issuance of additional common stock and/or cash. Any such acquisitions and related issuances of stock may have a dilutive effect on earnings per share and the percentage ownership of current shareholders. The use of cash as consideration in any such acquisitions could impact our capital position and may require us to raise additional capital.

Furthermore, notwithstanding our recent acquisitions, we cannot provide any assurance as to the extent to which we can continue to grow through acquisitions as this will depend on the availability of prospective target opportunities at valuations we find attractive and the competition for such opportunities from other parties.

Our decisions regarding the fair value of assets acquired, including the FDIC loss-sharing assets, could be inaccurate, which could materially and adversely affect our business, financial condition, results of operations, and future prospects.

Management makes various assumptions and judgments about the collectability of the acquired loans, including the creditworthiness of borrowers and the value of the real estate and other assets serving as collateral for the repayment of secured loans. In FDIC-assisted acquisitions that include loss-sharing agreements, we may record a loss-sharing asset that we consider adequate to absorb the indemnified portion of future losses which may occur in the acquired loan portfolio. The FDIC loss-sharing asset is accounted for on the same basis as the related acquired loans and OREO and primarily represents the present value of the cash flows the Company expects to collect from the FDIC under the loss-sharing agreements.

If our assumptions are incorrect, significant earnings volatility can occur and the balance of the FDIC loss-sharing asset may at any time be insufficient to cover future loan losses, and credit loss provisions may be needed to respond to different economic conditions or adverse developments in the acquired loan portfolio. Any increase in future loan losses could have a material adverse effect on our operating results.

Our profitability measures could be adversely affected if we are unable to effectively deploy the capital we raised in 2010.

We may use the net proceeds of our capital raise completed in May 2010 for selective acquisitions that meet our disciplined acquisition criteria, to fund internal growth, or for general corporate purposes. Although we are periodically engaged in discussions with potential acquisition candidates, we are not currently a party to any purchase or merger agreement. There can be no assurance that we will be able to negotiate future acquisitions on terms acceptable to us. Investing the proceeds of our 2010 capital raise until we are able to deploy the proceeds will provide lower margins than we generally earn on loans, potentially adversely impacting shareholder returns, including earnings per share, net interest margin, return on assets and return on equity.

If the goodwill we have recorded in connection with acquisitions becomes impaired, it could have an adverse impact on our earnings and capital.

Accounting standards require that we account for acquisitions using the acquisition method of accounting. Under acquisition accounting, if the purchase price of an acquired company exceeds the fair value of its net assets, the excess is carried on the acquirer's balance sheet as goodwill. In accordance with generally accepted accounting principles, our goodwill is evaluated for impairment on an annual basis or more frequently if events or circumstances indicate that a potential impairment exists. Such evaluation may be based on a variety of factors, including the quoted price of our common stock, market prices of common stock of other banking organizations, common stock trading multiples, discounted cash flows, and data from comparable acquisitions. Future evaluations of goodwill may result in impairment and ensuing write-down, which could be material, resulting in an adverse impact on our earnings and capital.

Fluctuating interest rates could adversely affect our business.

Significant increases in market interest rates on loans, or the perception that an increase may occur, could adversely affect both our ability to originate new loans and our ability to grow. Conversely, decreases in interest rates could result in an acceleration of loan prepayments. An increase in market interest rates could also adversely affect the

ability of our floating-rate borrowers to meet their higher payment obligations. If this occurred, it could cause an increase in nonperforming assets and charge offs, which could adversely affect our business. Further, our profitability is dependent to a large extent upon net interest income, which is the difference (or “spread”) between the interest earned on loans, securities and other interest-earning assets and the interest paid on deposits, borrowings,

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and other interest-bearing liabilities. Because of the differences in maturities and repricing characteristics of our interest-earning assets and interest-bearing liabilities, changes in interest rates do not produce equivalent changes in interest income earned on interest-earning assets and interest paid on interest-bearing liabilities. Accordingly, fluctuations in interest rates could adversely affect our interest rate spread, and, in turn, our profitability.

The FDIC has increased insurance premiums to restore and maintain the federal deposit insurance fund, which has increased our costs and could adversely affect our business.

In 2009, the FDIC imposed a special deposit insurance assessment of five basis points on all insured institutions, and also required insured institutions to prepay estimated quarterly risk-based assessments through 2012.

The Dodd-Frank Act established 1.35% as the minimum deposit insurance fund reserve ratio. The FDIC has determined that the fund reserve ratio should be 2.0% and has adopted a plan under which it will meet the statutory minimum fund reserve ratio of 1.35% by the statutory deadline of September 30, 2020. The Dodd-Frank Act requires the FDIC to offset the effect on institutions with assets less than \$10 billion of the increase in the statutory minimum fund reserve ratio to 1.35% from the former statutory minimum of 1.15%.

Effective April 1, 2011, the FDIC implemented changes to the assessment rules resulting from the Dodd-Frank Act. The adopted regulations: (1) modify the definition of an institution's deposit insurance assessment base; (2) alter certain adjustments to the assessment rates; (3) revise the assessment rate schedules in light of the new assessment base and altered adjustments; and (4) provide for the automatic adjustment of the assessment rates in the future when the reserve ratio reaches certain milestones. These rule changes favorably impacted the Company's results of operations in 2011 by approximately \$1.0 million as the assessment rates, though applied to a larger assessment base, were lower than rates in prior periods.

Despite the FDIC's actions to restore the deposit insurance fund, the fund will suffer additional losses in the future due to failures of insured institutions. There may be additional significant deposit insurance premium increases, special assessments or prepayments in order to restore the insurance fund's reserve ratio. Any significant premium increases or special assessments could have a material adverse effect on the Company's financial condition and results of operations.

We operate in a highly regulated environment and changes of or increases in, or supervisory enforcement of, banking or other laws and regulations or governmental fiscal or monetary policies could adversely affect us.

We are subject to extensive regulation, supervision and examination by federal and state banking authorities. In addition, as a publicly-traded company, we are subject to regulation by the Securities and Exchange Commission. Any change in applicable regulations or federal, state or local legislation or in policies or interpretations or regulatory approaches to compliance and enforcement, income tax laws and accounting principles could have a substantial impact on us and our operations. Changes in laws and regulations may also increase our expenses by imposing additional fees or taxes or restrictions on our operations. Additional legislation and regulations that could significantly affect our powers, authority and operations may be enacted or adopted in the future, which could have a material adverse effect on our financial condition and results of operations. Failure to appropriately comply with any such laws, regulations or principles could result in sanctions by regulatory agencies or damage to our reputation, all of which could adversely affect our business, financial condition or results of operations.

In that regard, the Dodd-Frank Wall Street Reform and Consumer Protection Act was enacted in July 2010. Among other provisions, the legislation (i) created a new Bureau of Consumer Financial Protection with broad powers to regulate consumer financial products such as credit cards and mortgages, (ii) created a Financial Stability Oversight Council comprised of the heads of other regulatory agencies, (iii) will lead to new capital requirements from federal banking agencies, (iv) places new limits on electronic debit card interchange fees and (v) requires the Securities and Exchange Commission and national stock exchanges to adopt significant new corporate governance and executive compensation reforms. The new legislation and regulations are expected to increase the overall costs of regulatory compliance.

Further, regulators have significant discretion and authority to prevent or remedy unsafe or unsound practices or violations of laws or regulations by financial institutions and holding companies in the performance of their supervisory and enforcement duties. Recently, these powers have been utilized more frequently due to the serious national, regional and local economic conditions we are facing. The exercise of regulatory authority may have a

negative impact on our financial condition and results of operations. Additionally, our business is affected significantly by the fiscal and monetary policies of the U.S. federal government and its agencies, including the Federal Reserve Board.

We cannot accurately predict the full effects of recent legislation or the various other governmental, regulatory, monetary and fiscal initiatives which have been and may be enacted on the financial markets, on the Company and on the Bank. The terms and costs of these activities, or any worsening of current financial market and economic conditions, could materially and



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adversely affect our business, financial condition, results of operations, and the trading price of our common stock. We may be required, in the future, to recognize impairment with respect to investment securities, including the FHLB stock we hold.

Our securities portfolio currently includes securities with unrecognized losses. We may continue to observe declines in the fair market value of these securities. Securities issued by certain states and municipalities have recently come under scrutiny due to concerns about credit quality. Although management believes the credit quality of the Company's state and municipal securities portfolio to be good, there can be no assurance that the credit quality of these securities will not decline in the future. We evaluate the securities portfolio for any other than temporary impairment each reporting period, as required by generally accepted accounting principles in the United States of America, and as of December 31, 2011, we recognized one municipal bond as being other-than-temporarily impaired. For further information regarding this other-than-temporarily impaired security see Note 4 to the Consolidated Financial Statements in "Item 8. Financial Statements and Supplementary Data" of this report. There can be no assurance, however, that future evaluations of the securities portfolio will not require us to recognize further impairment charges with respect to these and other holdings. For example, it is possible that government-sponsored programs to allow mortgages to be refinanced to lower rates could materially adversely impact the yield on our portfolio of mortgage-backed securities, since a significant portion of our investment portfolio is composed of such securities. In addition, as a condition to membership in the FHLB, we are required to purchase and hold a certain amount of FHLB stock. Our stock purchase requirement is based, in part, upon the outstanding principal balance of advances from the FHLB. At December 31, 2011 we had stock in the FHLB totaling \$22.2 million. The FHLB stock held by us is carried at cost and is subject to recoverability testing under applicable accounting standards. The FHLB has discontinued the repurchase of their stock and discontinued the distribution of dividends. As of December 31, 2011, we did not recognize an impairment charge related to our FHLB stock holdings. There can be no assurance, however, that future negative changes to the financial condition of the FHLB may not require us to recognize an impairment charge with respect to such holdings.

Substantial competition in our market areas could adversely affect us.

Commercial banking is a highly competitive business. We compete with other commercial banks, savings and loan associations, credit unions, finance, insurance and other non-depository companies operating in our market areas. We also experience competition, especially for deposits, from Internet-based banking institutions, which have grown rapidly in recent years. We are subject to substantial competition for loans and deposits from other financial institutions. Some of our competitors are not subject to the same degree of regulation and restriction as we are and/or have greater financial resources than we do. Some of our competitors have severe liquidity issues, which could impact the pricing of deposits in our marketplace. If we are unable to effectively compete in our market areas, our business, results of operations and prospects could be adversely affected.

Changes in accounting standards could materially impact our financial statements.

From time to time the Financial Accounting Standards Board and the SEC change the financial accounting and reporting standards that govern the preparation of our financial statements. These changes can be very difficult to predict and can materially impact how we record and report our financial condition and results of operations. In some cases, we could be required to apply a new or revised standard retroactively, resulting in our restating prior period financial statements.

There can be no assurance as to the level of dividends we may pay on our common stock.

Holders of our common stock are only entitled to receive such dividends as our Board of Directors may declare out of funds legally available for such payments. Although we have historically declared cash dividends on our common stock, we are not required to do so and there may be circumstances under which we would eliminate our common stock dividend in the future. This could adversely affect the market price of our common stock.

Significant legal or regulatory actions could subject us to substantial uninsured liabilities and reputational harm and have a material adverse effect on our business and results of operations.

We are from time to time subject to claims and proceedings related to our operations. These claims and legal actions, which could include supervisory or enforcement actions by our regulators, or criminal proceedings by prosecutorial authorities, could involve large monetary claims, including civil money penalties or fines imposed by government

authorities, and significant defense costs. To mitigate the cost of some of these claims, we maintain insurance coverage in amounts and with deductibles that we believe are appropriate for our operations. However, our insurance coverage does not cover any civil money penalties or fines imposed by government authorities and may not cover all other claims that might be brought against us or continue to be available to us at a reasonable cost. As a result, we may be exposed to substantial uninsured liabilities,

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which could adversely affect our business, prospects, results of operations and financial condition. Substantial legal liability or significant regulatory action against us could have material adverse financial effects or cause significant reputational harm to us, which in turn could seriously harm our business prospects.

We are subject to a variety of operational risks, including reputational risk, legal risk and compliance risk, and the risk of fraud or theft by employees or outsiders, which may adversely affect our business and results of operations.

We are exposed to many types of operational risks, including reputational risk, legal and compliance risk, the risk of fraud or theft by employees or outsiders, and unauthorized transactions by employees or operational errors, including clerical or record-keeping errors or those resulting from faulty or disabled computer or telecommunications systems. If personal, non-public, confidential or proprietary information of customers in our possession were to be mishandled or misused, we could suffer significant regulatory consequences, reputational damage and financial loss. Such mishandling or misuse could include, for example, if such information were erroneously provided to parties who are not permitted to have the information, either by fault of our systems, employees, or counterparties, or where such information is intercepted or otherwise inappropriately taken by third parties.

Because the nature of the financial services business involves a high volume of transactions, certain errors may be repeated or compounded before they are discovered and successfully rectified. Our necessary dependence upon automated systems to record and process transactions and our large transaction volume may further increase the risk that technical flaws or employee tampering or manipulation of those systems will result in losses that are difficult to detect. We also may be subject to disruptions of our operating systems arising from events that are wholly or partially beyond our control (for example, computer viruses or electrical or telecommunications outages, or natural disasters, disease pandemics or other damage to property or physical assets) which may give rise to disruption of service to customers and to financial loss or liability. We are further exposed to the risk that our external vendors may be unable to fulfill their contractual obligations (or will be subject to the same risk of fraud or operational errors by their respective employees as we are) and to the risk that we (or our vendors') business continuity and data security systems prove to be inadequate. The occurrence of any of these risks could result in a diminished ability of us to operate our business (for example, by requiring us to expend significant resources to correct the defect), as well as potential liability to clients, reputational damage and regulatory intervention, which could adversely affect our business, financial condition and results of operations, perhaps materially.

We may pursue additional capital, which may not be available on acceptable terms or at all, could dilute the holders of our outstanding common stock and may adversely affect the market price of our common stock.

In the current economic environment, there may be circumstances under which it would be prudent to consider alternatives for raising capital when opportunities to raise capital at attractive prices present themselves, in order to further strengthen our capital and better position ourselves to take advantage of opportunities that may arise in the future. Such alternatives may include issuance and sale of common or preferred stock, or borrowings by the Company, with proceeds contributed to the Bank. Our ability to raise additional capital, if needed, will depend on, among other things, conditions in the capital markets at the time, which are outside of our control, and our financial performance. We cannot assure you that such capital will be available to us on acceptable terms or at all. Any such capital raising alternatives could dilute the holders of our outstanding common stock, and may adversely affect the market price of our common stock and our performance measures such as earnings per share.

We have various anti-takeover measures that could impede a takeover.

Our articles of incorporation include certain provisions that could make it more difficult to acquire us by means of a tender offer, a proxy contest, merger or otherwise. These provisions include certain non-monetary factors that our board of directors may consider when evaluating a takeover offer, and a requirement that any "Business Combination" be approved by the affirmative vote of no less than 66 2/3% of the total shares attributable to persons other than a "Control Person." These provisions may have the effect of lengthening the time required for a person to acquire control of us through a tender offer, proxy contest or otherwise, and may deter any potentially hostile offers or other efforts to obtain control of us. This could deprive our shareholders of opportunities to realize a premium for their Columbia common stock, even in circumstances where such action is favored by a majority of our shareholders.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.



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## ITEM 2. PROPERTIES

The Company's principal Columbia Bank properties include our corporate headquarters which is located at 13th & A Street, Tacoma, Washington, in Pierce County, where we occupy 62 thousand square feet of office space, 4 thousand square feet of commercial lending space and 750 square feet of branch space under various operating lease agreements, an operations facility in Lakewood, Washington, where we own 57 thousand square feet of office space and an office facility in Tacoma, Washington, that includes a branch where we occupy 26 thousand square feet under various operating lease agreements.

The Company's branch network as of December 31, 2011 is made up of 102 branches located throughout several Washington and Oregon counties. The number of branches per county, as well as whether it is owned or operated under a lease agreement is detailed in the following table.

County	Number of Branches	Occupancy Type	
		Owned	Leased
Pierce	23	15	8
King	13	8	5
Kitsap	6	3	3
Snohomish	5	5	—
Skagit	3	3	—
Other Washington Counties	27	16	11
Total Washington Branches	77	50	27
Clatsop (dba Bank of Astoria)	4	4	—
Tillamook (dba Bank of Astoria)	2	2	—
Clackamas	4	—	4
Multnomah	2	1	1
Deschutes	4	2	2
Other Oregon Counties	9	7	2
Total Oregon Branches	25	16	9
Total Columbia Bank Branches	102	66	36

For additional information concerning our premises and equipment and lease obligations, see Note 9 and 17, respectively, to the Consolidated Financial Statements in "Item 8. Financial Statements and Supplementary Data" of this report.

## ITEM 3. LEGAL PROCEEDINGS

The Company and its banking subsidiary are parties to routine litigation arising in the ordinary course of business. Management believes that, based on the information currently known to them, any liabilities arising from such litigation will not have a material adverse impact on the Company's financial condition, results of operations or cash flows.

## ITEM 4. MINE SAFETY DISCLOSURES

Not applicable

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## PART II

ITEM MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND  
5. ISSUER PURCHASES OF EQUITY SECURITIES

## Quarterly Common Stock Prices and Dividends

Our common stock is traded on the NASDAQ Global Select Market under the symbol "COLB". Quarterly high and low sales prices and dividend information for the last two years are presented in the following table. The prices shown do not include retail mark-ups, mark-downs or commissions:

2011	High	Low	Cash Dividends Declared		Total Cash Dividends Declared
			Regular	Special	
First quarter	\$22.14	\$17.91	\$0.03	\$—	\$0.03
Second quarter	\$19.95	\$16.56	0.05	—	0.05
Third quarter	\$18.14	\$14.01	0.06	—	0.06
Fourth quarter	\$19.76				