

CITY NATIONAL CORP  
Form 10-Q  
August 08, 2012  
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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

**FORM 10-Q**

(Mark One)

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

**For the quarterly period ended June 30, 2012**

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

**FOR THE TRANSITION PERIOD FROM TO**

**COMMISSION FILE NUMBER: 1-10521**

**CITY NATIONAL CORPORATION**

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

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**Delaware**  
(State of Incorporation)

**95-2568550**  
(I.R.S. Employer Identification No.)

**City National Plaza**  
**555 South Flower Street, Los Angeles, California, 90071**

(Address of principal executive offices)(Zip Code)

**(213) 673-7700**

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

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

Large accelerated filer ☒

Accelerated filer ☐

Non-accelerated filer ☐

Smaller reporting company ☐

(Do not check if a smaller reporting company)

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

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As of July 31, 2012, there were 53,570,205 shares of Common Stock outstanding (including unvested restricted shares).

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**CITY NATIONAL CORPORATION**  
**CONSOLIDATED BALANCE SHEETS**

| (in thousands, except share amounts)  | June 30,<br>2012<br>(Unaudited) | December 31,<br>2011 |
|---|---------------------------------|----------------------|
| <b>Assets</b>   |                                 |                      |
| Cash and due from banks   | \$ 162,893                      | \$ 168,376           |
| Due from banks - interest-bearing   | 106,109                         | 76,438               |
| Federal funds sold  | 162,000                         |                      |
| Securities available-for-sale - cost \$6,723,761 and \$7,445,999 at June 30, 2012 and December 31, 2011, respectively:          |                                 |                      |
| Securities pledged as collateral  | 42,789                          | 37,861               |
| Held in portfolio   | 6,823,092                       | 7,534,040            |
| Securities held-to-maturity - fair value \$1,127,053 and \$473,903 at June 30, 2012 and December 31, 2011, respectively         | 1,100,229                       | 467,680              |
| Trading securities  | 62,585                          | 61,975               |
| Loans and leases, excluding covered loans   | 13,507,209                      | 12,309,385           |
| Less: Allowance for loan and lease losses   | 269,534                         | 262,557              |
| Loans and leases, excluding covered loans, net  | 13,237,675                      | 12,046,828           |
| Covered loans, net of allowance for loan losses   | 1,216,988                       | 1,417,289            |
| Net loans and leases  | 14,454,663                      | 13,464,117           |
| Premises and equipment, net   | 147,245                         | 143,641              |
| Deferred tax asset  | 147,503                         | 155,529              |
| Goodwill  | 556,149                         | 486,383              |
| Customer-relationship intangibles, net  | 32,965                          | 36,370               |
| Affordable housing investments  | 145,582                         | 121,039              |
| Customers acceptance liability  | 1,746                           | 1,702                |
| Other real estate owned (\$82,834 and \$98,550 covered by FDIC loss share at June 30, 2012 and December 31, 2011, respectively) | 117,501                         | 129,340              |
| FDIC indemnification asset  | 170,654                         | 204,259              |
| Other assets  | 568,268                         | 577,541              |
| Total assets  | \$ 24,801,973                   | \$ 23,666,291        |
| <b>Liabilities</b>  |                                 |                      |
| Demand deposits   | \$ 12,187,075                   | \$ 11,146,627        |
| Interest checking deposits  | 1,849,588                       | 2,034,815            |
| Money market deposits   | 5,714,258                       | 5,954,886            |
| Savings deposits  | 368,544                         | 339,858              |
| Time deposits-under \$100,000   | 222,368                         | 251,782              |
| Time deposits-\$100,000 and over  | 767,219                         | 659,614              |
| Total deposits  | 21,109,052                      | 20,387,582           |
| Short-term borrowings   | 322,077                         | 50,000               |
| Long-term debt  | 712,280                         | 697,778              |
| Reserve for off-balance sheet credit commitments  | 24,351                          | 23,097               |
| Acceptances outstanding   | 1,746                           | 1,702                |
| Other liabilities   | 335,203                         | 316,640              |

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|   |               |               |
|---|---------------|---------------|
| Total liabilities   | 22,504,709    | 21,476,799    |
| <b>Redeemable noncontrolling interest</b>   | <b>41,899</b> | <b>44,643</b> |
| <b>Commitments and contingencies</b>  |               |               |
| <b>Shareholders' Equity</b>   |               |               |
| Common stock, par value \$1.00 per share; 75,000,000 shares authorized; 53,885,886 shares issued at June 30, 2012 and December 31, 2011 | 53,886        | 53,886        |
| Additional paid-in capital  | 491,439       | 489,200       |
| Accumulated other comprehensive income  | 82,807        | 72,372        |
| Retained earnings   | 1,686,163     | 1,611,969     |
| Treasury shares, at cost - 1,063,534 and 1,386,705 shares at June 30, 2012 and December 31, 2011, respectively                          | (58,930)      | (82,578)      |
| Total shareholders' equity  | 2,255,365     | 2,144,849     |
| Total liabilities and shareholders' equity  | \$ 24,801,973 | \$ 23,666,291 |

See accompanying Notes to the Unaudited Consolidated Financial Statements.

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**CITY NATIONAL CORPORATION**

**CONSOLIDATED STATEMENTS OF INCOME**

**(Unaudited)**

| (in thousands, except per share amounts)                                 | For the three months ended<br>June 30, |            | For the six months ended<br>June 30, |            |
|--|--|------------|--------------------------------------|------------|
|  | 2012                                   | 2011       | 2012                                 | 2011       |
| <b>Interest income</b>   |  |            |                                      |            |
| Loans and leases   | \$ 186,071                             | \$ 169,992 | \$ 354,173                           | \$ 332,931 |
| Securities   | 43,549                                 | 39,639     | 88,935                               | 77,058     |
| Due from banks - interest-bearing  | 173                                    | 407        | 266                                  | 705        |
| Federal funds sold and securities purchased under resale agreements      | 96                                     | 98         | 107                                  | 252        |
| Total interest income  | 229,889                                | 210,136    | 443,481                              | 410,946    |
| <b>Interest expense</b>  |  |            |                                      |            |
| Deposits   | 3,566                                  | 10,016     | 7,599                                | 20,206     |
| Federal funds purchased and securities sold under repurchase agreements  | 1                                      | 2          | 32                                   | 2          |
| Subordinated debt  | 4,308                                  | 4,635      | 8,369                                | 9,283      |
| Other long-term debt   | 5,535                                  | 4,656      | 10,289                               | 9,338      |
| Total interest expense   | 13,410                                 | 19,309     | 26,289                               | 38,829     |
| <b>Net interest income</b>   | 216,479                                | 190,827    | 417,192                              | 372,117    |
| Provision for credit losses on loans and leases, excluding covered loans | 1,000                                  |            | 1,000                                |            |
| Provision for losses on covered loans                                    | 13,293                                 | 1,716      | 20,759                               | 20,832     |
| Net interest income after provision                                      | 202,186                                | 189,111    | 395,433                              | 351,285    |
| <b>Noninterest income</b>  |  |            |                                      |            |
| Trust and investment fees  | 34,067                                 | 36,687     | 67,721                               | 72,325     |
| Brokerage and mutual fund fees   | 5,293                                  | 4,864      | 10,321                               | 10,525     |
| Cash management and deposit transaction charges                          | 11,475                                 | 10,905     | 22,643                               | 22,630     |
| International services   | 10,017                                 | 9,015      | 18,802                               | 17,331     |
| FDIC loss sharing expense, net   | (6,026)                                | (10,684)   | (5,160)                              | (2,079)    |
| Gain on disposal of assets   | 3,011                                  | 8,422      | 5,202                                | 10,846     |
| (Loss) gain on sale of securities  | (279)                                  | 1,689      | 170                                  | 1,819      |
| Gain on acquisition  |  | 8,164      |                                      | 8,164      |
| Other  | 17,388                                 | 23,169     | 30,947                               | 44,727     |
| Impairment loss on securities:   |  |            |                                      |            |
| Total other-than-temporary impairment loss on securities                 | (4,129)                                | (4,132)    | (4,129)                              | (4,296)    |
| Less: Portion of loss recognized in other comprehensive income           | 3,951                                  | 3,838      | 3,951                                | 3,838      |
| Net impairment loss recognized in earnings                               | (178)                                  | (294)      | (178)                                | (458)      |
| Total noninterest income   | 74,768                                 | 91,937     | 150,468                              | 185,830    |
| <b>Noninterest expense</b>   |  |            |                                      |            |
| Salaries and employee benefits   | 115,035                                | 112,139    | 235,280                              | 223,151    |
| Net occupancy of premises  | 14,056                                 | 13,665     | 27,742                               | 27,011     |
| Legal and professional fees  | 11,359                                 | 14,790     | 23,239                               | 24,867     |
| Information services   | 8,539                                  | 8,335      | 16,688                               | 15,832     |
| Depreciation and amortization  | 8,013                                  | 6,904      | 15,441                               | 13,652     |
| Amortization of intangibles  | 1,518                                  | 2,104      | 3,404                                | 4,272      |
| Marketing and advertising  | 7,597                                  | 7,626      | 14,413                               | 14,144     |
| Office services and equipment  | 4,492                                  | 4,672      | 8,440                                | 9,278      |
| Other real estate owned  | 7,541                                  | 22,162     | 19,635                               | 36,651     |

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|   |                  |                  |                   |                  |
|---|------------------|------------------|-------------------|------------------|
| FDIC assessments  | 4,523            | 8,524            | 9,002             | 18,330           |
| Other operating   | 11,843           | 10,911           | 21,952            | 22,041           |
| Total noninterest expense                                   | 194,516          | 211,832          | 395,236           | 409,229          |
| Income before income taxes                                  | 82,438           | 69,216           | 150,665           | 127,886          |
| Income taxes  | 27,271           | 20,650           | 48,990            | 38,536           |
| <b>Net income</b>   | <b>\$ 55,167</b> | <b>\$ 48,566</b> | <b>\$ 101,675</b> | <b>\$ 89,350</b> |
| Less: Net income attributable to noncontrolling interest    | 409              | 1,095            | 652               | 2,187            |
| <b>Net income attributable to City National Corporation</b> | <b>\$ 54,758</b> | <b>\$ 47,471</b> | <b>\$ 101,023</b> | <b>\$ 87,163</b> |
| Net income per share, basic                                 | \$ 1.02          | \$ 0.89          | \$ 1.88           | \$ 1.64          |
| Net income per share, diluted                               | \$ 1.01          | \$ 0.88          | \$ 1.87           | \$ 1.62          |
| Shares used to compute net income per share, basic          | 53,105           | 52,462           | 52,923            | 52,392           |
| Shares used to compute net income per share, diluted        | 53,373           | 52,977           | 53,217            | 52,931           |
| Dividends per share   | \$ 0.25          | \$ 0.20          | \$ 0.50           | \$ 0.40          |

See accompanying Notes to the Unaudited Consolidated Financial Statements.



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**CITY NATIONAL CORPORATION**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

**(Unaudited)**

| (in thousands)   | For the three months ended<br>June 30, |           | For the six months ended<br>June 30, |            |
|--|--|-----------|--------------------------------------|------------|
|  | 2012                                   | 2011      | 2012                                 | 2011       |
| Net income   | \$ 55,167                              | \$ 48,566 | \$ 101,675                           | \$ 89,350  |
| Other comprehensive income, net of tax:                            |  |           |                                      |            |
| Securities available for sale:                                     |  |           |                                      |            |
| Net unrealized gains arising during the period                     | 3,815                                  | 33,254    | 11,971                               | 23,541     |
| Reclassification adjustment for net gains included in net income   | (10)                                   | (1,048)   | (239)                                | (1,099)    |
| Non-credit related impairment loss                                 | (2,299)                                | (2,233)   | (2,299)                              | (2,233)    |
| Net change on cash flow hedges (1)                                 | (41)                                   | (248)     | (83)                                 | (834)      |
| Pension liability adjustment                                       |  | 33        | 1,085                                | 65         |
| Total other comprehensive income                                   | 1,465                                  | 29,758    | 10,435                               | 19,440     |
| Comprehensive income   | \$ 56,632                              | \$ 78,324 | \$ 112,110                           | \$ 108,790 |
| Less: Comprehensive income attributable to noncontrolling interest | 409                                    | 1,095     | 652                                  | 2,187      |
| Comprehensive income attributable to City National Corporation     | \$ 56,223                              | \$ 77,229 | \$ 111,458                           | \$ 106,603 |

(1) See Note 12 for additional information on other comprehensive income related to cash flow hedges.

See accompanying Notes to the Unaudited Consolidated Financial Statements.

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**CITY NATIONAL CORPORATION**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(Unaudited)**

| (in thousands)  | For the six months ended<br>June 30, |              |
|---|--------------------------------------|--------------|
|   | 2012                                 | 2011         |
| <b>Cash Flows From Operating Activities</b>   |                                      |              |
| Net income  | \$ 101,675                           | \$ 89,350    |
| Adjustments to net income:  |                                      |              |
| Provision for credit losses on loans and leases, excluding covered loans                | 1,000                                |              |
| Provision for losses on covered loans   | 20,759                               | 20,832       |
| Amortization of intangibles   | 3,404                                | 4,272        |
| Depreciation and amortization   | 15,441                               | 13,652       |
| Share-based employee compensation expense   | 8,968                                | 9,468        |
| Deferred income tax benefit   | 1,276                                | 2,686        |
| Gain on disposal of assets  | (5,202)                              | (10,846)     |
| Gain on sale of securities  | (170)                                | (1,819)      |
| Gain on acquisition   |                                      | (8,164)      |
| Impairment loss on securities   | 178                                  | 458          |
| Other, net  | (19,467)                             | (9,418)      |
| Net change in:  |                                      |              |
| Trading securities  | (851)                                | 129,818      |
| Other assets and other liabilities, net   | 40,111                               | 51,709       |
| Net cash provided by operating activities   | 167,122                              | 291,998      |
| <b>Cash Flows From Investing Activities</b>   |                                      |              |
| Purchase of securities available-for-sale   | (1,331,692)                          | (2,017,983)  |
| Sales of securities available-for-sale  | 5,189                                | 53,304       |
| Maturities and paydowns of securities available-for-sale                                | 2,031,596                            | 1,367,512    |
| Purchase of securities held-to-maturity   | (638,006)                            |              |
| Maturities and paydowns of securities held-to-maturity                                  | 4,617                                |              |
| Loan originations, net of principal collections   | (671,623)                            | (108,530)    |
| Net payments for premises and equipment   | (14,703)                             | (19,637)     |
| Net cash (paid) acquired in acquisitions  | (69,987)                             | 28,066       |
| Other investing activities, net   | 28,527                               | 59,628       |
| Net cash used in investing activities   | (656,082)                            | (637,640)    |
| <b>Cash Flows From Financing Activities</b>   |                                      |              |
| Net increase in deposits  | 721,470                              | 961,463      |
| Net increase in federal funds purchased and securities sold under repurchase agreements | 60,000                               |              |
| Net decrease in short-term borrowings, net of transfers from long-term debt             | (95,691)                             | (3,105)      |
| Net increase (decrease) in long-term debt   | 7,707                                | (757)        |
| Proceeds from exercise of stock options   | 9,044                                | 4,507        |
| Tax benefit from exercise of stock options  | 1,180                                | 992          |
| Cash dividends paid   | (26,632)                             | (21,211)     |
| Other financing activities, net   | (1,930)                              | (1,429)      |
| Net cash provided by financing activities   | 675,148                              | 940,460      |
| Net increase in cash and cash equivalents   | 186,188                              | 594,818      |
| Cash and cash equivalents at beginning of year  | 244,814                              | 434,689      |
| Cash and cash equivalents at end of period  | \$ 431,002                           | \$ 1,029,507 |
| <b>Supplemental Disclosures of Cash Flow Information:</b>                               |                                      |              |
| Cash paid during the period for:  |                                      |              |
| Interest  | \$ 25,674                            | \$ 40,129    |

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|  |    |           |    |           |
|--|----|-----------|----|-----------|
| Income taxes   |    | 30,373    |    | 26,072    |
| Non-cash investing activities:                         |    |           |    |           |
| Transfer of loans to other real estate owned           | \$ | 41,728    | \$ | 64,191    |
| Transfer of SERP liability to equity                   |    | 8,348     |    |           |
| Assets acquired (liabilities assumed) in acquisitions: |    |           |    |           |
| Securities available-for-sale                          | \$ |           | \$ | 10,441    |
| Loans and leases                                       |    | 318,301   |    |           |
| Covered loans  |    |           |    | 55,313    |
| Covered other real estate owned                        |    |           |    | 7,463     |
| Deposits   |    |           |    | (126,795) |
| Other borrowings                                       |    | (320,856) |    | (3,165)   |

See accompanying Notes to the Unaudited Consolidated Financial Statements.

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## CITY NATIONAL CORPORATION

## CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(Unaudited)

| (in thousands, except share amounts)                    | City National Corporation Shareholders' Equity |              |                            |   |                   |                 |                          | Total equity |
|---|--|--------------|----------------------------|---|-------------------|-----------------|--------------------------|--------------|
|   | Common shares issued                           | Common stock | Additional paid-in capital | Accumulated other comprehensive income (loss) | Retained earnings | Treasury shares | Non-controlling interest |              |
| Balance, January 1, 2011                                | 53,885,886                                     | \$ 53,886    | \$ 487,868                 | \$ 36,853                                     | \$ 1,482,037      | \$ (101,065)    | \$ 25,139                | \$ 1,984,718 |
| Net income (1)  |  |              |                            |   | 87,163            |                 | 1,067                    | 88,230       |
| Other comprehensive income, net of tax                  |  |              |                            | 19,440  |                   |                 |                          | 19,440       |
| Dividends and distributions to noncontrolling interest  |  |              |                            |   |                   |                 | (1,067)                  | (1,067)      |
| Issuance of shares under share-based compensation plans |  |              | (14,229)                   |   |                   | 16,754          |                          | 2,525        |
| Share-based employee compensation expense               |  |              | 9,363                      |   |                   |                 |                          | 9,363        |
| Tax benefit from share-based compensation plans         |  |              | 1,037                      |   |                   |                 |                          | 1,037        |
| Common stock dividends                                  |  |              |                            |   | (21,211)          |                 |                          | (21,211)     |
| Net change in deferred compensation plans               |  |              | 600                        |   |                   |                 |                          | 600          |
| Change in redeemable noncontrolling interest            |  |              | 349                        |   |                   |                 |                          | 349          |
| Other   |  |              | 76                         |   |                   |                 | (50)                     | 26           |
| Balance, June 30, 2011                                  | 53,885,886                                     | \$ 53,886    | \$ 485,064                 | \$ 56,293                                     | \$ 1,547,989      | \$ (84,311)     | \$ 25,089                | \$ 2,084,010 |
| Balance, January 1, 2012                                | 53,885,886                                     | \$ 53,886    | \$ 489,200                 | \$ 72,372                                     | \$ 1,611,969      | \$ (82,578)     |                          | \$ 2,144,849 |
| Net income (1)  |  |              |                            |   | 101,023           |                 |                          | 101,023      |
| Other comprehensive income, net of tax                  |  |              |                            | 10,435  |                   |                 |                          | 10,435       |
| Issuance of shares under share-based compensation plans |  |              | (16,506)                   |   |                   | 23,646          |                          | 7,140        |
| Share-based employee compensation expense               |  |              | 8,502                      |   |                   |                 |                          | 8,502        |
| Tax benefit from share-based compensation plans         |  |              | 400                        |   |                   |                 |                          | 400          |
| Common stock dividends                                  |  |              |                            |   | (26,829)          |                 |                          | (26,829)     |
| Net change in deferred compensation plans               |  |              | 703                        |   |                   | 2               |                          | 705          |
| Change in redeemable noncontrolling interest            |  |              | 792                        |   |                   |                 |                          | 792          |
| Other (2)   |  |              | 8,348                      |   |                   |                 |                          | 8,348        |
| Balance, June 30, 2012                                  | 53,885,886                                     | \$ 53,886    | \$ 491,439                 | \$ 82,807                                     | \$ 1,686,163      | \$ (58,930)     |                          | \$ 2,255,365 |

(1) Net income excludes net income attributable to redeemable noncontrolling interest of \$652 and \$1,120 for the six month periods ended June 30, 2012 and 2011, respectively. Redeemable noncontrolling interest is reflected in the mezzanine section of the consolidated balance sheets. See Note 17 of the Notes to the Unaudited Consolidated Financial Statements.

- (2) Conversion of pension liability to equity due to SERP amendment. See Note 14 for additional information.

See accompanying Notes to the Unaudited Consolidated Financial Statements.

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**CITY NATIONAL CORPORATION**

**NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**Note 1. Summary of Significant Accounting Policies**

*Organization*

City National Corporation (the "Corporation") is the holding company for City National Bank (the "Bank"). The Bank delivers banking, trust and investment services through 78 offices in Southern California, the San Francisco Bay area, Nevada, New York City, Nashville, Tennessee and Atlanta, Georgia. As of June 30, 2012, the Corporation had five consolidated investment advisory affiliates and one unconsolidated subsidiary, Business Bancorp Capital Trust I. Because the Bank comprises substantially all of the business of the Corporation, references to the "Company" mean the Corporation and the Bank together. The Corporation is approved as a financial holding company pursuant to the Gramm-Leach-Bliley Act of 1999.

*Consolidation*

The consolidated financial statements of the Company include the accounts of the Corporation, its non-bank subsidiaries, the Bank and the Bank's wholly owned subsidiaries, after the elimination of all material intercompany transactions. It also includes noncontrolling interest, which is the portion of equity in a subsidiary not attributable to a parent. Preferred stock of consolidated bank affiliates that is owned by third parties is reflected as Noncontrolling interest in the equity section of the consolidated balance sheets. This preferred stock was liquidated or redeemed in full by the Bank in the third quarter of 2011. Redeemable noncontrolling interest includes noncontrolling ownership interests that are redeemable at the option of the holder or outside the control of the issuer. The redeemable equity ownership interests of third parties in the Corporation's investment advisory affiliates are not considered to be permanent equity and are reflected as Redeemable noncontrolling interest in the mezzanine section between liabilities and equity in the consolidated balance sheets. Noncontrolling interests' share of subsidiary earnings is reflected as Net income attributable to noncontrolling interest in the consolidated statements of income.

The Company's investment management and wealth advisory affiliates are organized as limited liability companies. The Corporation generally owns a majority position in each affiliate and certain management members of each affiliate own the remaining shares. The Corporation has contractual arrangements with its affiliates whereby a percentage of revenue is allocable to fund affiliate operating expenses ("operating share") while the remaining portion of revenue ("distributable revenue") is allocable to the Corporation and the noncontrolling owners. All majority-owned affiliates that meet the prescribed criteria for consolidation are consolidated. The Corporation's interests in investment management affiliates in which it holds a noncontrolling share are accounted for using the equity method. Additionally, the Company has various interests in variable interest entities ("VIEs") that are not required to be consolidated. See Note 16 for a more detailed discussion on VIEs.

*Use of Estimates*

The Company's accounting and reporting policies conform to generally accepted accounting principles ( GAAP ) and practices in the financial services industry. To prepare the financial statements in conformity with GAAP, management must make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements, and income and expenses during the reporting period. Circumstances and events that differ significantly from those underlying the Company's estimates and assumptions could cause actual financial results to differ from those estimates. The material estimates included in the financial statements relate to the allowance for loan and lease losses, the reserve for off-balance sheet credit commitments, valuation of stock options and restricted stock, income taxes, goodwill and intangible asset impairment, securities impairment, private equity and alternative investment impairment, valuation of assets and liabilities acquired in business combinations, subsequent valuations of acquired impaired loans, Federal Deposit Insurance Corporation ( FDIC ) indemnification assets, valuation of noncontrolling interest and the valuation of financial assets and liabilities reported at fair value.

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**Note 1. Summary of Significant Accounting Policies (Continued)**

The Company has applied its critical accounting policies and estimation methods consistently in all periods presented in these financial statements. The Company's estimates and assumptions are expected to change as changes in market conditions and the Company's portfolio occur in subsequent periods.

*Basis of Presentation*

The Company is on the accrual basis of accounting for income and expenses. The results of operations reflect any adjustments, all of which are of a normal recurring nature, unless otherwise disclosed in this Form 10-Q, and which, in the opinion of management, are necessary for a fair presentation of the results for the periods presented. In accordance with the usual practice of banks, assets and liabilities of individual trust, agency and fiduciary funds have not been included in the financial statements. These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011.

The results for the 2012 interim period are not necessarily indicative of the results expected for the full year. The Company has not made any significant changes in its critical accounting policies or in its estimates and assumptions from those disclosed in its 2011 Annual Report other than the adoption of new accounting pronouncements and other authoritative guidance that became effective for the Company on or after January 1, 2012. Refer to *Accounting Pronouncements* for discussion of accounting pronouncements adopted in 2012.

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

*Accounting Pronouncements*

During the six months ended June 30, 2012, the following accounting pronouncements applicable to the Company were issued or became effective:

- In April 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2011-03, *Transfers and Servicing (Topic 860): Reconsideration of Effective Control for Repurchase Agreements* (ASU 2011-03). Accounting Standards Codification (ASC) Topic 860, *Transfers and Servicing*, provides the criteria for determining whether a transfer of financial assets under a repurchase agreement is accounted for as a secured borrowing or as a sale. In a typical repurchase transaction, an entity transfers financial assets to a counterparty in exchange for cash with an agreement for the counterparty to return the same or equivalent financial assets for a fixed price in the future. Under the guidance, an entity that maintains effective control over transferred assets must account for the transfer as a secured borrowing. ASU 2011-03 eliminates the requirement for entities to consider whether a transferor has the ability to repurchase the financial assets in a repurchase agreement for purposes of determining whether the transferor has maintained effective control. The ASU does not change the other criteria applicable to the assessment of effective control. Adoption of ASU 2011-03 on January 1, 2012 did not have a material effect on the Company's consolidated financial statements.



- In May 2011, the FASB issued ASU 2011-04, *Fair Value Measurements (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs* ( ASU 2011-04 ). ASU 2011-04 represents the converged guidance of the FASB and International Accounting Standards Board on fair value. The new guidance establishes a common framework for measuring fair value and for disclosing information about fair value measurements. While ASU 2011-04 is largely consistent with existing fair value measurement principles, it does expand disclosure requirements and amends certain guidance. Under the revised guidance, the highest and best use and valuation premise concepts only apply to measuring the fair value of nonfinancial assets. The highest and best use of a nonfinancial asset is one that is physically possible, legally permissible and financially feasible. The valuation premise guidance provides that the highest and best use of a nonfinancial asset is either on a stand-alone basis or in combination with other assets as a group. The ASU provides a framework for considering whether a premium or discount can be applied in a fair value measurement and provides a model for measuring the fair value of an instrument classified in shareholders' equity. ASU 2011-04 requires entities to make an accounting policy election regarding fair value measurements of financial assets and liabilities, such as derivatives, for which the exposure to market or counterparty credit risks is managed on a net or portfolio basis.

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**Note 1. Summary of Significant Accounting Policies (Continued)**

The Company elected to continue measuring derivative instruments that are subject to master netting agreements on the net risk exposure at the measurement date.

The expanded disclosure requirements include more detailed disclosures about the valuation processes used in fair value measurements within Level 3 of the fair value hierarchy, and categorization by level of the fair value hierarchy for items that are not measured at fair value in the statement of financial position but for which fair value is required to be disclosed in accordance with ASC Topic 825, *Financial Instruments*. The Company adopted ASU 2011-04 and expanded its disclosures starting with its first quarter 2012 reporting. Adoption of the new guidance did not have a significant impact on the Company's consolidated financial statements.

- In June 2011, the FASB issued ASU 2011-05, *Comprehensive Income (Topic 220), Presentation of Comprehensive Income* (ASU 2011-05). ASU 2011-05 revises the manner in which entities present comprehensive income in their financial statements. The new guidance requires entities to report components of comprehensive income in either (1) a continuous statement of comprehensive income or (2) two separate but consecutive statements. Under the two-statement approach, the first statement would include components of net income, which is consistent with the income statement format used today, and the second statement would include components of other comprehensive income. In December 2011, the FASB issued ASU 2011-12, *Comprehensive Income (Topic 220), Deferral of the Effective Date for Amendments to the Presentation of Reclassification of Items out of Accumulated Other Comprehensive Income in ASU 2011-05* (ASU 2011-12). ASU 2011-12 indefinitely defers the provision of ASU 2011-05 that would have required entities to present reclassification adjustments out of accumulated other comprehensive income (AOCI) by component in both the statement in which net income is presented and the statement in which other comprehensive income is presented. ASU 2011-05 and ASU 2011-12 became effective for the Company for first quarter 2012 reporting. The Company elected to report components of comprehensive income in two separate but consecutive statements. The new guidances were applied retrospectively for all periods presented.

**Note 2. Business Combinations**

*First American Equipment Finance*

The Company acquired First American Equipment Finance (FAEF), a privately owned equipment leasing company, in an all-cash transaction on April 30, 2012. Headquartered in Rochester, New York, FAEF leases technology and office equipment nationwide. Its clients include educational institutions, hospitals and health systems, large law firms, insurance underwriters, enterprise businesses, professional service businesses and nonprofit organizations. FAEF operates as a wholly owned subsidiary of the Bank.

Excluding the effects of acquisition accounting adjustments, the Company acquired approximately \$343.0 million in assets and assumed \$325.0 million in liabilities. The Company acquired lease receivables with a fair value of \$318.3 million and assumed borrowings and nonrecourse debt with a fair value of \$320.9 million. The Company recognized goodwill of approximately \$68.4 million and acquisition-related expense of \$0.6 million. This expense is included in Legal and professional fees in the consolidated statements of income.

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The consolidated statement of income for 2012 includes the operating results produced by the acquired assets and assumed liabilities of FAEF from its acquisition date through June 30, 2012, which are not material to total operating results for the three and six month periods ended June 30, 2012. Further, the historical results of the acquired entity are not material to the Company's results, and consequently, no pro forma information is presented.

### *Nevada Commerce Bank*

On April 8, 2011, the Bank acquired the banking operations of Nevada Commerce Bank ( NCB ), based in Las Vegas, Nevada, in a purchase and assumption agreement with the FDIC. Excluding the effects of acquisition accounting adjustments, the Bank acquired approximately \$138.9 million in assets and assumed \$121.9 million in liabilities. The Bank acquired most of NCB's assets, including loans and other real estate owned ( OREO ) with a fair value of \$56.4 million and \$7.5 million, respectively, and assumed deposits with a fair value of \$118.4 million. The Bank received approximately \$2.7 million in cash from the FDIC at acquisition and recognized a gain of \$8.2 million on the acquisition of NCB in the second quarter of 2011.

In connection with the acquisition of NCB, the Bank entered into loss-sharing agreements with the FDIC under which the FDIC will reimburse the Bank for 80 percent of eligible losses with respect to covered assets. Covered assets include acquired loans ( covered loans ) and OREO ( covered OREO ) that are covered under loss-sharing agreements with the FDIC.

Table of Contents**Note 2. Business Combinations (Continued)**

The term of the loss-sharing agreements is 10 years for single-family residential loans and eight years for all other loans. The expected reimbursements under the loss-sharing agreements were recorded as an indemnification asset at their estimated fair value of \$33.8 million. The difference between the fair value of the FDIC indemnification asset and the undiscounted cash flow the Bank expects to collect from the FDIC is accreted into noninterest income.

**Note 3. Fair Value Measurements**

The following tables summarize assets and liabilities measured at fair value as of June 30, 2012 and December 31, 2011 by level in the fair value hierarchy:

| (in thousands)                           | Fair Value Measurements at Reporting Date Using |   |  |  |
|--|---|---|--|--|
|  | Balance as of<br>June 30, 2012                  | Quoted Prices in<br>Active Markets<br>Level 1 | Significant Other<br>Observable<br>Inputs<br>Level 2 | Significant<br>Unobservable<br>Inputs<br>Level 3 |
| Measured on a Recurring Basis            |   |   |  |  |
| Assets                                   |   |   |  |  |
| Securities available-for-sale:           |   |   |  |  |
| U.S. Treasury                            | \$ 17,208                                       | \$ 17,208                                     | \$   | \$   |
| Federal agency - Debt                    | 999,207   |   | 999,207  |  |
| Federal agency - MBS                     | 691,672   |   | 691,672  |  |
| CMOs - Federal agency                    | 4,477,264                                       |   | 4,477,264  |  |
| CMOs - Non-agency                        | 65,466  |   | 65,466   |  |
| State and municipal                      | 383,650   |   | 336,483  | 47,167   |
| Other debt securities                    | 229,908   |   | 210,724  | 19,184   |
| Equity securities and mutual funds       | 1,506   | 1,506   |  |  |
| Trading securities                       | 62,585  | 55,034  | 7,551  |  |
| Mark-to-market derivatives (1)           | 66,659  | 3,177   | 63,482   |  |
| Total assets at fair value               | \$ 6,995,125                                    | \$ 76,925                                     | \$ 6,851,849   | \$ 66,351  |
| Liabilities                              |   |   |  |  |
| Mark-to-market derivatives (2)           | \$ 61,400                                       | \$ 1,690                                      | \$ 59,710  | \$   |
| Other liabilities                        | 417   |   | 417  |  |
| Total liabilities at fair value          | \$ 61,817                                       | \$ 1,690                                      | \$ 60,127  | \$   |
| Measured on a Nonrecurring Basis         |   |   |  |  |
| Assets                                   |   |   |  |  |
| Collateral dependent impaired loans (3): |   |   |  |  |
| Commercial (4)                           | \$ 1,671  | \$  | \$   | \$ 1,671   |
| Commercial real estate mortgages         | 13,238  |   | 12,565   | 673  |
| Residential mortgages                    | 7,899   |   | 7,435  | 464  |
| Real estate construction                 | 7,499   |   |  | 7,499  |
| Equity lines of credit                   | 790   |   |  | 790  |
| Installment                              | 550   |   | 550  |  |
| Other real estate owned (5)              | 48,550  |   | 37,865   | 10,685   |

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|  |       |        |       |           |
|--|-------|--------|-------|-----------|
| Private equity and alternative investments | 3,455 |        | 3,455 |           |
| <b>Total assets at fair value</b>          | \$    | 83,652 | \$    | 58,415    |
|  |       |        |       | \$ 25,237 |

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- (1) Reported in Other assets in the consolidated balance sheets.
- (2) Reported in Other liabilities in the consolidated balance sheets.
- (3) Impaired loans for which fair value was calculated using the collateral valuation method.
- (4) Includes lease financing.
- (5) Other real estate owned balance of \$117.5 million in the consolidated balance sheets includes \$82.8 million of covered OREO and is net of estimated disposal costs.

Table of Contents**Note 3. Fair Value Measurements (Continued)**

| (in thousands)                                   | Fair Value Measurements at Reporting Date Using |   |  |  |
|--|---|---|--|--|
|  | Balance as of<br>December 31,<br>2011           | Quoted Prices in<br>Active Markets<br>Level 1 | Significant Other<br>Observable<br>Inputs<br>Level 2 | Significant<br>Unobservable<br>Inputs<br>Level 3 |
| <b>Measured on a Recurring Basis</b>             |   |   |  |  |
| <b>Assets</b>                                    |   |   |  |  |
| Securities available-for-sale:                   |   |   |  |  |
| U.S. Treasury                                    | \$ 19,182                                       | \$ 19,182                                     | \$   | \$   |
| Federal agency - Debt                            | 1,973,862                                       |   | 1,973,862  |  |
| Federal agency - MBS                             | 681,044   |   | 681,044  |  |
| CMOs - Federal agency                            | 4,326,907                                       |   | 4,326,907  |  |
| CMOs - Non-agency                                | 69,001  |   | 69,001   |  |
| State and municipal                              | 401,604   |   | 401,604  |  |
| Other debt securities                            | 99,074  |   | 79,491   | 19,583   |
| Equity securities and mutual funds               | 1,227   | 1,227   |  |  |
| Trading securities                               | 61,975  | 61,922  | 53   |  |
| Mark-to-market derivatives (1)                   | 62,230  | 2,552   | 59,678   |  |
| <b>Total assets at fair value</b>                | <b>\$ 7,696,106</b>                             | <b>\$ 84,883</b>                              | <b>\$ 7,591,640</b>                                  | <b>\$ 19,583</b>                                 |
| <b>Liabilities</b>                               |   |   |  |  |
| Mark-to-market derivatives (2)                   | \$ 52,881                                       | \$ 1,542                                      | \$ 51,339  | \$   |
| Other liabilities                                | 263   |   | 263  |  |
| <b>Total liabilities at fair value</b>           | <b>\$ 53,144</b>                                | <b>\$ 1,542</b>                               | <b>\$ 51,602</b>                                     | <b>\$</b>  |
| <b>Measured on a Nonrecurring Basis</b>          |   |   |  |  |
| <b>Assets</b>                                    |   |   |  |  |
| Collateral dependent impaired loans (3):         |   |   |  |  |
| Commercial (4)                                   | \$ 2,484  | \$  | \$   | \$ 2,484   |
| Commercial real estate mortgages                 | 6,830   |   | 6,830  |  |
| Residential mortgages                            | 5,555   |   | 5,084  | 471  |
| Real estate construction                         | 18,528  |   | 9,680  | 8,848  |
| Equity lines of credit                           | 3,471   |   | 2,588  | 883  |
| Installment                                      | 675   |   | 675  |  |
| Collateral dependent impaired covered loans (3): |   |   |  |  |
| Commercial                                       | 422   |   |  | 422  |
| Other real estate owned (5)                      | 66,837  |   | 56,898   | 9,939  |
| Private equity and alternative investments       | 6,558   |   |  | 6,558  |
| <b>Total assets at fair value</b>                | <b>\$ 111,360</b>                               | <b>\$</b>                                     | <b>\$ 81,755</b>                                     | <b>\$ 29,605</b>                                 |

(1) Reported in Other assets in the consolidated balance sheets.

(2) Reported in Other liabilities in the consolidated balance sheets.

(3) Impaired loans for which fair value was calculated using the collateral valuation method.

(4) Includes lease financing.

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(5) Other real estate owned balance of \$129.3 million in the consolidated balance sheets includes \$98.6 million of covered OREO and is net of estimated disposal costs.

Table of Contents**Note 3. Fair Value Measurements (Continued)**

At June 30, 2012, \$7.00 billion, or approximately 28 percent, of the Company's total assets were recorded at fair value on a recurring basis, compared with \$7.70 billion, or 33 percent, at December 31, 2011. The majority of these financial assets were valued using Level 1 or Level 2 inputs. Less than 1 percent of total assets were measured using Level 3 inputs. At June 30, 2012, \$61.8 million of the Company's total liabilities were recorded at fair value using Level 1 or Level 2 inputs, compared with \$53.1 million at December 31, 2011. There were no transfers between Level 1 and Level 2 of the fair value hierarchy for assets or liabilities measured on a recurring basis during the six months ended June 30, 2012. At June 30, 2012, \$83.7 million, or approximately 0.3 percent, of the Company's total assets, were recorded at fair value on a nonrecurring basis, compared with \$111.4 million, or approximately 0.5 percent, at December 31, 2011. These assets were measured using Level 2 and Level 3 inputs.

*Recurring Fair Value Measurements*

Assets and liabilities for which fair value measurement is based on significant unobservable inputs are classified as Level 3 in the fair value hierarchy. The following table provides a reconciliation of the beginning and ending balances for Level 3 assets measured at fair value on a recurring basis for the six months ended June 30, 2012 and 2011.

**Level 3 Assets Measured on a Recurring Basis**

| (in thousands)                            | For the six months ended         |                                  |
|---|----------------------------------|----------------------------------|
|   | June 30, 2012                    | June 30, 2011                    |
|   | Securities<br>Available-for-Sale | Securities<br>Available-for-Sale |
| Balance, beginning of period              | \$ 19,583                        | \$ 20,982                        |
| Total realized/unrealized gains (losses): |                                  |                                  |
| Included in other comprehensive income    | 1,221                            | 1,585                            |
| Settlements                               | (1,664)                          | (1,728)                          |
| Transfers into Level 3                    | 47,165                           |                                  |
| Other (1)                                 | 46                               | (33)                             |
| Balance, end of period                    | \$ 66,351                        | \$ 20,806                        |

(1) Other rollforward activity consists of amortization of premiums and accretion of discounts recognized on the initial purchase of the securities available-for-sale.

Level 3 assets measured at fair value on a recurring basis consist of municipal auction rate securities and collateralized debt obligation senior notes that are included in securities available-for-sale. During the six months ended June 30, 2012, municipal auction rate securities totaling \$47.2 million were transferred from Level 2 to Level 3 of the fair value hierarchy as a result of a change in the method used to value these securities. The valuation methodology was revised due to the prolonged period of inactivity in the market for auction rate securities. At June 30, 2012, these securities were valued using an average yield on California variable rate notes that were comparable in credit rating and maturity to the securities held, plus a liquidity premium. Senior notes totaling \$19.2 million at June 30, 2012 were valued using the discounted cash flow



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method with the following unobservable inputs: (1) risk-adjusted discount rate consistent with similarly-rated securities, (2) prepayment rate of 2 percent, (3) default rate of 0.75 percent of performing collateral, and (4) 15 percent recovery rate with a 2-year lag. The Company had no liabilities with fair value measurements categorized as Level 3 at June 30, 2012 or 2011.

There were no purchases, sales, or transfers out of Level 3 assets measured on a recurring basis during the six months ended June 30, 2012 and 2011. Paydowns of \$1.7 million were received on Level 3 assets measured on a recurring basis for the six months ended June 30, 2012 and 2011, respectively. There were no gains or losses for the six months ended June 30, 2012 and 2011 included in earnings that were attributable to the change in unrealized gains or losses relating to Level 3 assets still held as of June 30, 2012 and 2011.

Table of Contents**Note 3. Fair Value Measurements (Continued)***Nonrecurring Fair Value Measurements*

Assets measured at fair value on a nonrecurring basis using significant unobservable inputs include certain collateral dependent impaired loans, OREO for which fair value is not solely based on market observable inputs, and certain private equity and alternative investments. Private equity and alternative investments do not have readily determinable fair values. These investments are carried at cost and evaluated for impairment on a quarterly basis. Due to the lack of readily determinable fair values for these investments, the impairment assessment is based primarily on a review of investment performance and the likelihood that the capital invested would be recovered.

The table below provides information about valuation method, inputs and assumptions for nonrecurring Level 3 fair value measurements. The weight assigned to each input is based on the facts and circumstances that exist at the date of measurement.

**Information About Nonrecurring Level 3 Fair Value Measurements**

| (in thousands)                             | Fair Value at<br>June 30, 2012 | Valuation<br>Method | Unobservable Inputs  |
|--|--------------------------------|---------------------|--|
| Collateral dependent impaired loans        | \$ 11,097                      | Market              | <ul style="list-style-type: none"> <li>- Adjustments to external or internal appraised values</li> <li>- Probability weighting of broker price opinions</li> <li>- Management assumptions regarding market trends or other relevant factors</li> </ul> |
| Other real estate owned                    | \$ 10,685                      | Market              | <ul style="list-style-type: none"> <li>- Adjustments to external or internal appraised values</li> <li>- Probability weighting of broker price opinions</li> <li>- Management assumptions regarding market trends or other relevant factors</li> </ul> |
| Private equity and alternative investments | \$ 3,455                       | Cost Recovery       | <ul style="list-style-type: none"> <li>- Management's assumptions regarding recoverability of investment based on fund financial performance, market conditions and other relevant factors</li> </ul>  |

Market-based valuation methods use prices and other relevant information generated by market transactions involving identical or comparable assets. Under the cost recovery approach, fair value represents an estimate of the amount of an asset expected to be recovered. The Company only employs the cost recovery approach for assets that are not readily marketable and for which minimal market-based information exists.

Table of Contents**Note 3. Fair Value Measurements (Continued)**

For assets measured at fair value on a nonrecurring basis, the following table presents the total net (losses) gains, which include charge-offs, recoveries, specific reserves, OREO valuation write-downs and write-ups, gains and losses on sales of OREO, and impairment write-downs on private equity investments, recognized in the three and six months ended June 30, 2012 and 2011:

| (in thousands)                             | For the three months ended<br>June 30, |             | For the six months ended<br>June 30, |             |
|--|--|-------------|--------------------------------------|-------------|
|  | 2012                                   | 2011        | 2012                                 | 2011        |
| Collateral dependent impaired loans:       |  |             |                                      |             |
| Commercial                                 | \$                                     | \$          | \$ (367)                             | \$ (606)    |
| Commercial real estate mortgages           | (1,572)                                | 340         | (1,937)                              | 7,454       |
| Residential mortgages                      | (540)                                  | (47)        | (1,122)                              | (189)       |
| Real estate construction                   | (281)                                  | (3,417)     | (6,753)                              | (1,199)     |
| Equity lines of credit                     | (115)                                  | (546)       | (62)                                 | (510)       |
| Installment                                |  | 197         | (107)                                | (4,317)     |
| Other real estate owned (1)                | (3,700)                                | (16,869)    | (12,165)                             | (25,991)    |
| Private equity and alternative investments | (333)                                  | (200)       | (460)                                | (200)       |
| Total net losses recognized                | \$ (6,541)                             | \$ (20,542) | \$ (22,973)                          | \$ (25,558) |

(1) Net losses on OREO includes \$3.5 million and \$11.0 million of net losses related to covered OREO for the three and six months ended June 30, 2012, respectively, and \$14.6 million and \$22.8 million of net losses for the three and six months ended June 30, 2011, respectively. A significant portion of net losses on covered OREO is reimbursable by the FDIC.

*Fair Value of Financial Instruments*

A financial instrument is broadly defined as cash, evidence of an ownership interest in another entity, or a contract that imposes a contractual obligation on one entity and conveys a corresponding right to a second entity to require delivery or exchange of a financial instrument. The table below summarizes the estimated fair values for the Company's financial instruments as of June 30, 2012 and December 31, 2011. The table also provides information on the level in the fair value hierarchy for inputs used in the fair value of financial assets and financial liabilities. Refer to Note 1, *Summary of Significant Accounting Policies*, in the Company's 2011 Form 10-K for additional information on fair value measurements. Most financial assets and financial liabilities for which carrying amount equals fair value are considered by the Company to be Level 1 measurements in the fair value hierarchy. Additional detail on assets and liabilities that are categorized in multiple levels of the fair value hierarchy is provided in the above tables of this Note.

The disclosure does not include estimated fair value amounts for assets and liabilities which are not defined as financial instruments but which have significant value. These assets and liabilities include the value of customer-relationship intangibles, goodwill, affordable housing investments carried at cost, other assets, deferred taxes and other liabilities. Accordingly, the total of the fair values presented does not represent the underlying value of the Company.

Following is a description of the methods and assumptions used in estimating the fair values for each class of financial instrument:

*Cash and due from banks, Due from banks interest bearing and Federal funds sold* For these short-term instruments, the carrying amount is a reasonable estimate of fair value.

*Securities available-for-sale, Securities held-to-maturity and Trading securities* For securities held as available-for-sale and held-to-maturity, the fair value is determined by quoted market prices, where available, or on observable market inputs appropriate for the type of security. If quoted market prices or observable market inputs are not available, discounted cash flows or market valuations of comparable securities with similar credit risk and maturities may be used to determine an appropriate fair value. Fair values for trading securities are based on quoted market prices or dealer quotes. The fair value of trading securities for which quoted prices are not available is based on observable market inputs.

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**Note 3. Fair Value Measurements (Continued)**

*Loans and leases* Loans and leases, excluding covered loans, are not recorded at fair value on a recurring basis. Nonrecurring fair value adjustments are periodically recorded on impaired loans that are measured for impairment based on the fair value of collateral. Due to the lack of activity in the secondary market for the types of loans in the Company's portfolio, a model-based approach is used for determining the fair value of loans for purposes of the disclosures in the following table. The fair value of loans is estimated by discounting future cash flows using discount rates that incorporate the Company's assumptions concerning current market yields, credit risk and liquidity premiums. Loan cash flow projections are based on contractual loan terms adjusted for the impact of current interest rate levels on borrower behavior, including prepayments. Loan prepayment assumptions are based on industry standards for the type of loans being valued. Projected cash flows are discounted using yield curves based on current market conditions. Yield curves are constructed by product type using the Bank's loan pricing model for like-quality credits. The discount rates used in the Company's model represent the rates the Bank would offer to current borrowers for like-quality credits. These rates could be different from what other financial institutions could offer for these loans.

*Covered loans* The fair value of covered loans is based on estimates of future loan cash flows and appropriate discount rates, which incorporate the Company's assumptions about market funding cost and liquidity premium. The estimates of future loan cash flows are determined using the Company's assumptions concerning the amount and timing of principal and interest payments, prepayments and credit losses.

*FDIC indemnification asset* The fair value of the FDIC indemnification asset is estimated by discounting estimated future cash flows based on estimated current market rates.

*Investment in FHLB and FRB stock* Investments in government agency stock are recorded at cost. Ownership of these securities is restricted to member banks and the securities do not have a readily determinable market value. Purchases and sales of these securities are at par value with the issuer. The fair value of investments in FRB and FHLB stock is equal to the carrying amount.

*Derivative contracts* The fair value of non-exchange traded (over-the-counter) derivatives is obtained from third party market sources. The Company provides client data to the third party source for purposes of calculating the credit valuation component of the fair value measurement of client derivative contracts. The fair values of interest rate contracts include interest receivable and payable and cash collateral, if any.

*Deposits* The fair value of demand and interest checking deposits, savings deposits, and certain money market accounts is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposit (CD) is determined by discounting expected future cash flows using the rates offered by the Bank for deposits of similar type and remaining maturity at the measurement date. This value is compared to the termination value of each CD given the Bank's standard early withdrawal penalties. The fair value reported is the higher of the discounted present value of each CD and the termination value after the recovery of prepayment penalties. The Bank reviews pricing for its CD products weekly. This review gives consideration to market pricing for products of similar type and maturity offered by other financial institutions.

*Federal funds purchased and Securities sold under repurchase agreements* The carrying amount is a reasonable estimate of fair value.

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*Other short-term borrowings* The fair value of the current portion of long-term debt classified in short-term borrowings is obtained through third-party pricing sources. The fair value of nonrecourse debt is determined by discounting estimated future cash flows based on estimated current market rates. The carrying amount of the remaining other short-term borrowings is a reasonable estimate of fair value.

*Long-term debt* The fair value of long-term debt, excluding nonrecourse debt, is obtained through third-party pricing sources. The fair value of nonrecourse debt is determined by discounting estimated future cash flows based on estimated current market rates.

Table of Contents**Note 3. Fair Value Measurements (Continued)**

*FDIC clawback liability* The FDIC clawback liability represents an estimated payment by the Company to the FDIC if actual cumulative losses on acquired covered assets are lower than the cumulative losses originally estimated by the FDIC at the time of acquisition. The fair value of the FDIC clawback liability is estimated by discounting estimated future cash flows based on estimated current market rates.

Off-balance sheet commitments, which include commitments to extend credit, are excluded from the table below. A reasonable estimate of fair value for these instruments is the carrying amount of deferred fees and the reserve for any credit losses related to these off-balance sheet instruments. This estimate is not material to the Company's financial position.

|   |                  | June 30, 2012   |             | December 31, 2011 |             |
|---|------------------|-----------------|-------------|-------------------|-------------|
| (in millions)   | Fair Value Level | Carrying Amount | Fair Value  | Carrying Amount   | Fair Value  |
| Financial Assets:   |                  |                 |             |                   |             |
| Cash and due from banks   | 1                | \$ 162.9        | \$ 162.9    | \$ 168.4          | \$ 168.4    |
| Due from banks - interest bearing                                       | 1                | 106.1           | 106.1       | 76.4              | 76.4        |
| Federal funds sold  | 1                | 162.0           | 162.0       |                   |             |
| Securities available-for-sale   | 1, 2, 3          | 6,865.9         | 6,865.9     | 7,571.9           | 7,571.9     |
| Securities held-to-maturity   | 2                | 1,100.2         | 1,127.1     | 467.7             | 473.9       |
| Trading securities  | 1, 2             | 62.6            | 62.6        | 62.0              | 62.0        |
| Loans and leases, net of allowance                                      | 3                | 13,237.7        | 13,694.6    | 12,046.8          | 12,400.5    |
| Covered loans, net of allowance   | 3                | 1,217.0         | 1,282.2     | 1,417.3           | 1,472.6     |
| FDIC indemnification asset  | 3                | 170.7           | 149.4       | 204.3             | 184.3       |
| Investment in FHLB and FRB stock  | 2                | 99.7            | 99.7        | 107.4             | 107.4       |
| Derivative assets   | 1, 2             | 66.7            | 66.7        | 62.2              | 62.2        |
|   |                  |                 |             |                   |             |
| Financial Liabilities:  |                  |                 |             |                   |             |
| Deposits  | 2, 3             | \$ 21,109.1     | \$ 21,112.9 | \$ 20,387.6       | \$ 20,392.3 |
| Federal funds purchased and securities sold under repurchase agreements | 1                | 110.0           | 110.0       | 50.0              | 50.0        |
| Other short-term borrowings   | 2, 3             | 212.1           | 216.0       |                   |             |
| Long-term debt  | 2, 3             | 712.3           | 758.2       | 697.8             | 718.7       |
| Derivative liabilities  | 1, 2             | 61.4            | 61.4        | 52.9              | 52.9        |
| FDIC clawback liability   | 3                | 9.2             | 9.2         | 8.1               | 8.1         |

**Note 4. Securities**

At June 30, 2012, the Company had total securities of \$8.03 billion, comprised of securities available-for-sale at fair value of \$6.87 billion, securities held-to-maturity at amortized cost of \$1.10 billion and trading securities at fair value of \$62.6 million. At December 31, 2011, the Company had total securities of \$8.10 billion, comprised of securities available-for-sale at fair value of \$7.57 billion, securities held-to-maturity at amortized cost of \$467.7 million and trading securities at fair value of \$62.0 million.





Table of Contents**Note 4. Securities (Continued)**

The following is a summary of amortized cost and estimated fair value for the major categories of securities available-for-sale and securities held-to-maturity at June 30, 2012 and December 31, 2011:

| (in thousands)                          | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair Value   |
|---|-------------------|------------------------------|-------------------------------|--------------|
| <b>June 30, 2012</b>                    |                   |                              |                               |              |
| <b>Securities available-for-sale:</b>   |                   |                              |                               |              |
| U.S. Treasury                           | \$ 17,223         | \$ 1                         | \$ (16)                       | \$ 17,208    |
| Federal agency - Debt                   | 994,268           | 4,954                        | (15)                          | 999,207      |
| Federal agency - MBS                    | 655,384           | 36,288                       |                               | 691,672      |
| CMOs - Federal agency                   | 4,388,817         | 89,297                       | (850)                         | 4,477,264    |
| CMOs - Non-agency                       | 70,702            | 839                          | (6,075)                       | 65,466       |
| State and municipal                     | 365,236           | 18,515                       | (101)                         | 383,650      |
| Other debt securities                   | 231,795           | 5,291                        | (7,178)                       | 229,908      |
| Total debt securities                   | 6,723,425         | 155,185                      | (14,235)                      | 6,864,375    |
| Equity securities and mutual funds      | 336               | 1,170                        |                               | 1,506        |
| Total securities available-for-sale     | \$ 6,723,761      | \$ 156,355                   | \$ (14,235)                   | \$ 6,865,881 |
| <b>Securities held-to-maturity (1):</b> |                   |                              |                               |              |
| Federal agency - Debt                   | \$ 103,439        | \$ 2,002                     | \$                            | \$ 105,441   |
| Federal agency - MBS                    | 200,763           | 5,520                        | (99)                          | 206,184      |
| CMOs - Federal agency                   | 642,102           | 18,384                       | (22)                          | 660,464      |
| State and municipal                     | 153,925           | 2,248                        | (1,209)                       | 154,964      |
| Total securities held-to-maturity       | \$ 1,100,229      | \$ 28,154                    | \$ (1,330)                    | \$ 1,127,053 |
| <b>December 31, 2011</b>                |                   |                              |                               |              |
| <b>Securities available-for-sale:</b>   |                   |                              |                               |              |
| U.S. Treasury                           | \$ 19,163         | \$ 24                        | \$ (5)                        | \$ 19,182    |
| Federal agency - Debt                   | 1,967,928         | 6,230                        | (296)                         | 1,973,862    |
| Federal agency - MBS                    | 650,091           | 31,040                       | (87)                          | 681,044      |
| CMOs - Federal agency                   | 4,239,205         | 89,926                       | (2,224)                       | 4,326,907    |
| CMOs - Non-agency                       | 79,999            | 322                          | (11,320)                      | 69,001       |
| State and municipal                     | 383,210           | 18,767                       | (373)                         | 401,604      |
| Other debt securities                   | 106,051           | 1,896                        | (8,873)                       | 99,074       |
| Total debt securities                   | 7,445,647         | 148,205                      | (23,178)                      | 7,570,674    |
| Equity securities and mutual funds      | 352               | 875                          |                               | 1,227        |
| Total securities available-for-sale     | \$ 7,445,999      | \$ 149,080                   | \$ (23,178)                   | \$ 7,571,901 |
| <b>Securities held-to-maturity (1):</b> |                   |                              |                               |              |
| Federal agency - Debt                   | \$ 40,423         | \$ 780                       | \$                            | \$ 41,203    |
| Federal agency - MBS                    | 75,231            | 1,632                        |                               | 76,863       |
| CMOs - Federal agency                   | 292,547           | 2,580                        | (195)                         | 294,932      |
| State and municipal                     | 59,479            | 1,463                        | (37)                          | 60,905       |
| Total securities held-to-maturity       | \$ 467,680        | \$ 6,455                     | \$ (232)                      | \$ 473,903   |

(1) Securities held-to-maturity are presented in the consolidated balance sheets at amortized cost.



Table of Contents**Note 4. Securities (Continued)**

Proceeds from sales of securities available-for-sale were \$5.2 million for the three and six months ended June 30, 2012, respectively, compared with \$47.2 million and \$53.3 million for the three and six months ended June 30, 2011, respectively. There were no sales of securities held-to-maturity during the three and six months ended June 30, 2012 and June 30, 2011. The following table provides the gross realized gains and losses on the sales and calls of securities (including trading securities):

| (in thousands)              | For the three months ended<br>June 30, |          | For the six months ended<br>June 30, |          |
|-----------------------------|--|----------|--------------------------------------|----------|
|                             | 2012                                   | 2011     | 2012                                 | 2011     |
| Gross realized gains        | \$ 40                                  | \$ 2,621 | \$ 536                               | \$ 2,781 |
| Gross realized losses       | (319)                                  | (932)    | (366)                                | (962)    |
| Net realized (losses) gains | \$ (279)                               | \$ 1,689 | \$ 170                               | \$ 1,819 |

Interest income on securities (including trading securities) for the three months ended June 30, 2012 and 2011 is comprised of: (i) taxable interest income of \$39.3 million and \$36.3 million, respectively (ii) nontaxable interest income of \$4.0 million and \$2.9 million, respectively, and (iii) dividend income of \$0.2 million and \$0.4 million, respectively. Interest income on securities (including trading securities) for the six months ended June 30, 2012 and 2011 is comprised of: (i) taxable interest income of \$80.9 million and \$70.6 million, respectively (ii) nontaxable interest income of \$7.8 million and \$5.9 million, respectively, and (iii) dividend income of \$0.2 million and \$0.6 million, respectively.

The following table provides the expected remaining maturities of debt securities included in the securities portfolio at June 30, 2012. The maturities of mortgage-backed securities are allocated according to the average life of expected cash flows. Average expected maturities will differ from contractual maturities because of the amortizing nature of the loan collateral and prepayment behavior of borrowers.

| (in thousands)                           | One year or<br>less | Over 1 year<br>through<br>5 years | Over 5 years<br>through<br>10 years | Over 10<br>years | Total        |
|--|---------------------|-----------------------------------|-------------------------------------|------------------|--------------|
| <b>Securities available-for-sale:</b>    |                     |                                   |                                     |                  |              |
| U.S. Treasury                            | \$ 5,003            | \$ 12,205                         | \$                                  | \$               | \$ 17,208    |
| Federal agency - Debt                    | 663,719             | 335,488                           |                                     |                  | 999,207      |
| Federal agency - MBS                     | 11                  | 455,069                           | 236,592                             |                  | 691,672      |
| CMOs - Federal agency                    | 309,857             | 4,012,348                         | 155,059                             |                  | 4,477,264    |
| CMOs - Non-agency                        | 12,442              | 20,992                            | 32,032                              |                  | 65,466       |
| State and municipal                      | 47,369              | 218,736                           | 67,047                              | 50,498           | 383,650      |
| Other                                    | 3,416               | 184,044                           | 42,448                              |                  | 229,908      |
| Total debt securities available-for-sale | \$ 1,041,817        | \$ 5,238,882                      | \$ 533,178                          | \$ 50,498        | \$ 6,864,375 |
| Amortized cost                           | \$ 1,035,552        | \$ 5,130,739                      | \$ 506,789                          | \$ 50,345        | \$ 6,723,425 |
| <b>Securities held-to-maturity:</b>      |                     |                                   |                                     |                  |              |
| Federal agency - Debt                    | \$ 10,947           | \$                                | \$                                  | \$ 92,492        | \$ 103,439   |
| Federal agency - MBS                     |                     | 2,663                             | 198,100                             |                  | 200,763      |
| CMOs - Federal agency                    |                     | 92,378                            | 549,724                             |                  | 642,102      |
| State and municipal                      | 500                 | 10,386                            | 96,733                              | 46,306           | 153,925      |
|  | \$ 11,447           | \$ 105,427                        | \$ 844,557                          | \$ 138,798       | \$ 1,100,229 |

Total debt securities held-to-maturity at  
amortized cost

Table of Contents**Note 4. Securities (Continued)***Impairment Assessment*

The Company performs a quarterly assessment of the debt and equity securities in its investment portfolio that have an unrealized loss to determine whether the decline in the fair value of these securities below their cost is other-than-temporary. Impairment is considered other-than-temporary when it becomes probable that an investor will be unable to recover the cost of an investment. The Company's impairment assessment takes into consideration factors such as the length of time and the extent to which the market value has been less than cost; the financial condition and near-term prospects of the issuer, including events specific to the issuer or industry; defaults or deferrals of scheduled interest, principal or dividend payments; external credit ratings and recent downgrades; and whether the Company intends to sell the security and whether it is more likely than not it will be required to sell the security prior to recovery of its amortized cost basis. If a decline in fair value is judged to be other than temporary, the cost basis of the individual security is written down to fair value which then becomes the new cost basis. The new cost basis is not adjusted for subsequent recoveries in fair value.

When there are credit losses associated with an impaired debt security and the Company does not have the intent to sell the security and it is more likely than not that it will not have to sell the security before recovery of its cost basis, the Company will separate the amount of the impairment into the amount that is credit-related and the amount related to non-credit factors. The credit-related impairment is recognized in Net impairment loss recognized in earnings in the consolidated statements of income. The non-credit-related impairment is recognized in AOCI.

*Securities Deemed to be Other-Than-Temporarily Impaired*

Through the impairment assessment process, the Company determined that certain non-agency CMOs were other-than-temporarily impaired at June 30, 2012. See *Non-Agency CMOs* below. The Company recorded impairment losses in earnings on securities available-for-sale of \$0.2 million for the three and six months ended June 30, 2012. Impairment losses recognized in earnings on securities available-for-sale during the three and six months ended June 30, 2011 were \$0.3 million and \$0.5 million, respectively. The Company recognized \$4.0 million and \$3.8 million of non-credit-related other-than-temporary impairment in AOCI on securities available-for-sale at June 30, 2012 and 2011, respectively. There were no impairment losses recognized in earnings or AOCI for securities held-to-maturity during the three and six months ended June 30, 2012.

The following table summarizes the changes in cumulative credit-related other-than-temporary impairment recognized in earnings for debt securities for the three and six months ended June 30, 2012 and 2011. Credit-related other-than-temporary impairment that was recognized in earnings is reflected as an Initial credit-related impairment if the period reported is the first time the security had a credit impairment. A credit-related other-than-temporary impairment is reflected as a Subsequent credit-related impairment if the period reported is not the first time the security had a credit impairment. Cumulative impairment is reduced for securities with previously recognized credit-related impairment that were sold during the period. Cumulative impairment is further reduced for increases in expected cash flows.

| (in thousands) | For the three months ended<br>June 30, |      | For the six months ended<br>June 30, |      |
|----------------|--|------|--------------------------------------|------|
|                | 2012                                   | 2011 | 2012                                 | 2011 |

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|  |    |        |    |        |    |        |    |        |
|--|----|--------|----|--------|----|--------|----|--------|
| Balance, beginning of period   | \$ | 17,369 | \$ | 17,550 | \$ | 17,531 | \$ | 17,923 |
| Subsequent credit-related impairment   |    | 178    |    | 294    |    | 178    |    | 458    |
| Reduction for securities sold  |    |        |    | (455)  |    |        |    | (455)  |
| Reduction for net increase in expected cash flows on securities for which OTTI was previously recognized |    | (181)  |    | (96)   |    | (343)  |    | (633)  |
| Balance, end of period   | \$ | 17,366 | \$ | 17,293 | \$ | 17,366 | \$ | 17,293 |

Table of Contents**Note 4. Securities (Continued)***Non-Agency CMOs*

The Company held \$44.3 million of variable rate non-agency CMOs at June 30, 2012, of which \$19.3 million of these securities were other-than-temporarily impaired because the present value of expected cash flows was less than cost. These CMOs have a fixed interest rate for an initial period after which they become variable-rate instruments with annual rate resets. For purposes of projecting future cash flows, the current fixed coupon was used through the reset date for each security. The prevailing LIBOR/Treasury forward curve as of the measurement date was used to project all future floating-rate cash flows based on the characteristics of each security. Other factors considered in the projection of future cash flows include the current level of subordination from other CMO classes, anticipated prepayment rates, cumulative defaults and loss given default. The Company recognized credit-related impairment losses in earnings on its investments in certain variable rate non-agency CMOs totaling \$0.2 million for the three and six months ended June 30, 2012. The Company recognized credit-related impairment losses of \$0.3 million and \$0.5 million in earnings for the three and six months ended June 30, 2011, respectively. The non-credit portion of other-than-temporary impairment for these securities at June 30, 2012 and 2011 was recognized in AOCI and is attributed to external market conditions, primarily the lack of liquidity in these securities, resulting in an increase in interest rate spreads for these securities. The Company also holds \$21.2 million in fixed rate non-agency CMOs at June 30, 2012, none of which have experienced any other-than-temporary impairment.

The following table provides a summary of the gross unrealized losses and fair value of investment securities that are not deemed to be other-than-temporarily impaired aggregated by investment category and length of time that the securities have been in a continuous unrealized loss position as of June 30, 2012 and December 31, 2011. The table also includes investment securities that had both a credit-related impairment recognized in earnings and a non-credit-related impairment recognized in AOCI.

| (in thousands)                        | Less than 12 months |                           | 12 months or greater |                           | Total      |                           |
|---------------------------------------|---------------------|---------------------------|----------------------|---------------------------|------------|---------------------------|
|                                       | Fair Value          | Estimated Unrealized Loss | Fair Value           | Estimated Unrealized Loss | Fair Value | Estimated Unrealized Loss |
| <b>June 30, 2012</b>                  |                     |                           |                      |                           |            |                           |
| <b>Securities available-for-sale:</b> |                     |                           |                      |                           |            |                           |
| U.S. Treasury                         | \$ 12,206           | \$ 16                     | \$                   | \$                        | \$ 12,206  | \$ 16                     |
| Federal agency - Debt                 | 54,606              | 15                        |                      |                           | 54,606     | 15                        |
| CMOs - Federal agency                 | 416,059             | 850                       |                      |                           | 416,059    | 850                       |
| CMOs - Non-agency                     | 3,918               | 19                        | 33,743               | 6,056                     | 37,661     | 6,075                     |
| State and municipal                   | 4,006               | 60                        | 1,415                | 41                        | 5,421      | 101                       |
| Other debt securities                 | 13,244              | 3                         | 15,768               | 7,175                     | 29,012     | 7,178                     |
| Total securities available-for-sale   | \$ 504,039          | \$ 963                    | \$ 50,926            | \$ 13,272                 | \$ 554,965 | \$ 14,235                 |
| <b>Securities held-to-maturity:</b>   |                     |                           |                      |                           |            |                           |
| Federal agency - MBS                  | \$ 9,852            | \$ 99                     | \$                   | \$                        | \$ 9,852   | \$ 99                     |
| CMOs - Federal agency                 | 5,121               | 22                        |                      |                           | 5,121      | 22                        |
| State and municipal                   | 66,954              | 1,209                     |                      |                           | 66,954     | 1,209                     |
| Total securities held-to-maturity     | \$ 81,927           | \$ 1,330                  | \$                   | \$                        | \$ 81,927  | \$ 1,330                  |

Table of Contents**Note 4. Securities (Continued)**

| (in thousands)                        | Less than 12 months |                           | 12 months or greater |                           | Total        |                           |
|---------------------------------------|---------------------|---------------------------|----------------------|---------------------------|--------------|---------------------------|
|                                       | Fair Value          | Estimated Unrealized Loss | Fair Value           | Estimated Unrealized Loss | Fair Value   | Estimated Unrealized Loss |
| <b>December 31, 2011</b>              |                     |                           |                      |                           |              |                           |
| <b>Securities available-for-sale:</b> |                     |                           |                      |                           |              |                           |
| U.S. Treasury                         | \$ 4,145            | \$ 5                      | \$                   | \$                        | \$ 4,145     | \$ 5                      |
| Federal agency - Debt                 | 409,129             | 296                       |                      |                           | 409,129      | 296                       |
| Federal agency - MBS                  | 24,519              | 87                        |                      |                           | 24,519       | 87                        |
| CMOs - Federal agency                 | 744,737             | 2,224                     |                      |                           | 744,737      | 2,224                     |
| CMOs - Non-agency                     | 20,094              | 833                       | 31,400               | 10,487                    | 51,494       | 11,320                    |
| State and municipal                   | 42,164              | 268                       | 2,023                | 105                       | 44,187       | 373                       |
| Other debt securities                 | 34,153              | 508                       | 14,718               | 8,365                     | 48,871       | 8,873                     |
| Total securities available-for-sale   | \$ 1,278,941        | \$ 4,221                  | \$ 48,141            | \$ 18,957                 | \$ 1,327,082 | \$ 23,178                 |
| <b>Securities held-to-maturity:</b>   |                     |                           |                      |                           |              |                           |
| CMOs - Federal agency                 | \$ 32,256           | \$ 195                    | \$                   | \$                        | \$ 32,256    | \$ 195                    |
| State and municipal                   | 5,784               | 37                        |                      |                           | 5,784        | 37                        |
| Total securities held-to-maturity     | \$ 38,040           | \$ 232                    | \$                   | \$                        | \$ 38,040    | \$ 232                    |

At June 30, 2012, the Company had \$555.0 million of securities available-for-sale in an unrealized loss position, consisting of \$535.7 million of temporarily impaired securities and \$19.3 million of securities that had non-credit-related impairment recognized in AOCI. The Company had \$81.9 million of securities held-to-maturity in an unrealized loss position. At June 30, 2012, the Company had 141 debt securities available-for-sale and held-to-maturity in an unrealized loss position. The debt securities in an unrealized loss position include 4 U.S. Treasury securities, 2 federal agency debt securities, 1 federal agency MBS, 20 federal agency CMOs, 7 non-agency CMOs, 105 state and municipal securities and 2 other debt securities.

The unrealized loss on non-agency CMOs reflects the lack of liquidity in this sector of the market. The Company only holds the most senior tranches of each non-agency issue which provides protection against defaults. The Company expects to receive principal and interest payments equivalent to or greater than the current cost basis of its portfolio of debt securities. Additionally, the Company does not intend to sell the securities, and it is not more likely than not that it will be required to sell the securities before it recovers the cost basis of its investment. The mortgages in these asset pools are well diversified geographically. Over the past year, the real estate market has stabilized somewhat, though performance varies substantially by geography and borrower. Though reduced, a significant weakening of economic fundamentals coupled with a return to elevated unemployment rates and substantial deterioration in the value of high-end residential properties could increase the probability of default and related credit losses. These conditions could cause the value of these securities to decline and trigger the recognition of further other-than-temporary impairment charges.

Other debt securities include the Company's investments in highly rated corporate debt and collateralized bond obligations backed by trust preferred securities (CDOs) issued by a geographically diverse pool of small- and medium-sized financial institutions. The CDOs held in securities available-for-sale at June 30, 2012 are the most senior tranches of each issue. Trading activity for the type of CDO held by the Company has been limited since 2008. Accordingly, the fair values of these securities were determined using an internal pricing model that incorporates assumptions about discount rates in an illiquid market, projected cash flows and collateral performance. The CDOs had a \$7.0 million net unrealized loss at June 30, 2012, which the Company attributes to the illiquid credit markets. The CDOs have collateral that well exceeds the outstanding debt. Security valuations reflect the current and prospective performance of the issuers whose debt is contained in these asset pools. The Company expects to receive all contractual principal and interest payments due on its CDOs. Additionally, the Company does not intend to sell the securities, and it is not more likely than not that it will be required to sell the securities before it recovers the cost basis of



its investment.

Table of Contents**Note 4. Securities (Continued)**

At December 31, 2011, the Company had \$1.33 billion of securities available-for-sale in an unrealized loss position consisting of \$1.32 billion of temporarily impaired securities and \$9.2 million of securities that had non-credit-related impairment recognized in AOCI. The Company had \$38.0 million of securities held-to-maturity in an unrealized loss position. At December 31, 2011, the Company had 90 debt securities available-for-sale and held-to-maturity in an unrealized loss position. The debt securities in an unrealized loss position included 2 U.S. Treasury securities, 12 federal agency debt securities, 3 federal agency MBS, 36 federal agency CMOs, 12 non-agency CMOs, 19 state and municipal securities and 6 other debt securities.

**Note 5. Other Investments***Federal Home Loan Bank of San Francisco and Federal Reserve Bank Stock*

The Company's investment in stock issued by the Federal Home Loan Bank of San Francisco ( FHLB ) and Federal Reserve Bank ( FRB ) totaled \$99.7 million and \$107.4 million at June 30, 2012 and December 31, 2011, respectively. Ownership of government agency securities is restricted to member banks, and the securities do not have readily determinable market values. The Company records investments in FHLB and FRB stock at cost in Other assets of the consolidated balance sheets and evaluates these investments for impairment. The Company expects to recover the full amount invested in FHLB and FRB stock and does not consider its investments to be impaired at June 30, 2012.

*Private Equity and Alternative Investments*

The Company has ownership interests in a limited number of private equity, venture capital, real estate and hedge funds that are not publicly traded and do not have readily determinable fair values. These investments are carried at cost in the Other assets section of the consolidated balance sheets and are net of impairment write-downs, if applicable. The Company's investments in these funds totaled \$40.2 million at June 30, 2012 and \$39.9 million at December 31, 2011. A summary of investments by fund type is provided below:

| (in thousands)<br>Fund Type        | June 30,<br>2012 | December 31,<br>2011 |
|------------------------------------|------------------|----------------------|
| Private equity and venture capital | \$ 23,306        | \$ 23,093            |
| Real estate                        | 10,711           | 10,541               |
| Hedge                              | 2,866            | 2,883                |
| Other                              | 3,355            | 3,402                |
| Total                              | \$ 40,238        | \$ 39,919            |

Management reviews these investments quarterly for impairment. The impairment assessment includes a review of the most recent financial statements and investment reports for each fund and discussions with fund management. An impairment loss is recognized if it is deemed probable that the Company will not recover the cost of an investment. The impairment loss is recognized in Other noninterest income in the consolidated statements of income. The new cost basis of the investment is not adjusted for subsequent recoveries in value. The Company

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recognized impairment losses totaling \$0.3 million and \$0.5 million on its investments during the three and six months ended June 30, 2012, respectively. The Company recognized impairment losses totaling \$0.2 million on its investments during the three and six months ended June 30, 2011.

Table of Contents**Note 5. Other Investments (Continued)**

The table below provides information as of June 30, 2012 on private equity and alternative investments measured at fair value on a nonrecurring basis due to the recognition of impairment:

**Alternative Investments Measured at Fair Value on a Nonrecurring Basis**

| (in thousands)<br>Fund Type            | Fair<br>Value | Unfunded<br>Commitments | Redemption<br>Frequency | Redemption<br>Notice Period |
|--|---------------|-------------------------|-------------------------|-----------------------------|
| Private equity and venture capital (2) | \$ 42         | \$                      | None (1)                | N/A                         |
| Real estate (3)                        | 3,413         | 506                     | None (1)                | N/A                         |
| Total                                  | \$ 3,455      | \$ 506                  |                         |                             |

- 
- (1) Funds make periodic distributions of income but do not permit redemptions prior to the end of the investment term.
- (2) Funds invest in securities and other instruments of public and private companies, including corporations, partnerships, limited liability companies and joint ventures.
- (3) Funds invest in commercial, industrial and retail projects and select multi-family housing opportunities which are part of mixed use projects in low and moderate income neighborhoods.

**Note 6. Loans, Allowance for Loan and Lease Losses, and Reserve for Off-Balance Sheet Credit Commitments**

The following is a summary of the major categories of loans:

**Loans and Leases**

| (in thousands)                            | June 30,<br>2012 | December 31,<br>2011 |
|---|------------------|----------------------|
| Commercial                                | \$ 5,379,489     | \$ 4,846,594         |
| Commercial real estate mortgages          | 2,424,333        | 2,110,749            |
| Residential mortgages                     | 3,822,630        | 3,763,218            |
| Real estate construction                  | 301,829          | 315,609              |
| Equity lines of credit                    | 741,270          | 741,081              |
| Installment                               | 130,200          | 132,647              |
| Lease financing                           | 707,458          | 399,487              |
| Loans and leases, excluding covered loans | 13,507,209       | 12,309,385           |

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|  |               |               |
|--|---------------|---------------|
| Less: Allowance for loan and lease losses      | (269,534)     | (262,557)     |
| Loans and leases, excluding covered loans, net | 13,237,675    | 12,046,828    |
| Covered loans                                  | 1,260,135     | 1,481,854     |
| Less: Allowance for loan losses                | (43,147)      | (64,565)      |
| Covered loans, net                             | 1,216,988     | 1,417,289     |
| Total loans and leases                         | \$ 14,767,344 | \$ 13,791,239 |
| Total loans and leases, net                    | \$ 14,454,663 | \$ 13,464,117 |

The loan amounts above include unamortized fees, net of deferred costs, of \$5.0 million and \$7.5 million as of June 30, 2012 and December 31, 2011, respectively.

Table of Contents**Note 6. Loans, Allowance for Loan and Lease Losses, and Reserve for Off-Balance Sheet Credit Commitments (Continued)**

Concentrations of credit risk arise when a number of clients are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic conditions. Although the Company's lending activities are predominantly in California, and to a lesser extent, New York and Nevada, the Company has various specialty lending businesses that lend to businesses located throughout the United States of America. Excluding covered loans, at June 30, 2012, California represented 81 percent of total loans outstanding and New York and Nevada represented 7 percent and 3 percent, respectively. The remaining 9 percent of total loans outstanding represented other states. Although the Company has a diversified loan portfolio, a substantial portion of the loan portfolio and credit performance depends on the economic stability of Southern California. Credit performance also depends, to a lesser extent, on economic conditions in the San Francisco Bay area, New York and Nevada. Within the Company's covered loan portfolio at June 30, 2012, the five states with the largest concentration were California (39 percent), Texas (12 percent), Nevada (8 percent), Arizona (4 percent) and Ohio (4 percent). The remaining 33 percent of total covered loans outstanding represented other states.

*Covered Loans*

Covered loans represent loans acquired from the FDIC that are subject to loss-sharing agreements. Covered loans were \$1.26 billion as of June 30, 2012 and \$1.48 billion as of December 31, 2011. Covered loans, net of allowance for loan losses, were \$1.22 billion at June 30, 2012 and \$1.42 billion at December 31, 2011.

The following is a summary of the major categories of covered loans:

| (in thousands)                   | June 30,<br>2012 | December 31,<br>2011 |
|----------------------------------|------------------|----------------------|
| Commercial                       | \$ 22,772        | \$ 30,911            |
| Commercial real estate mortgages | 1,135,071        | 1,288,352            |
| Residential mortgages            | 5,766            | 14,931               |
| Real estate construction         | 90,196           | 140,992              |
| Equity lines of credit           | 5,265            | 5,167                |
| Installment                      | 1,065            | 1,501                |
| Covered loans                    | 1,260,135        | 1,481,854            |
| Less: Allowance for loan losses  | (43,147)         | (64,565)             |
| Covered loans, net               | \$ 1,216,988     | \$ 1,417,289         |

The Company evaluated the acquired loans from its FDIC-assisted acquisitions and concluded that all loans, with the exception of a small population of acquired loans, would be accounted for under ASC Topic 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality* (ASC 310-30). Loans are accounted for under ASC 310-30 when there is evidence of credit deterioration since origination and for which it is probable, at acquisition, that the Company would be unable to collect all contractually required payments. Interest income is recognized on all acquired impaired loans through accretion of the difference between the carrying amount of the loans and their expected cash flows.

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As of NCB's acquisition date in 2011, the estimates of the contractually required payments receivable for all acquired impaired covered loans of NCB were \$107.4 million, the cash flows expected to be collected were \$66.2 million, and the fair value of the acquired impaired loans was \$55.3 million. The above amounts were determined based on the estimated performance over the remaining life of the underlying loans, which included the effects of estimated prepayments. Fair value of the acquired loans included estimated credit losses.

Table of Contents**Note 6. Loans, Allowance for Loan and Lease Losses, and Reserve for Off-Balance Sheet Credit Commitments (Continued)**

The excess of cash flows expected to be collected over the carrying value of the underlying acquired impaired loans is referred to as the accretable yield. This amount is not reported in the consolidated balance sheets, but is accreted into interest income at a level yield over the remaining estimated lives of the underlying pools of loans. Changes in the accretable yield for acquired impaired loans were as follows for the six months ended June 30, 2012 and 2011:

| (in thousands)                                  | For the six months ended<br>June 30, |            |
|---|--------------------------------------|------------|
|   | 2012                                 | 2011       |
| Balance, beginning of period                    | \$ 436,374                           | \$ 562,826 |
| Additions                                       |                                      | 10,871     |
| Accretion                                       | (43,085)                             | (54,558)   |
| Reclassifications (to) from nonaccretable yield | (10,212)                             | 13,461     |
| Disposals and other                             | (36,944)                             | (27,127)   |
| Balance, end of period                          | \$ 346,133                           | \$ 505,473 |

The factors that most significantly affect estimates of cash flows expected to be collected, and accordingly the accretable yield balance, include: (i) changes in credit assumptions, including both credit loss amounts and timing; (ii) changes in prepayment assumptions; and (iii) changes in interest rates for variable-rate loans. Reclassifications between accretable yield and nonaccretable yield may vary from period to period as the Company periodically updates its cash flow projections. The reclassification of accretable yield to nonaccretable yield during 2012 was principally driven by negative changes in future cash flows, both timing and amount, which were primarily a result of changes in credit assumptions.

The Company recorded an indemnification asset related to its FDIC-assisted acquisitions, which represents the present value of the expected reimbursement from the FDIC for expected losses on acquired loans, OREO and unfunded commitments. The FDIC indemnification asset from all FDIC-assisted acquisitions was \$170.7 million at June 30, 2012 and \$204.3 million at December 31, 2011.

***Credit Quality on Loans and Leases, Excluding Covered Loans******Allowance for Loan and Lease Losses and Reserve for Off-Balance Sheet Credit Commitments***

The Company accounts for the credit risk associated with lending activities through its allowance for loan and lease losses, reserve for off-balance sheet credit commitments and provision for credit losses. The provision is the expense recognized in the consolidated statements of income to adjust the allowance and reserve to the levels deemed appropriate by management, as determined through application of the Company's allowance methodology procedures. The provision for credit losses reflects management's judgment of the adequacy of the allowance for loan and lease losses and the reserve for off-balance sheet credit commitments. It is determined through quarterly analytical reviews of the loan and commitment portfolios and consideration of such other factors as the Company's loan and lease loss experience, trends in problem loans, concentrations of credit risk, underlying collateral values, and current economic conditions, as well as the results of the Company's ongoing credit review process. As conditions change, the Company's level of provisioning and the allowance for loan and lease losses and reserve for off-balance sheet credit commitments may change.



For commercial, non-homogenous loans that are not impaired, the Bank derives loss factors via a process that begins with estimates of probable losses inherent in the portfolio based upon various statistical analyses. The factors considered in the analysis include loan type, migration analysis, in which historical delinquency and credit loss experience is applied to the current aging of the portfolio, as well as analyses that reflect current trends and conditions. Each portfolio of smaller balance homogeneous loans, including residential first mortgages, installment, revolving credit and most other consumer loans, is collectively evaluated for loss potential. Management also establishes a qualitative reserve that considers overall portfolio indicators, including current and historical credit losses; delinquent, nonperforming and criticized loans; portfolio concentrations, trends in volumes and terms of loans; and economic trends in the broad market and in specific industries.

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**Note 6. Loans, Allowance for Loan and Lease Losses, and Reserve for Off-Balance Sheet Credit Commitments (Continued)**

The allowance for loan and lease losses attributed to impaired loans considers all available evidence, including as appropriate, the probability that a specific loan will default, the expected exposure of a loan at default, an estimate of loss given default, the present value of expected future cash flows discounted using the loan's contractual effective rate, the secondary market value of the loan and the fair value of collateral.

The quantitative portion of the allowance for loan and lease losses is adjusted for qualitative factors to account for model imprecision and to incorporate the range of probable outcomes inherent in the estimates used for the allowance. The qualitative portion of the allowance attempts to incorporate the risks inherent in the portfolio, economic uncertainties, competition, regulatory requirements and other subjective factors including industry trends, changes in underwriting standards, and existence of concentrations.

The relative significance of risk considerations vary by portfolio segment. For commercial loans, the primary risk consideration is a borrower's ability to generate sufficient cash flows to repay their loan. Secondary considerations include the creditworthiness of guarantors and the valuation of collateral. In addition to the creditworthiness of a borrower, the type and location of real estate collateral is an important risk factor for commercial real estate and real estate construction loans. The primary risk considerations for consumer loans are a borrower's personal cash flow and liquidity, as well as collateral value.

Generally, commercial, commercial real estate and real estate construction loans are charged off immediately when it is determined that advances to the borrower are in excess of the calculated current fair value of the collateral or if a borrower is deemed incapable of repayment of unsecured debt, there is little or no prospect for near term improvement and no realistic strengthening action of significance pending. Consumer loans are charged-off based on delinquency, ranging from 60 days for overdrafts to 180 days for secured consumer loans, or earlier when it is determined that the loan is uncollectible due to a triggering event, such as bankruptcy, fraud or death.

Table of Contents**Note 6. Loans, Allowance for Loan and Lease Losses, and Reserve for Off-Balance Sheet Credit Commitments (Continued)**

The following tables provide a summary of activity in the allowance for loan and lease losses and the period-end recorded investment balances of loans evaluated for impairment, excluding covered loans, for the three and six months ended June 30, 2012 and 2011. Activity is provided by loan type which is consistent with the Company's methodology for determining the allowance for loan and lease losses.

| (in thousands)                                       | Commercial<br>(1) | Commercial<br>Real Estate<br>Mortgages | Residential<br>Mortgages | Real Estate<br>Construction | Equity<br>Lines<br>of Credit | Installment | Unallocated | Total         |
|--|-------------------|--|--------------------------|-----------------------------|------------------------------|-------------|-------------|---------------|
| <b>Three months ended<br/>June 30, 2012</b>          |                   |  |                          |                             |                              |             |             |               |
| <b>Allowance for loan and<br/>lease losses:</b>      |                   |  |                          |                             |                              |             |             |               |
| Beginning balance                                    | \$ 84,087         | \$ 46,586                              | \$ 13,803                | \$ 22,096                   | \$ 8,032                     | \$ 1,938    | \$ 89,535   | \$ 266,077    |
| Provision for credit losses<br>(2)                   | 1,228             | (51)                                   | (846)                    | 326                         | 386                          | 100         | (427)       | 716           |
| Charge-offs  | (1,302)           | (181)                                  | (749)                    | (7,858)                     | (846)                        | (617)       |             | (11,553)      |
| Recoveries   | 9,394             | 1,294                                  | 206                      | 3,019                       | 38                           | 343         |             | 14,294        |
| Net (charge-offs)<br>recoveries                      | 8,092             | 1,113                                  | (543)                    | (4,839)                     | (808)                        | (274)       |             | 2,741         |
| Ending balance                                       | \$ 93,407         | \$ 47,648                              | \$ 12,414                | \$ 17,583                   | \$ 7,610                     | \$ 1,764    | \$ 89,108   | \$ 269,534    |
| <b>Six months ended<br/>June 30, 2012</b>            |                   |  |                          |                             |                              |             |             |               |
| <b>Allowance for loan and<br/>lease losses:</b>      |                   |  |                          |                             |                              |             |             |               |
| Beginning balance                                    | \$ 82,965         | \$ 45,967                              | \$ 14,029                | \$ 23,347                   | \$ 8,024                     | \$ 1,959    | \$ 86,266   | \$ 262,557    |
| Provision for credit losses<br>(2)                   | (2,933)           | 1,234                                  | (578)                    | (1,029)                     | 548                          | (338)       | 2,842       | (254)         |
| Charge-offs  | (10,219)          | (873)                                  | (1,303)                  | (9,459)                     | (1,035)                      | (826)       |             | (23,715)      |
| Recoveries   | 23,594            | 1,320                                  | 266                      | 4,724                       | 73                           | 969         |             | 30,946        |
| Net (charge-offs)<br>recoveries                      | 13,375            | 447                                    | (1,037)                  | (4,735)                     | (962)                        | 143         |             | 7,231         |
| Ending balance                                       | \$ 93,407         | \$ 47,648                              | \$ 12,414                | \$ 17,583                   | \$ 7,610                     | \$ 1,764    | \$ 89,108   | \$ 269,534    |
| <b>Ending balance of<br/>allowance:</b>              |                   |  |                          |                             |                              |             |             |               |
| Individually evaluated for<br>impairment             | \$ 2,850          | \$ 2,282                               | \$ 398                   | \$ 1,866                    | \$ 154                       | \$          | \$          | \$ 7,550      |
| Collectively evaluated for<br>impairment             | 90,557            | 45,366                                 | 12,016                   | 15,717                      | 7,456                        | 1,764       | 89,108      | 261,984       |
| <b>Loans and leases,<br/>excluding covered loans</b> |                   |  |                          |                             |                              |             |             |               |
| <b>Ending balance of loans<br/>and leases:</b>       |                   |  |                          |                             |                              |             |             |               |
| Loans and leases,<br>excluding covered loans         | \$ 6,086,947      | \$ 2,424,333                           | \$ 3,822,630             | \$ 301,829                  | \$ 741,270                   | \$ 130,200  | \$          | \$ 13,507,209 |
| Individually evaluated for<br>impairment             | 43,144            | 45,491                                 | 13,634                   | 66,529                      | 4,434                        | 550         |             | 173,782       |
| Collectively evaluated for<br>impairment             | 6,043,803         | 2,378,842                              | 3,808,996                | 235,300                     | 736,836                      | 129,650     |             | 13,333,427    |

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- (1) Includes lease financing loans.
- (2) Provision for credit losses in the allowance rollforward for the three months ended June 30, 2012 includes total provision expense of \$1.0 million and total transfers to the reserve for off-balance sheet credit commitments of \$0.3 million. Provision for credit losses for the six months ended June 30, 2012 includes total provision expense of \$1.0 million and total transfers to the reserve for off-balance sheet credit commitments of \$1.3 million.

Table of Contents**Note 6. Loans, Allowance for Loan and Lease Losses, and Reserve for Off-Balance Sheet Credit Commitments (Continued)**

| (in thousands)                                       | Commercial<br>(1) | Commercial<br>Real Estate<br>Mortgages | Residential<br>Mortgages | Real Estate<br>Construction | Equity<br>Lines<br>of Credit | Installment | Unallocated | Total         |
|--|-------------------|--|--------------------------|-----------------------------|------------------------------|-------------|-------------|---------------|
| <b>Three months ended<br/>June 30, 2011</b>          |                   |  |                          |                             |                              |             |             |               |
| <b>Allowance for loan and<br/>lease losses:</b>      |                   |  |                          |                             |                              |             |             |               |
| Beginning balance                                    | \$ 75,661         | \$ 47,519                              | \$ 13,527                | \$ 36,693                   | \$ 6,445                     | \$ 5,445    | \$ 78,066   | \$ 263,356    |
| Provision for credit losses<br>(2)                   | 7,440             | 272                                    | (401)                    | (7,815)                     | 343                          | (3,600)     | 2,143       | (1,618)       |
| Charge-offs  | (3,446)           | (98)                                   | (375)                    | (1,897)                     | (128)                        | (131)       |             | (6,075)       |
| Recoveries   | 6,062             | 1,367                                  | 122                      | 2,474                       | 8                            | 237         |             | 10,270        |
| Net charge-offs<br>(recoveries)                      | 2,616             | 1,269                                  | (253)                    | 577                         | (120)                        | 106         |             | 4,195         |
| Ending balance                                       | \$ 85,717         | \$ 49,060                              | \$ 12,873                | \$ 29,455                   | \$ 6,668                     | \$ 1,951    | \$ 80,209   | \$ 265,933    |
| <b>Six months ended<br/>June 30, 2011</b>            |                   |  |                          |                             |                              |             |             |               |
| <b>Allowance for loan and<br/>lease losses:</b>      |                   |  |                          |                             |                              |             |             |               |
| Beginning balance                                    | \$ 82,451         | \$ 52,516                              | \$ 16,753                | \$ 40,824                   | \$ 7,229                     | \$ 3,931    | \$ 53,303   | \$ 257,007    |
| Provision for credit losses<br>(2)                   | 2,587             | (10,937)                               | (3,012)                  | (15,772)                    | 316                          | (1,884)     | 26,906      | (1,796)       |
| Charge-offs  | (6,684)           | (2,897)                                | (1,022)                  | (2,463)                     | (921)                        | (455)       |             | (14,442)      |
| Recoveries   | 7,363             | 10,378                                 | 154                      | 6,866                       | 44                           | 359         |             | 25,164        |
| Net charge-offs<br>(recoveries)                      | 679               | 7,481                                  | (868)                    | 4,403                       | (877)                        | (96)        |             | 10,722        |
| Ending balance                                       | \$ 85,717         | \$ 49,060                              | \$ 12,873                | \$ 29,455                   | \$ 6,668                     | \$ 1,951    | \$ 80,209   | \$ 265,933    |
| <b>Ending balance of<br/>allowance:</b>              |                   |  |                          |                             |                              |             |             |               |
| Individually evaluated for<br>impairment             | \$ 7,605          | \$ 1,150                               | \$ 56                    | \$ 1,853                    | \$ 404                       | \$          | \$          | \$ 11,068     |
| Collectively evaluated for<br>impairment             | 78,112            | 47,910                                 | 12,817                   | 27,602                      | 6,264                        | 1,951       | 80,209      | 254,865       |
| <b>Loans and leases,<br/>excluding covered loans</b> |                   |  |                          |                             |                              |             |             |               |
| <b>Ending balance of loans<br/>and leases:</b>       |                   |  |                          |                             |                              |             |             |               |
| Loans and leases<br>excluding covered loans          | \$ 4,800,252      | \$ 1,930,269                           | \$ 3,710,765             | \$ 355,014                  | \$ 735,899                   | \$ 130,924  | \$          | \$ 11,663,123 |
| Individually evaluated for<br>impairment             | 19,236            | 23,769                                 | 12,536                   | 60,630                      | 4,522                        | 41          |             | 120,734       |
| Collectively evaluated for<br>impairment             | 4,781,016         | 1,906,500                              | 3,698,229                | 294,384                     | 731,377                      | 130,883     |             | 11,542,389    |

(1) Includes lease financing loans.

(2) There was no provision for credit losses for the three and six months ended June 30, 2011. Net transfers to the reserve for off-balance sheet credit commitments were \$1.6 million and \$1.8 million for the three and six months ended June 30, 2011, respectively.

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Off-balance sheet credit exposures include loan commitments and letters of credit. The following table provides a summary of activity in the reserve for off-balance sheet credit commitments for the three and six months ended June 30, 2012 and 2011:

| (in thousands)                                     | For the three months ended<br>June 30, |           | For the six months ended<br>June 30, |           |
|--|--|-----------|--------------------------------------|-----------|
|  | 2012                                   | 2011      | 2012                                 | 2011      |
| Balance, beginning of period                       | \$ 24,067                              | \$ 21,707 | \$ 23,097                            | \$ 21,529 |
| Transfers from allowance for loan and lease losses | 284                                    | 1,618     | 1,254                                | 1,796     |
| Balance, end of period                             | \$ 24,351                              | 23,325    | \$ 24,351                            | 23,325    |

Table of Contents**Note 6. Loans, Allowance for Loan and Lease Losses, and Reserve for Off-Balance Sheet Credit Commitments (Continued)***Impaired Loans and Leases*

Information on impaired loans, excluding covered loans, at June 30, 2012, December 31, 2011 and June 30, 2011 is provided in the following tables:

| (in thousands)                      | Recorded<br>Investment | Unpaid<br>Contractual<br>Principal<br>Balance | Related<br>Allowance | For the three months ended<br>June 30, 2012 |                                  | For the six months ended<br>June 30, 2012 |                                  |
|-------------------------------------|------------------------|---|----------------------|---|----------------------------------|---|----------------------------------|
|                                     |                        |   |                      | Average<br>Recorded<br>Investment           | Interest<br>Income<br>Recognized | Average<br>Recorded<br>Investment         | Interest<br>Income<br>Recognized |
| <b>June 30, 2012</b>                |                        |   |                      |   |                                  |   |                                  |
| With no related allowance recorded: |                        |   |                      |   |                                  |   |                                  |
| Commercial                          | \$ 32,378              | \$ 43,247                                     | \$                   | \$ 30,100                                   | \$                               | \$ 23,451                                 | \$                               |
| Commercial real estate mortgages    | 28,368                 | 33,107  |                      | 21,188                                      | 55                               | 20,748                                    | 124                              |
| Residential mortgages:              |                        |   |                      |   |                                  |   |                                  |
| Fixed                               | 1,830                  | 2,518   |                      | 2,248                                       |                                  | 2,663                                     |                                  |
| Variable                            | 6,257                  | 6,688   |                      | 6,412                                       | 39                               | 5,504                                     | 39                               |
| Total residential mortgages         | 8,087                  | 9,206   |                      | 8,660                                       | 39                               | 8,167                                     | 39                               |
| Real estate construction:           |                        |   |                      |   |                                  |   |                                  |
| Construction                        | 38,828                 | 52,209  |                      | 29,937                                      | 126                              | 29,103                                    | 242                              |
| Land                                | 18,936                 | 22,101  |                      | 21,513                                      |                                  | 24,006                                    |                                  |
| Total real estate construction      | 57,764                 | 74,310  |                      | 51,450                                      | 126                              | 53,109                                    | 242                              |
| Equity lines of credit              | 3,207                  | 4,245   |                      | 4,621                                       |                                  | 4,861                                     |                                  |
| Installment:                        |                        |   |                      |   |                                  |   |                                  |
| Consumer                            | 550                    | 927   |                      | 550   |                                  | 586                                       |                                  |
| Total installment                   | 550                    | 927   |                      | 550   |                                  | 586                                       |                                  |
| Lease financing                     |                        |   |                      |   |                                  | 9   |                                  |
| Total with no related allowance     | \$ 130,354             | \$ 165,042                                    | \$                   | \$ 116,569                                  | \$ 220                           | \$ 110,931                                | \$ 405                           |
| With an allowance recorded:         |                        |   |                      |   |                                  |   |                                  |
| Commercial                          | \$ 10,766              | \$ 11,591                                     | \$ 2,850             | \$ 11,680                                   | \$                               | \$ 12,995                                 | \$                               |
| Commercial real estate mortgages    | 17,123                 | 18,266  | 2,282                | 12,711                                      |                                  | 12,077                                    |                                  |
| Residential mortgages:              |                        |   |                      |   |                                  |   |                                  |
| Fixed                               | 2,291                  | 2,353   | 236                  | 2,316                                       |                                  | 1,716                                     |                                  |
| Variable                            | 3,256                  | 3,951   | 162                  | 2,341                                       |                                  | 2,044                                     |                                  |
| Total residential mortgages         | 5,547                  | 6,304   | 398                  | 4,657                                       |                                  | 3,760                                     |                                  |
| Real estate construction:           |                        |   |                      |   |                                  |   |                                  |
| Land                                | 8,765                  | 18,575  | 1,866                | 15,658                                      |                                  | 16,900                                    |                                  |
| Total real estate construction      | 8,765                  | 18,575  | 1,866                | 15,658                                      |                                  | 16,900                                    |                                  |

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|                         |    |        |    |        |    |       |    |        |    |  |    |        |
|-------------------------|----|--------|----|--------|----|-------|----|--------|----|--|----|--------|
| Equity lines of credit  |    | 1,227  |    | 1,421  |    | 154   |    | 1,086  |    |  |    | 1,155  |
| Total with an allowance | \$ | 43,428 | \$ | 56,157 | \$ | 7,550 | \$ | 45,792 | \$ |  | \$ | 46,887 |

Total impaired loans by type:

|                                  |    |         |    |         |    |       |    |         |    |     |    |         |     |
|----------------------------------|----|---------|----|---------|----|-------|----|---------|----|-----|----|---------|-----|
| Commercial                       | \$ | 43,144  | \$ | 54,838  | \$ | 2,850 | \$ | 41,780  | \$ |     | \$ | 36,446  | \$  |
| Commercial real estate mortgages |    | 45,491  |    | 51,373  |    | 2,282 |    | 33,899  |    | 55  |    | 32,825  | 124 |
| Residential mortgages            |    | 13,634  |    | 15,510  |    | 398   |    | 13,317  |    | 39  |    | 11,927  | 39  |
| Real estate construction         |    | 66,529  |    | 92,885  |    | 1,866 |    | 67,108  |    | 126 |    | 70,009  | 242 |
| Equity lines of credit           |    | 4,434   |    | 5,666   |    | 154   |    | 5,707   |    |     |    | 6,016   |     |
| Installment                      |    | 550     |    | 927     |    |       |    | 550     |    |     |    | 586     |     |
| Lease financing                  |    |         |    |         |    |       |    |         |    |     |    | 9       |     |
| Total impaired loans             | \$ | 173,782 | \$ | 221,199 | \$ | 7,550 | \$ | 162,361 | \$ | 220 | \$ | 157,818 | 405 |



Table of Contents**Note 6. Loans, Allowance for Loan and Lease Losses, and Reserve for Off-Balance Sheet Credit Commitments (Continued)**

| (in thousands)                      | Recorded<br>Investment | Unpaid<br>Contractual<br>Principal<br>Balance (1) | Related<br>Allowance |
|-------------------------------------|------------------------|---|----------------------|
| <b>December 31, 2011</b>            |                        |   |                      |
| With no related allowance recorded: |                        |   |                      |
| Commercial                          | \$ 10,153              | \$ 11,588   | \$                   |
| Commercial real estate mortgages    | 19,867                 | 23,983  |                      |
| Residential mortgages:              |                        |   |                      |
| Fixed                               | 3,493                  | 4,035   |                      |
| Variable                            | 3,689                  | 4,000   |                      |
| Total residential mortgages         | 7,182                  | 8,035   |                      |
| Real estate construction:           |                        |   |                      |
| Construction                        | 27,435                 | 40,605  |                      |
| Land                                | 28,991                 | 32,335  |                      |
| Total real estate construction      | 56,426                 | 72,940  |                      |
| Equity lines of credit              | 5,341                  | 6,325   |                      |
| Installment:                        |                        |   |                      |
| Consumer                            | 658                    | 976   |                      |
| Total installment                   | 658                    | 976   |                      |
| Lease financing                     | 28                     | 5,225   |                      |
| Total with no related allowance     | \$ 99,655              | \$ 129,072  | \$                   |
| With an allowance recorded:         |                        |   |                      |
| Commercial                          | \$ 15,627              | \$ 21,377   | \$ 7,135             |
| Commercial real estate mortgages    | 10,811                 | 11,215  | 1,551                |
| Residential mortgages:              |                        |   |                      |
| Fixed                               | 515                    | 535   | 40                   |
| Variable                            | 1,449                  | 1,476   | 68                   |
| Total residential mortgages         | 1,964                  | 2,011   | 108                  |
| Real estate construction:           |                        |   |                      |
| Land                                | 19,385                 | 29,381  | 4,377                |
| Total real estate construction      | 19,385                 | 29,381  | 4,377                |
| Equity lines of credit              | 1,292                  | 1,461   | 91                   |
| Total with an allowance             | \$ 49,079              | \$ 65,445   | \$ 13,262            |
| Total impaired loans by type:       |                        |   |                      |
| Commercial                          | \$ 25,780              | \$ 32,965   | \$ 7,135             |
| Commercial real estate mortgages    | 30,678                 | 35,198  | 1,551                |
| Residential mortgages               | 9,146                  | 10,046  | 108                  |
| Real estate construction            | 75,811                 | 102,321   | 4,377                |
| Equity lines of credit              | 6,633                  | 7,786   | 91                   |
| Installment                         | 658                    | 976   |                      |
| Lease financing                     | 28                     | 5,225   |                      |
| Total impaired loans                | \$ 148,734             | \$ 194,517  | \$ 13,262            |

- (1) The table has been revised to present unpaid contractual principal balances, whereas the Company had previously disclosed unpaid contractual principal balances that were net of charge-offs.



Table of Contents**Note 6. Loans, Allowance for Loan and Lease Losses, and Reserve for Off-Balance Sheet Credit Commitments (Continued)**

| (in thousands)                      | Recorded<br>Investment | Unpaid<br>Contractual<br>Principal<br>Balance (1) | Related<br>Allowance | For the three months ended<br>June 30, 2011 |                                  | For the six months ended<br>June 30, 2011 |                                  |
|-------------------------------------|------------------------|---|----------------------|---|----------------------------------|---|----------------------------------|
|                                     |                        |   |                      | Average<br>Recorded<br>Investment           | Interest<br>Income<br>Recognized | Average<br>Recorded<br>Investment         | Interest<br>Income<br>Recognized |
| <b>June 30, 2011</b>                |                        |   |                      |   |                                  |   |                                  |
| With no related allowance recorded: |                        |   |                      |   |                                  |   |                                  |
| Commercial                          | \$ 4,007               | \$ 23,764   | \$                   | \$ 5,204                                    | \$                               | \$ 5,901                                  | \$                               |
| Commercial real estate mortgages    | 14,610                 | 21,607  |                      | 16,550                                      | 60                               | 18,866                                    | 190                              |
| Residential mortgages:              |                        |   |                      |   |                                  |   |                                  |
| Fixed                               | 7,834                  | 8,678   |                      | 7,036                                       | 17                               | 8,338                                     | 162                              |
| Variable                            | 4,163                  | 4,595   |                      | 3,717                                       | 24                               | 3,827                                     | 34                               |
| Total residential mortgages         | 11,997                 | 13,273  |                      | 10,753                                      | 41                               | 12,165                                    | 196                              |
| Real estate construction:           |                        |   |                      |   |                                  |   |                                  |
| Construction                        | 39,184                 | 73,136  |                      | 44,221                                      | 175                              | 54,740                                    | 405                              |
| Land                                | 11,271                 | 15,100  |                      | 17,400                                      |                                  | 19,510                                    |                                  |
| Total real estate construction      | 50,455                 | 88,236  |                      | 61,621                                      | 175                              | 74,250                                    | 405                              |
| Equity lines of credit              | 2,420                  | 2,551   |                      | 2,856                                       |                                  | 2,906                                     |                                  |
| Installment:                        |                        |   |                      |   |                                  |   |                                  |
| Consumer                            | 41                     | 41  |                      | 41  |                                  | 41  |                                  |
| Total installment                   | 41                     | 41  |                      | 41  |                                  | 41  |                                  |
| Lease financing                     | 762                    | 6,279   |                      | 935   |                                  | 1,002                                     | 99                               |
| Total with no related allowance     | \$ 84,292              | \$ 155,751  | \$                   | \$ 97,960                                   | \$ 276                           | \$ 115,131                                | \$ 890                           |
| With an allowance recorded:         |                        |   |                      |   |                                  |   |                                  |
| Commercial                          | \$ 14,467              | \$ 46,222   | \$ 7,605             | \$ 10,695                                   | \$                               | \$ 9,986                                  | \$                               |
| Commercial real estate mortgages    | 9,159                  | 10,960  | 1,150                | 8,229                                       |                                  | 11,866                                    |                                  |
| Residential mortgages:              |                        |   |                      |   |                                  |   |                                  |
| Fixed                               | 539                    | 549   | 56                   | 1,046                                       |                                  | 886                                       |                                  |
| Variable                            |                        |   |                      | 707   |                                  | 950                                       |                                  |
| Total residential mortgages         | 539                    | 549   | 56                   | 1,753                                       |                                  | 1,836                                     |                                  |
| Real estate construction:           |                        |   |                      |   |                                  |   |                                  |
| Construction                        |                        |   |                      | 4,409                                       |                                  | 5,889                                     |                                  |
| Land                                | 10,175                 | 10,700  | 1,853                | 5,087                                       |                                  | 3,392                                     |                                  |
| Total real estate construction      | 10,175                 | 10,700  | 1,853                | 9,496                                       |                                  | 9,281                                     |                                  |
| Equity lines of credit              | 2,102                  | 2,555   | 404                  | 1,530                                       | 3                                | 1,642                                     | 6                                |
| Installment:                        |                        |   |                      |   |                                  |   |                                  |
| Commercial                          |                        |   |                      | 3,448                                       |                                  | 2,299                                     |                                  |
| Total installment                   |                        |   |                      | 3,448                                       |                                  | 2,299                                     |                                  |
| Lease financing                     |                        |   |                      |   |                                  | 285                                       |                                  |
| Total with an allowance             | \$ 36,442              | \$ 70,986   | \$ 11,068            | \$ 35,151                                   | \$ 3                             | \$ 37,195                                 | \$ 6                             |

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Total impaired loans by type:

|                                  |    |         |    |         |    |        |    |         |    |     |    |         |    |     |
|----------------------------------|----|---------|----|---------|----|--------|----|---------|----|-----|----|---------|----|-----|
| Commercial                       | \$ | 18,474  | \$ | 69,986  | \$ | 7,605  | \$ | 15,899  | \$ |     | \$ | 15,887  | \$ |     |
| Commercial real estate mortgages |    | 23,769  |    | 32,567  |    | 1,150  |    | 24,779  |    | 60  |    | 30,732  |    | 190 |
| Residential mortgages            |    | 12,536  |    | 13,822  |    | 56     |    | 12,506  |    | 41  |    | 14,001  |    | 196 |
| Real estate construction         |    | 60,630  |    | 98,936  |    | 1,853  |    | 71,117  |    | 175 |    | 83,531  |    | 405 |
| Equity lines of credit           |    | 4,522   |    | 5,106   |    | 404    |    | 4,386   |    | 3   |    | 4,548   |    | 6   |
| Installment                      |    | 41      |    | 41      |    |        |    | 3,489   |    |     |    | 2,340   |    |     |
| Lease financing                  |    | 762     |    | 6,279   |    |        |    | 935     |    |     |    | 1,287   |    | 99  |
| Total impaired loans             | \$ | 120,734 | \$ | 226,737 | \$ | 11,068 | \$ | 133,111 | \$ | 279 | \$ | 152,326 | \$ | 896 |

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- (1) The table has been revised to present unpaid contractual principal balances, whereas the Company had previously disclosed unpaid contractual principal balances that were net of charge-offs.

Table of Contents**Note 6. Loans, Allowance for Loan and Lease Losses, and Reserve for Off-Balance Sheet Credit Commitments (Continued)**

Impaired loans at June 30, 2012 and December 31, 2011 included \$72.8 million and \$46.6 million, respectively, of restructured loans that are on accrual status. With the exception of restructured loans on accrual status and a limited number of loans on cash basis nonaccrual for which the full collection of principal and interest is expected, interest income is not recognized on impaired loans until the principal balance of these loans is paid off.

*Troubled Debt Restructured Loans*

The following tables provide a summary of loans modified in a troubled debt restructuring during the three and six months ended June 30, 2012:

| (in thousands)                          | Number<br>of<br>Contracts | Pre-Modification<br>Outstanding<br>Principal | Period-End<br>Outstanding<br>Principal | Financial<br>Effects (1) |
|---|---------------------------|--|--|--------------------------|
| <b>Three months ended June 30, 2012</b> |                           |  |  |                          |
| Commercial                              | 4                         | \$ 18,179                                    | \$ 18,148                              | \$                       |
| Commercial real estate mortgages        | 2                         | 15,832                                       | 15,832                                 |                          |
| Real estate construction:               |                           |  |  |                          |
| Construction                            | 2                         | 9,325  | 9,325                                  |                          |
| Total troubled debt restructured loans  | 8                         | \$ 43,336                                    | \$ 43,305                              | \$                       |
| <b>Six months ended June 30, 2012</b>   |                           |  |  |                          |
| Commercial                              | 9                         | \$ 35,161                                    | \$ 32,351                              | \$                       |
| Commercial real estate mortgages        | 2                         | 15,832                                       | 15,832                                 |                          |
| Residential mortgages:                  |                           |  |  |                          |
| Fixed                                   | 1                         | 655  |  |                          |
| Real estate construction:               |                           |  |  |                          |
| Construction                            | 3                         | 14,857                                       | 14,458                                 |                          |
| Total troubled debt restructured loans  | 15                        | \$ 66,505                                    | \$ 62,641                              | \$                       |

(1) Financial effects are comprised of charge-offs and specific reserves recognized on TDR loans at modification date.

The following table provides a summary of troubled debt restructured ( TDR ) loans that subsequently defaulted during the six months ended June 30, 2012, that had been modified as a troubled debt restructuring during the 12 months prior to their default:

For the three months ended  
June 30, 2012

For the six months ended  
June 30, 2012

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| (in thousands)                             | Number<br>of<br>Contracts | Period-End<br>Outstanding<br>Principal | Period-End<br>Specific<br>Reserve | Number<br>of<br>Contracts | Period-End<br>Outstanding<br>Principal | Period-End<br>Specific<br>Reserve |
|--|---------------------------|--|-----------------------------------|---------------------------|--|-----------------------------------|
| Commercial                                 | 2                         | \$ 4,327                               | \$ 277                            | 3                         | \$ 4,341                               | \$ 277                            |
| Real estate construction:                  |                           |  |                                   |                           |  |                                   |
| Land                                       |                           |  |                                   | 2                         | 1,371                                  |                                   |
| Total loans that subsequently<br>defaulted | 2                         | \$ 4,327                               | \$ 277                            | 5                         | \$ 5,712                               | \$ 277                            |

Table of Contents**Note 6. Loans, Allowance for Loan and Lease Losses, and Reserve for Off-Balance Sheet Credit Commitments (Continued)**

A restructuring constitutes a troubled debt restructuring when a lender, for reasons related to a borrower's financial difficulties, grants a concession to the borrower it would not otherwise consider. Loans with pre-modification outstanding balances totaling \$43.3 million and \$66.5 million were modified in troubled debt restructurings during the three and six months ended June 30, 2012. The concessions granted in the restructurings completed in 2012 largely consisted of interest rate concessions and modification of payment terms to interest only. The unpaid principal balance of TDR loans was \$113.7 million, before specific reserves of \$2.6 million, at June 30, 2012 and \$89.4 million, before specific reserves of \$1.7 million, at December 31, 2011. The net increase in TDR loans from the prior year-end was attributable to \$66.4 million of additions that were partially offset by \$35.9 million of payments received. The remaining change in TDR loans was a result of charge-offs and loans that were removed from TDR status. Loans modified in troubled debt restructurings are impaired loans at the time of restructuring and subject to the same measurement criteria as all other impaired loans.

During the six months ended June 30, 2012, three commercial loans and two land loans that had been restructured within the preceding 12 months were not performing in accordance with their new terms. The defaults were primarily due to missed or late payments. Additionally, a land loan went into technical default when the borrower failed to sell the collateral by the date specified in the restructuring agreement. All other TDR loans were performing in accordance with their restructured terms at June 30, 2012. As of June 30, 2012, there were no commitments to lend additional funds on restructured loans.

*Past Due and Nonaccrual Loans and Leases*

Loans are considered past due following the date when either interest or principal is contractually due and unpaid. The following tables provide a summary of past due and nonaccrual loans, excluding covered loans, at June 30, 2012 and December 31, 2011 based upon the length of time the loans have been past due:

| (in thousands)                      | 30-59 Days<br>Past Due | 60-89 Days<br>Past Due | Greater<br>Than 90<br>Days and<br>Accruing | Nonaccrual | Total Past<br>Due and<br>Nonaccrual<br>Loans | Current      | Total Loans<br>and Leases |
|-------------------------------------|------------------------|------------------------|--|------------|--|--------------|---------------------------|
| <b>June 30, 2012</b>                |                        |                        |  |            |  |              |                           |
| Commercial                          | \$ 6,864               | \$ 2,218               |  | \$ 18,936  | \$ 28,018                                    | \$ 5,351,471 | \$ 5,379,489              |
| Commercial real estate<br>mortgages | 21,290                 | 20,859                 |  | 28,780     | 70,929                                       | 2,353,404    | 2,424,333                 |
| Residential mortgages:              |                        |                        |  |            |  |              |                           |
| Fixed                               |                        |                        | 1,244                                      | 5,000      | 6,244  | 1,493,281    | 1,499,525                 |
| Variable                            |                        |                        |  | 9,064      | 9,064  | 2,314,041    | 2,323,105                 |
| Total residential<br>mortgages      |                        |                        | 1,244                                      | 14,064     | 15,308                                       | 3,807,322    | 3,822,630                 |
| Real estate construction:           |                        |                        |  |            |  |              |                           |
| Construction                        | 1,717                  |                        |  | 15,126     | 16,843                                       | 219,930      | 236,773                   |
| Land                                |                        |                        |  | 14,550     | 14,550                                       | 50,506       | 65,056                    |
| Total real estate<br>construction   | 1,717                  |                        |  | 29,676     | 31,393                                       | 270,436      | 301,829                   |
| Equity lines of credit              | 520                    |                        | 322  | 6,505      | 7,347  | 733,923      | 741,270                   |
| Installment:                        |                        |                        |  |            |  |              |                           |

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|                   |           |           |          |           |            |               |               |         |  |     |     |
|-------------------|-----------|-----------|----------|-----------|------------|---------------|---------------|---------|--|-----|-----|
| Commercial        |           |           |          |           |            |               |               |         |  | 467 | 467 |
| Consumer          | 37        |           |          |           | 575        | 612           | 129,121       | 129,733 |  |     |     |
| Total installment | 37        |           |          |           | 575        | 612           | 129,588       | 130,200 |  |     |     |
| Lease financing   | 61        | 158       | 499      | 120       | 838        | 706,620       | 707,458       |         |  |     |     |
| Total             | \$ 30,489 | \$ 23,235 | \$ 2,065 | \$ 98,656 | \$ 154,445 | \$ 13,352,764 | \$ 13,507,209 |         |  |     |     |



Table of Contents**Note 6. Loans, Allowance for Loan and Lease Losses, and Reserve for Off-Balance Sheet Credit Commitments (Continued)**

| (in thousands)                      | 30-59 Days<br>Past Due | 60-89 Days<br>Past Due | Greater<br>Than 90<br>Days and<br>Accruing | Nonaccrual | Total Past<br>Due and<br>Nonaccrual<br>Loans | Current       | Total Loans<br>and Leases |
|-------------------------------------|------------------------|------------------------|--|------------|--|---------------|---------------------------|
| <b>December 31, 2011</b>            |                        |                        |  |            |  |               |                           |
| Commercial                          | \$ 6,817               | \$ 1,003               | \$   | \$ 19,888  | \$ 27,708                                    | \$ 4,818,886  | \$ 4,846,594              |
| Commercial real estate<br>mortgages | 5,838                  |                        |  | 21,948     | 27,786                                       | 2,082,963     | 2,110,749                 |
| Residential mortgages:              |                        |                        |  |            |  |               |                           |
| Fixed                               | 662                    | 525                    | 379  | 5,572      | 7,138  | 1,574,658     | 1,581,796                 |
| Variable                            |                        | 2,983                  |  | 4,199      | 7,182  | 2,174,240     | 2,181,422                 |
| Total residential<br>mortgages      | 662                    | 3,508                  | 379  | 9,771      | 14,320                                       | 3,748,898     | 3,763,218                 |
| Real estate construction:           |                        |                        |  |            |  |               |                           |
| Construction                        |                        |                        |  | 15,582     | 15,582                                       | 202,279       | 217,861                   |
| Land                                |                        |                        |  | 35,294     | 35,294                                       | 62,454        | 97,748                    |
| Total real estate<br>construction   |                        |                        |  | 50,876     | 50,876                                       | 264,733       | 315,609                   |
| Equity lines of credit              |                        |                        | 74   | 8,669      | 8,743  | 732,338       | 741,081                   |
| Installment:                        |                        |                        |  |            |  |               |                           |
| Commercial                          |                        |                        |  | 4          | 4  | 601           | 605                       |
| Consumer                            | 150                    |                        |  | 870        | 1,020  | 131,022       | 132,042                   |
| Total installment                   | 150                    |                        |  | 874        | 1,024  | 131,623       | 132,647                   |
| Lease financing                     |                        |                        |  |            |  | 399,487       | 399,487                   |
| Total                               | \$ 13,467              | \$ 4,511               | \$ 453                                     | \$ 112,026 | \$ 130,457                                   | \$ 12,178,928 | \$ 12,309,385             |

*Credit Quality Monitoring*

The Company closely monitors and assesses credit quality and credit risk in the loan and lease portfolio on an ongoing basis. Loan risk classifications are continuously reviewed and updated. The following tables provide a summary of the loan and lease portfolio, excluding covered loans, by loan type and credit quality classification as of June 30, 2012 and December 31, 2011. Nonclassified loans generally include those loans that are expected to be repaid in accordance with contractual loan terms. Classified loans are those loans that are classified as substandard or doubtful consistent with regulatory guidelines.

| (in thousands)                      | Nonclassified | June 30, 2012<br>Classified | Total        | Nonclassified | December 31, 2011<br>Classified | Total        |
|-------------------------------------|---------------|-----------------------------|--------------|---------------|---------------------------------|--------------|
| Commercial                          | \$ 5,224,293  | \$ 155,196                  | \$ 5,379,489 | \$ 4,732,663  | \$ 113,931                      | \$ 4,846,594 |
| Commercial real estate<br>mortgages | 2,269,348     | 154,985                     | 2,424,333    | 1,930,001     | 180,748                         | 2,110,749    |
| Residential mortgages:              |               |                             |              |               |                                 |              |
| Fixed                               | 1,484,559     | 14,966                      | 1,499,525    | 1,565,420     | 16,376                          | 1,581,796    |
| Variable                            | 2,310,241     | 12,864                      | 2,323,105    | 2,163,458     | 17,964                          | 2,181,422    |
| Total residential<br>mortgages      | 3,794,800     | 27,830                      | 3,822,630    | 3,728,878     | 34,340                          | 3,763,218    |
| Real estate construction:           |               |                             |              |               |                                 |              |
| Construction                        | 177,950       | 58,823                      | 236,773      | 147,916       | 69,945                          | 217,861      |

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|                                |               |            |               |               |            |               |
|--------------------------------|---------------|------------|---------------|---------------|------------|---------------|
| Land                           | 33,350        | 31,706     | 65,056        | 43,717        | 54,031     | 97,748        |
| Total real estate construction | 211,300       | 90,529     | 301,829       | 191,633       | 123,976    | 315,609       |
| Equity lines of credit         | 721,715       | 19,555     | 741,270       | 724,045       | 17,036     | 741,081       |
| Installment:                   |               |            |               |               |            |               |
| Commercial                     | 467           |            | 467           | 601           | 4          | 605           |
| Consumer                       | 129,072       | 661        | 129,733       | 130,921       | 1,121      | 132,042       |
| Total installment              | 129,539       | 661        | 130,200       | 131,522       | 1,125      | 132,647       |
| Lease financing                | 703,518       | 3,940      | 707,458       | 396,256       | 3,231      | 399,487       |
| Total                          | \$ 13,054,513 | \$ 452,696 | \$ 13,507,209 | \$ 11,834,998 | \$ 474,387 | \$ 12,309,385 |

Table of Contents**Note 6. Loans, Allowance for Loan and Lease Losses, and Reserve for Off-Balance Sheet Credit Commitments (Continued)***Credit Quality on Covered Loans*

The following is a summary of activity in the allowance for loan losses on covered loans:

| (in thousands)                              | For the three months ended<br>June 30, |           |  | For the six months ended<br>June 30, |           |  |
|---|--|-----------|--|--------------------------------------|-----------|--|
|   | 2012                                   | 2011      |  | 2012                                 | 2011      |  |
| Balance, beginning of period                | \$ 61,471                              | \$ 82,016 |  | \$ 64,565                            | \$ 67,389 |  |
| Provision for losses                        | 13,293                                 | 1,716     |  | 20,759                               | 20,832    |  |
| Reduction in allowance due to loan removals | (31,617)                               | (16,103)  |  | (42,177)                             | (20,592)  |  |
| Balance, end of period                      | \$ 43,147                              | \$ 67,629 |  | \$ 43,147                            | \$ 67,629 |  |

The allowance for loan losses on covered loans was \$43.1 million, \$64.6 million and \$67.6 million as of June 30, 2012, December 31, 2011 and June 30, 2011, respectively. The Company recorded provision expense of \$13.3 million and \$20.8 million on covered loans for the three and six months ended June 30, 2012, respectively, and \$1.7 million and \$20.8 million for the three and six months ended June 30, 2011, respectively. The Company updates its cash flow projections for covered loans accounted for under ASC 310-30 on a quarterly basis, and may recognize provision expense and an allowance for loan losses as a result of that analysis. The loss on covered loans is the result of changes in expected cash flows, both amount and timing, due to loan payments and the Company's revised loss forecasts. The revisions of the loss forecasts were based on the results of management's review of the credit quality of the outstanding covered loans and the analysis of the loan performance data since the acquisition of covered loans. The allowance for loan losses on covered loans is reduced for any loan removals. A loan is removed when it has been fully paid-off, fully charged off, sold or transferred to OREO.

Covered loans accounted for under ASC 310-30 are generally considered accruing and performing loans as the loans accrete interest income over the estimated life of the loan when cash flows are reasonably estimable. Accordingly, acquired impaired loans that are contractually past due are still considered to be accruing and performing loans. If the timing and amount of future cash flows is not reasonably estimable, the loans may be classified as nonaccrual loans and interest income is not recognized until the timing and amount of future cash flows can be reasonably estimated. At June 30, 2012 and December 31, 2011, there were no acquired impaired covered loans accounted for under ASC 310-30 that were on nonaccrual status. Of the population of covered loans that are accounted for outside the scope of ASC 310-30, the Company had \$0.4 million of acquired covered loans that were on nonaccrual status and were considered to be impaired as of June 30, 2012 and December 31, 2011.

At June 30, 2012, covered loans that were 30 to 89 days delinquent totaled \$17.3 million and covered loans that were 90 days or more past due on accrual status totaled \$190.0 million. At December 31, 2011, covered loans that were 30 to 89 days delinquent totaled \$49.1 million and covered loans that were 90 days or more past due on accrual status totaled \$330.2 million.

Table of Contents**Note 7. Other Real Estate Owned**

The following table provides a summary of OREO activity for the three months ended June 30, 2012 and 2011:

| (in thousands)               | For the three months ended<br>June 30, 2012 |                 |            | For the three months ended<br>June 30, 2011 |                 |            |
|------------------------------|---|-----------------|------------|---|-----------------|------------|
|                              | Non-Covered<br>OREO                         | Covered<br>OREO | Total      | Non-Covered<br>OREO                         | Covered<br>OREO | Total      |
| Balance, beginning of period | \$ 29,074                                   | \$ 78,456       | \$ 107,530 | \$ 56,342                                   | \$ 121,822      | \$ 178,164 |
| Additions                    | 10,476                                      | 22,960          | 33,436     | 3,967                                       | 33,549          | 37,516     |
| Sales                        | (1,540)                                     | (14,332)        | (15,872)   | (11,083)                                    | (24,836)        | (35,919)   |
| Valuation adjustments        | (3,343)                                     | (4,250)         | (7,593)    | (1,592)                                     | (15,628)        | (17,220)   |
| Balance, end of period       | \$ 34,667                                   | \$ 82,834       | \$ 117,501 | \$ 47,634                                   | \$ 114,907      | \$ 162,541 |

The following table provides a summary of OREO activity for the six months ended June 30, 2012 and 2011:

| (in thousands)               | For the six months ended<br>June 30, 2012 |                 |            | For the six months ended<br>June 30, 2011 |                 |            |
|------------------------------|---|-----------------|------------|---|-----------------|------------|
|                              | Non-Covered<br>OREO                       | Covered<br>OREO | Total      | Non-Covered<br>OREO                       | Covered<br>OREO | Total      |
| Balance, beginning of period | \$ 30,790                                 | \$ 98,550       | \$ 129,340 | \$ 57,317                                 | \$ 120,866      | \$ 178,183 |
| Additions                    | 12,693                                    | 29,035          | 41,728     | 10,528                                    | 61,126          | 71,654     |
| Sales                        | (4,417)                                   | (32,693)        | (37,110)   | (17,147)                                  | (43,153)        | (60,300)   |
| Valuation adjustments        | (4,399)                                   | (12,058)        | (16,457)   | (3,064)                                   | (23,932)        | (26,996)   |
| Balance, end of period       | \$ 34,667                                 | \$ 82,834       | \$ 117,501 | \$ 47,634                                 | \$ 114,907      | \$ 162,541 |

At June 30, 2012, OREO was \$117.5 million and included \$82.8 million of covered OREO. At December 31, 2011, OREO was \$129.3 million and included \$98.6 million of covered OREO. The balance of OREO at June 30, 2012 and December 31, 2011 is net of valuation allowances of \$38.8 million and \$37.4 million, respectively.

Covered OREO expenses and valuation write-downs are recorded in the noninterest expense section of the consolidated statements of income. Under the loss-sharing agreements, 80 percent of eligible covered OREO expenses and valuation write-downs are reimbursable to the Company from the FDIC. The portion of these expenses that is reimbursable is recorded in FDIC loss sharing income (expense), net in the noninterest income section of the consolidated statements of income.

Table of Contents**Note 8. Borrowed Funds**

Short-term borrowings consist of funds with remaining maturities of one year or less and long-term debt consists of borrowings with remaining maturities greater than one year. The components of short-term borrowings and long-term debt as of June 30, 2012 and December 31, 2011 are provided below:

| (in thousands) (1)  | June 30,<br>2012 | December 31,<br>2011 |
|---|------------------|----------------------|
| <b>Short-term borrowings</b>  |                  |                      |
| Current portion of senior notes:  |                  |                      |
| City National Corporation - 5.125% Senior Notes Due February 2013               | \$ 210,466       | \$ 50,000            |
| Federal funds purchased   | 110,000          | 50,000               |
| Current portion of nonrecourse debt (5)   | 1,611            |                      |
| Total short-term borrowings   | \$ 322,077       | \$ 50,000            |
| <b>Long-term debt</b>   |                  |                      |
| Senior notes:   |                  |                      |
| City National Corporation - 5.125% Senior Notes Due February 2013               | \$               | \$ 215,848           |
| City National Corporation - 5.25% Senior Notes Due September 2020               | 297,461          | 297,308              |
| Subordinated debt:  |                  |                      |
| City National Bank - 9.00% Subordinated Notes Due July 2019 (2)                 | 49,736           | 49,718               |
| City National Bank - 9.00% Subordinated Notes Due August 2019                   | 74,867           | 74,858               |
| City National Bank - Fixed and Floating Subordinated Notes due August 2019 (3)  | 54,902           | 54,895               |
| City National Bank - 5.375% Subordinated Notes Due July 2022                    | 149,018          |                      |
| Junior subordinated debt:   |                  |                      |
| Floating Rate Business Bancorp Capital Trust I Securities due November 2034 (4) | 5,151            | 5,151                |
| Nonrecourse debt (5)  | 81,145           |                      |
| Total long-term debt  | \$ 712,280       | \$ 697,778           |

- (1) The carrying value of certain borrowed funds is net of discount and issuance costs, which are being amortized into interest expense, as well as the impact of fair value hedge accounting, if applicable.
- (2) These notes bear a fixed interest rate of 9 percent for the initial five years from the date of issuance (July 15, 2009) and thereafter the rate is reset at the Bank's option to either LIBOR plus 600 basis points or to prime plus 500 basis points.
- (3) These notes bear a fixed interest rate of 9 percent for the initial five years from the date of issuance (August 12, 2009) and thereafter bear an interest rate equal to the three-month LIBOR rate plus 6 percent. The rate is reset quarterly and is subject to an interest rate cap of 10 percent throughout the term of the notes.
- (4) These floating rate securities pay interest of three-month LIBOR plus 1.965 percent which is reset quarterly. As of June 30, 2012, the interest rate was 2.43 percent.
- (5) Nonrecourse debt bears interest at an average rate of 4.09 percent as of June 30, 2012 and has maturity dates ranging from September 2012 to July 2018.

On April 30, 2012, the Company assumed \$320.9 million in borrowings in its acquisition of FAEF. Subsequent to the acquisition date, the Company paid off a significant portion of the outstanding balance and as of June 30, 2012, FAEF borrowings were comprised of \$82.8 million of nonrecourse debt. FAEF assigns the future rentals of certain lease financing loans to financial institutions on a nonrecourse basis at fixed interest rates. In return for future minimum lease rentals assigned, FAEF receives a discounted cash payment. Proceeds from discounting are reflected in the table above as nonrecourse debt.

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On June 20, 2012, the Bank issued \$150.0 million in subordinated notes that bear a fixed rate of interest of 5.375 percent. The notes mature on July 15, 2022. The proceeds will be used for general corporate purposes.

Table of Contents**Note 9. Shareholders' Equity**

The components of AOCI at June 30, 2012 and December 31, 2011 are as follows:

| (in thousands)                                       |    | June 30,<br>2012 |    | December 31,<br>2011 |
|--|----|------------------|----|----------------------|
| Net unrealized gain on securities available-for-sale | \$ | 82,668           | \$ | 73,235               |
| Net unrealized gain on cash flow hedges              |    | 139              |    | 222                  |
| Pension liability adjustment                         |    |                  |    | (1,085)              |
| Total accumulated other comprehensive income         | \$ | 82,807           | \$ | 72,372               |

The following table presents the tax effects allocated to each component of other comprehensive income for the three and six month periods ended June 30, 2012 and 2011:

| (in thousands)   | For the three months ended<br>June 30, 2012 |                          |            | For the three months ended<br>June 30, 2011 |                          |            |
|--|---|--------------------------|------------|---|--------------------------|------------|
|  | Pre-tax                                     | Tax expense<br>(benefit) | Net-of-tax | Pre-tax                                     | Tax expense<br>(benefit) | Net-of-tax |
| Securities available for sale:                                   |   |                          |            |   |                          |            |
| Net unrealized gains arising during the period                   | \$ 6,559                                    | \$ 2,744                 | \$ 3,815   | \$ 57,168                                   | \$ 23,914                | \$ 33,254  |
| Reclassification adjustment for net gains included in net income | (17)  | (7)                      | (10)       | (1,807)                                     | (759)                    | (1,048)    |
| Non-credit related impairment loss                               | (3,951)                                     | (1,652)                  | (2,299)    | (3,838)                                     | (1,605)                  | (2,233)    |
| Net change on cash flow hedges                                   | (41)  |                          | (41)       | (248)                                       |                          | (248)      |
| Pension liability adjustment                                     |   |                          |            | 33  |                          | 33         |
| Total other comprehensive income                                 | \$ 2,550                                    | \$ 1,085                 | \$ 1,465   | \$ 51,308                                   | \$ 21,550                | \$ 29,758  |

| (in thousands)   | For the six months ended<br>June 30, 2012 |                          |            | For the six months ended<br>June 30, 2011 |                          |            |
|--|---|--------------------------|------------|---|--------------------------|------------|
|  | Pre-tax                                   | Tax expense<br>(benefit) | Net-of-tax | Pre-tax                                   | Tax expense<br>(benefit) | Net-of-tax |
| Securities available for sale:                                   |   |                          |            |   |                          |            |
| Net unrealized gains arising during the period                   | \$ 20,580                                 | \$ 8,609                 | \$ 11,971  | \$ 40,469                                 | \$ 16,928                | \$ 23,541  |
| Reclassification adjustment for net gains included in net income | (411)                                     | (172)                    | (239)      | (1,895)                                   | (796)                    | (1,099)    |
| Non-credit related impairment loss                               | (3,951)                                   | (1,652)                  | (2,299)    | (3,838)                                   | (1,605)                  | (2,233)    |
| Net change on cash flow hedges                                   | (83)                                      |                          | (83)       | (834)                                     |                          | (834)      |
| Pension liability adjustment                                     | 1,085                                     |                          | 1,085      | 65  |                          | 65         |
|  | \$ 17,220                                 | \$ 6,785                 | \$ 10,435  | \$ 33,967                                 | \$ 14,527                | \$ 19,440  |

Total other comprehensive  
income

The following table summarizes the Company's share repurchases for the three months ended June 30, 2012. All repurchases relate to shares withheld or previously owned shares used to pay taxes due upon vesting of restricted stock. There were no issuer repurchases of the Corporation's common stock as part of its repurchase plan for the six months ended June 30, 2012.

| Period                          | Total Number<br>of Shares<br>(or Units)<br>Purchased | Average<br>Price Paid<br>per Share<br>(or Unit) |
|---------------------------------|--|---|
| April 1, 2012 to April 30, 2012 | 131  | \$ 52.61  |
| May 1, 2012 to May 31, 2012     | 42   | 53.52   |
| June 1, 2012 to June 30, 2012   | 1,162  | 47.97   |
|                                 | 1,335  | 48.60   |



Table of Contents**Note 10. Earnings per Common Share**

The Company applies the two-class method of computing basic and diluted EPS. Under the two-class method, EPS is determined for each class of common stock and participating security according to dividends declared and participation rights in undistributed earnings. The Company grants restricted stock and restricted stock units under a share-based compensation plan that qualify as participating securities.

The computation of basic and diluted EPS is presented in the following table:

| (in thousands, except per share amounts)             | For the three months ended<br>June 30, |           | For the six months ended<br>June 30, |           |
|--|--|-----------|--------------------------------------|-----------|
|  | 2012                                   | 2011      | 2012                                 | 2011      |
| <b>Basic EPS:</b>                                    |  |           |                                      |           |
| Net income attributable to City National Corporation | \$ 54,758                              | \$ 47,471 | \$ 101,023                           | \$ 87,163 |
| Less: Earnings allocated to participating securities | 788                                    | 759       | 1,532                                | 1,333     |
| Earnings allocated to common shareholders            | \$ 53,970                              | \$ 46,712 | \$ 99,491                            | \$ 85,830 |
| Weighted average common shares outstanding           | 53,105                                 | 52,462    | 52,923                               | 52,392    |
| Basic earnings per common share                      | \$ 1.02                                | \$ 0.89   | \$ 1.88                              | \$ 1.64   |
| <b>Diluted EPS:</b>                                  |  |           |                                      |           |
| Earnings allocated to common shareholders (1)        | \$ 53,972                              | \$ 46,718 | \$ 99,496                            | \$ 85,841 |
| Weighted average common shares outstanding           | 53,105                                 | 52,462    | 52,923                               | 52,392    |
| Dilutive effect of equity awards                     | 268                                    | 515       | 294                                  | 539       |
| Weighted average diluted common shares outstanding   | 53,373                                 | 52,977    | 53,217                               | 52,931    |
| Diluted earnings per common share                    | \$ 1.01                                | \$ 0.88   | \$ 1.87                              | \$ 1.62   |

- (1) Earnings allocated to common shareholders for basic and diluted EPS may differ under the two-class method as a result of adding common stock equivalents for options to dilutive shares outstanding, which alters the ratio used to allocate earnings to common shareholders and participating securities for the purposes of calculating diluted EPS.

The average price of the Company's common stock for the period is used to determine the dilutive effect of outstanding stock options. Antidilutive stock options are not included in the calculation of basic or diluted EPS. There were 2.7 million and 2.0 million average outstanding stock options that were antidilutive for the three months ended June 30, 2012 and 2011, respectively. There were 2.8 million and 1.8 million average outstanding stock options that were antidilutive for the six months ended June 30, 2012 and 2011, respectively.

**Note 11. Share-Based Compensation**

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On June 30, 2012, the Company had one share-based compensation plan, the Amended and Restated City National Corporation 2008 Omnibus Plan (the Plan), which was approved by the Company's shareholders on April 23, 2008. No new awards have been or will be granted under predecessor plans since the adoption of the Plan. The Plan permits the grant of stock options, restricted stock, restricted stock units, performance shares, performance share units, performance units and stock appreciation rights, or any combination thereof, to the Company's eligible employees and non-employee directors. No grants of performance shares, performance share units or stock appreciation rights had been made as of June 30, 2012. At June 30, 2012, there were approximately 1.9 million shares available for future grants. Refer to the Company's Annual Report on Form 10-K for the year ended December 31, 2011 for further discussion of the Company's share-based compensation plan.

Table of Contents**Note 11. Share-Based Compensation (Continued)**

The compensation cost that has been recognized for all share-based awards was \$4.3 million and \$9.0 million for the three and six months ended June 30, 2012, respectively, compared with \$4.8 million and \$9.5 million for the three and six months ended June 30, 2011, respectively. The total income tax benefit recognized in the consolidated statements of income for share-based compensation arrangements was \$1.8 million and \$3.8 million for the three and six months ended June 30, 2012, respectively, compared with \$2.0 million and \$4.0 million for the three and six months ended June 30, 2011, respectively. The Company received \$9.0 million and \$4.5 million in cash for the exercise of stock options during the six months ended June 30, 2012 and 2011, respectively. The actual tax benefit realized for the tax deductions from stock option exercises was \$0.9 million and \$1.1 million for the six months ended June 30, 2012 and 2011, respectively.

To estimate the fair value of stock option awards, the Company uses the Black-Scholes methodology, which incorporates the assumptions summarized in the table below:

|                             | For the three months ended<br>June 30, |        | For the six months ended<br>June 30, |        |
|-----------------------------|--|--------|--------------------------------------|--------|
|                             | 2012                                   | 2011   | 2012                                 | 2011   |
| Weighted-average volatility |  | 30.85% | 30.58%                               | 30.91% |
| Dividend yield              |  | 2.48%  | 2.14%                                | 1.47%  |
| Expected term (in years)    |  | 5.81   | 6.11                                 | 6.04   |
| Risk-free interest rate     |  | 2.24%  | 1.44%                                | 2.97%  |

Using the Black-Scholes methodology, the weighted-average grant-date fair values of options granted during the six months ended June 30, 2012 and 2011 were \$11.64 and \$18.38, respectively. The total intrinsic values of options exercised during the six months ended June 30, 2012 and 2011 were \$2.1 million and \$2.5 million, respectively.

A summary of option activity and related information for the six months ended June 30, 2012 is presented below:

| Options                        | Number of<br>Shares<br>(in thousands) | Weighted<br>Average<br>Exercise<br>Price<br>(per share) | Aggregate<br>Intrinsic<br>Value<br>(in thousands) (1) | Weighted<br>Average<br>Remaining<br>Contractual<br>Term |
|--------------------------------|---------------------------------------|---|---|---|
| Outstanding at January 1, 2012 | 4,990                                 | \$ 52.61  |   |   |
| Granted                        | 603                                   | 46.66   |   |   |
| Exercised                      | (217)                                 | 41.81   |   |   |
| Forfeited or expired           | (521)                                 | 51.46   |   |   |
| Outstanding at June 30, 2012   | 4,855                                 | \$ 52.48  | \$ 254,779  | 5.89  |
| Exercisable at June 30, 2012   | 3,246                                 | \$ 54.94  | \$ 178,354  | 4.58  |

(1) Includes in-the-money options only.

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A summary of changes in unvested options and related information for the six months ended June 30, 2012 is presented below:

| <b>Unvested Options</b>     | <b>Number of<br/>Shares<br/>(in thousands)</b> | <b>Weighted Average<br/>Grant Date<br/>Fair Value<br/>(per share)</b> |
|-----------------------------|--|---|
| Unvested at January 1, 2012 | 1,641  | \$ 13.57  |
| Granted                     | 603  | 11.64   |
| Vested                      | (608)  | 12.20   |
| Forfeited                   | (27)   | 13.08   |
| Unvested at June 30, 2012   | 1,609  | \$ 13.37  |

Table of Contents**Note 11. Share-Based Compensation (Continued)**

The number of options vested during the six months ended June 30, 2012 and 2011 was 608,172 and 592,266, respectively. The total fair value of options vested during the six months ended June 30, 2012 and 2011 was \$7.4 million and \$7.0 million, respectively. As of June 30, 2012, there was \$16.0 million of unrecognized compensation cost related to unvested stock options granted under the Company's plans. That cost is expected to be recognized over a weighted-average period of 2.7 years.

A summary of changes in restricted stock and related information for the six months ended June 30, 2012 is presented below:

| <b>Restricted Stock (1)</b> | <b>Number of<br/>Shares<br/>(in thousands)</b> | <b>Weighted Average<br/>Grant Date<br/>Fair Value<br/>(per share)</b> |
|-----------------------------|--|---|
| Unvested at January 1, 2012 | 875  | \$ 50.12  |
| Granted                     | 81   | 47.04   |
| Vested                      | (175)  | 46.05   |
| Forfeited                   | (11)   | 48.93   |
| Unvested at June 30, 2012   | 770  | \$ 50.73  |

(1) Includes restricted stock units.

Restricted stock is valued at the closing price of the Company's stock on the date of award. The weighted-average grant-date fair values of restricted stock granted during the six months ended June 30, 2012 and 2011 were \$47.04 and \$60.83, respectively. The number of restricted shares vested during the six months ended June 30, 2012 and 2011 was 174,710 and 151,457, respectively. The total fair value of restricted stock vested during the six months ended June 30, 2012 and 2011 was \$8.0 million and \$7.4 million, respectively. As of June 30, 2012, the unrecognized compensation cost related to restricted stock granted under the Company's plans was \$24.3 million. That cost is expected to be recognized over a weighted-average period of 3.3 years.

In February 2012, the Company amended the Plan to permit the grant of cash-settled restricted stock units. In general, twenty-five percent of the cash-settled restricted stock units vests two years from the date of grant, then twenty-five percent vests on each of the next three consecutive grant anniversary dates. The units are subject to forfeiture until the restrictions lapse or terminate. Upon vesting, the units are converted to cash based on the closing stock price at vesting date and distributed to plan participants. Plan participants are entitled to dividends, which vest and are paid at the same time as the underlying cash-settled restricted stock units. Dividends are subject to forfeiture in the same manner as the underlying cash-settled restricted stock units. A summary of changes in cash-settled restricted stock units for the six months ended June 30, 2012 is presented below:

| <b>Cash-Settled Restricted Stock Units</b> | <b>Number of<br/>Shares<br/>(in thousands)</b> |
|--|--|
| Unvested at January 1, 2012                |  |
| Granted                                    | 99   |

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|                           |     |
|---------------------------|-----|
| Forfeited                 | (1) |
| Unvested at June 30, 2012 | 98  |

Cash-settled restricted stock units are initially valued at the closing price of the Company's stock on the date of award and subsequently remeasured at each reporting date until settlement. The compensation expense related to cash-settled restricted stock units for the three and six months ended June 30, 2012 was \$0.3 million and \$0.4 million, respectively.

Table of Contents**Note 12. Derivative Instruments**

The following tables summarize the fair value and balance sheet classification of derivative instruments as of June 30, 2012 and December 31, 2011. The notional amount of the contract is not recorded on the consolidated balance sheets, but is used as the basis for determining the amount of interest payments to be exchanged between the counterparties. If a counterparty fails to perform, the Company's counterparty credit risk is equal to the amount reported as a derivative asset.

**Notional Amounts and Fair Values of Derivative Instruments**

| (in millions) (1)  | Notional<br>Amount | June 30, 2012<br>Derivative<br>Assets | Derivative<br>Liabilities | Notional<br>Amount | December 31, 2011<br>Derivative<br>Assets | Derivative<br>Liabilities |
|--|--------------------|---------------------------------------|---------------------------|--------------------|---|---------------------------|
| <b>Derivatives designated as hedging instruments</b>     |                    |                                       |                           |                    |   |                           |
| Interest rate swaps - fair value:                        |                    |                                       |                           |                    |   |                           |
| Long-term and subordinated debt                          | 205.5              | 6.2                                   |                           | 207.4              | 9.8                                       |                           |
| Total derivatives designated as hedging instruments      | \$ 205.5           | \$ 6.2                                | \$                        | \$ 207.4           | \$ 9.8                                    | \$                        |
| <b>Derivatives not designated as hedging instruments</b> |                    |                                       |                           |                    |   |                           |
| Interest rate contracts:                                 |                    |                                       |                           |                    |   |                           |
| Swaps  | \$ 1,684.1         | \$ 59.4                               | \$ 61.1                   | \$ 1,482.1         | \$ 51.3                                   | \$ 52.5                   |
| Interest-rate caps, floors and collars                   | 239.4              |                                       |                           | 267.1              | 0.3                                       | 0.3                       |
| Options purchased  | 2.0                | 0.2                                   | 0.2                       | 2.0                | 0.1                                       | 0.1                       |
| Options written  | 2.0                |                                       |                           | 2.0                |   |                           |
| Total interest-rate contracts                            | \$ 1,927.5         | \$ 59.6                               | \$ 61.3                   | \$ 1,753.2         | \$ 51.7                                   | \$ 52.9                   |
| Option contracts   | \$                 | \$ 0.4                                | \$                        | \$                 | \$ 0.7                                    | \$                        |
| Foreign exchange contracts:                              |                    |                                       |                           |                    |   |                           |
| Spot and forward contracts                               | \$ 262.8           | \$ 3.6                                | \$ 3.2                    | \$ 203.8           | \$ 2.1                                    | \$ 2.1                    |
| Options purchased  | 3.8                |                                       |                           |                    |   |                           |
| Options written  | 3.8                | 0.1                                   | 0.1                       |                    |   |                           |
| Total foreign exchange contracts                         | \$ 270.4           | \$ 3.7                                | \$ 3.3                    | \$ 203.8           | \$ 2.1                                    | \$ 2.1                    |
| Total derivatives not designated as hedging instruments  | \$ 2,197.9         | \$ 63.7                               | \$ 64.6                   | \$ 1,957.0         | \$ 54.5                                   | \$ 55.0                   |

(1) Derivative assets include the estimated gain to settle a derivative contract net of cash collateral received from counterparties plus net interest receivable. Derivative liabilities include the estimated loss to settle a derivative contract.

*Derivatives Designated as Hedging Instruments*

As of June 30, 2012, the Company had \$205.5 million notional amount of interest-rate swap hedge transactions, all of which were designated as fair value hedges. There were no cash flow hedges at June 30, 2012. The positive fair value of the fair value hedges of \$6.2 million is recorded in other assets. It includes a mark-to-market asset of \$5.1 million and net interest receivable of \$1.1 million. The balance of borrowings reported in the consolidated balance sheet includes a \$5.1 million mark-to-market adjustment associated with interest-rate hedge transactions.

As of December 31, 2011, the Company had \$207.4 million notional amount of interest-rate swap hedge transactions, all of which were designated as fair value hedges. There were no cash flow hedges outstanding at December 31, 2011. The positive fair value of the fair value hedges of \$9.8 million is recorded in other assets. It includes a mark-to-market asset of \$8.8 million and net interest receivable of \$1.0 million. The balance of deposits and borrowings reported in the consolidated balance sheet include a \$8.8 million mark-to-market adjustment associated with interest-rate hedge transactions.



Table of Contents**Note 12. Derivative Instruments (Continued)**

The periodic net settlement of interest-rate swaps is recorded as an adjustment to interest income or interest expense. The impact of interest-rate swaps on interest income and interest expense for the three and six months ended June 30, 2012 and 2011 is provided below:

| (in millions)<br>Derivative Instruments Designated as<br>Hedging Instruments | Location in Consolidated<br>Statements of Income | For the three months ended<br>June 30, |          | For the six months ended<br>June 30, |          |
|--|--|--|----------|--------------------------------------|----------|
|  |  | 2012                                   | 2011     | 2012                                 | 2011     |
| Interest-rate swaps-fair value   | Interest expense                                 | \$ (2.1)                               | \$ (4.3) | \$ (4.1)                             | \$ (8.5) |
| Interest-rate swaps-cash flow  | Interest income                                  |  | 0.2      | 0.1                                  | 0.8      |
| Total income   |  | \$ 2.1                                 | \$ 4.5   | \$ 4.2                               | \$ 9.3   |

Fair value interest-rate swaps increased net interest income by \$2.1 million and \$4.2 million for the three and six months ended June 30, 2012, respectively, and by \$4.5 million and \$9.3 million for the three and six months ended June 30, 2011, respectively.

Changes in fair value of the effective portion of cash flow hedges are reported in AOCI. When the cash flows associated with the hedged item are realized, the gain or loss included in AOCI is recognized in Interest income on loans and leases, the same location in the consolidated statements of income as the income on the hedged item. There were no cash flow hedges outstanding during the six month periods ended June 30, 2012 and June 30, 2011. The \$0.1 million of gain on cash flow hedges reclassified from AOCI to interest income for the six months ended June 30, 2012, respectively, represents the amortization of deferred gains on cash flow hedges that were terminated in 2010 prior to their respective maturity dates for which the hedge transactions had yet to occur. The amount of gains on cash flow hedges reclassified from AOCI to interest income for the three and six months ended June 30, 2011 was \$0.2 million and \$0.8 million, respectively. At June 30, 2012, the balance of deferred gain on terminated swaps reported in AOCI was \$0.1 million. This balance will be amortized into interest income within the next 12 months.

*Derivatives Not Designated as Hedging Instruments*

Derivative contracts not designated as hedges are composed primarily of interest rate contracts with clients that are offset by paired trades with unrelated bank counterparties and foreign exchange contracts. Derivative contracts not designated as hedges are marked-to-market each reporting period with changes in fair value recorded as a part of Noninterest income in the consolidated statements of income. The table below provides the amount of gains and losses on these derivative contracts for the three and six months ended June 30, 2012 and 2011:

| (in millions)<br>Derivatives Not Designated<br>as Hedging Instruments | Location in Consolidated<br>Statements of Income | For the three months ended<br>June 30, |          | For the six months ended<br>June 30, |          |
|---|--|--|----------|--------------------------------------|----------|
|   |  | 2012                                   | 2011     | 2012                                 | 2011     |
| Interest-rate contracts   | Other noninterest income                         | \$ (1.2)                               | \$ (0.4) | \$ (0.5)                             | \$ (0.3) |
| Option contracts  | Other noninterest income                         | (0.1)                                  | (0.1)    | (0.7)                                | (0.1)    |
| Foreign exchange contracts  | International services income                    | 6.5                                    | 5.8      | 12.3                                 | 11.3     |
| Total income  |  | \$ 5.2                                 | \$ 5.3   | \$ 11.1                              | \$ 10.9  |



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**Note 12. Derivative Instruments (Continued)**

*Credit Risk Exposure and Collateral*

The Company's swap agreements require the deposit of cash or marketable debt securities as collateral based on certain risk thresholds. These requirements apply individually to the Corporation and to the Bank. Additionally, certain of the Company's swap contracts contain security agreements that include credit-risk-related contingent features. Under these agreements, the collateral requirements are based on the Company's credit rating from the major credit rating agencies. The amount of collateral required may vary by counterparty based on a range of credit ratings that correspond with exposure thresholds established in the derivative agreements. If the credit ratings on the Company's debt were to fall below the level associated with a particular exposure threshold and the derivatives with a counterparty are in a net liability position that exceeds that threshold, the counterparty could request immediate payment or delivery of collateral for the difference between the net liability amount and the exposure threshold. The aggregate fair value of all derivative instruments with credit-risk-related contingent features that were in a net liability position on June 30, 2012 was \$36.4 million. The Company delivered collateral valued at \$22.1 million on swap agreements that had credit-risk contingent features and were in a net liability position at June 30, 2012.

The Company's interest-rate swaps had \$3.1 million and \$5.3 million of credit risk exposure at June 30, 2012 and December 31, 2011, respectively. The credit exposure represents the cost to replace, on a present value basis and at current market rates, all contracts by trading counterparty having an aggregate positive market value, net of margin collateral received. The Company enters into master netting agreements with swap counterparties to mitigate credit risk. Under these agreements, the net amount due from or payable to each counterparty is settled on the contract payment date. Collateral in the form of securities valued at \$3.0 million and \$5.0 million had been received from swap counterparties at June 30, 2012 and December 31, 2011, respectively. The Company delivered collateral valued at \$20.7 million on swap agreements that did not have credit-risk contingent features at June 30, 2012.

**Note 13. Income Taxes**

The Company recognized income tax expense of \$27.3 million and \$49.0 million for the three and six months ended June 30, 2012, respectively. The Company recognized income tax expense of \$20.7 million and \$38.5 million for the same periods in 2011.

The Company recognizes accrued interest and penalties relating to uncertain tax positions as an income tax provision expense. The Company recognized interest and penalties expense of approximately \$0.1 million and \$0.3 million for the six months ended June 30, 2012 and 2011, respectively. The Company had approximately \$3.3 million and \$3.2 million of accrued interest and penalties as of June 30, 2012 and December 31, 2011.

The Company and its subsidiaries file a consolidated federal income tax return and also file income tax returns in various state jurisdictions. The Company is currently being audited by the Internal Revenue Service for the tax years 2011 and 2012. The Company is also under audit with the California Franchise Tax Board for the tax years 2005 to 2007. The potential financial statement impact, if any, resulting from completion of these audits is expected to be minimal.

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From time to time, there may be differences in opinion with respect to the tax treatment of certain transactions. If a tax position which was previously recognized on the consolidated financial statements is no longer more likely than not to be sustained upon a challenge from the taxing authorities, the tax benefit from the tax position will be derecognized. The Company did not have any tax positions for which previously recognized benefits were derecognized during the six month period ended June 30, 2012.

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**Note 14. Employee Benefit Plans**

*Defined Contribution Plan*

The Company has a profit-sharing retirement plan with an Internal Revenue Code Section 401(k) feature covering eligible employees. Employer contributions are made annually into a trust fund and are allocated to participants based on their salaries. The profit sharing contribution requirement is based on a percentage of annual operating income subject to a percentage of salary cap. Eligible employees may contribute up to 50 percent of their salary to the 401(k) plan, but not more than the maximum allowed under Internal Revenue Service ( IRS ) regulations. The Company matches 50 percent of the first 6 percent of covered compensation. The Company recorded total profit sharing and matching contribution expense of \$4.8 million and \$9.4 million for the three and six months ended June 30, 2012, respectively. Profit sharing and matching contribution expense was \$4.5 million and \$9.0 million for the same periods in 2011, respectively.

*Deferred Compensation Plan*

The Company offers a deferred compensation plan for eligible employees and non-employee directors. Participants under the employee plan may make an annual irrevocable election to defer a portion of base salary and up to 100 percent of commission and incentive compensation while employed with the Company. Participants under the non-employee director plan also may make an annual irrevocable election to defer all or part of annual retainers, annual awards, committee chair retainers and meeting fees (collectively, directors fees ) until board service with the Company ceases. The deferred compensation plans are nonqualified plans under IRS regulations. Deferrals are made on a pretax basis and are allocated among the investment options available under the plans as directed by the plan participants. The Company funds plan benefits through the purchase of life insurance policies which are recorded in Other assets on the consolidated balance sheets. Participant deferrals are recorded in Other liabilities on the consolidated balance sheets. Employee salaries and non-employee directors fees deferred under the plan are charged to Salaries and employee benefits and Other operating expense, respectively, on the consolidated statements of income. Earnings on plan assets, net of benefits payable to plan participants, are reported in Salaries and employee benefits on the consolidated statements of income, and were \$0.3 million and \$0.4 million for the three and six months ended June 30, 2012, respectively. Earnings on plan assets, net of benefits payable to plan participants, were \$0.3 million and \$0.4 million for the same periods in 2011, respectively.

*Other Plans*

The Company administers a Supplemental Executive Retirement Plan ( SERP ) for one of its executive officers. On March 14, 2012, the SERP was amended. In exchange for cancellation of the executive officer s rights to receive supplemental retirement benefits under the SERP, the executive officer would receive fully vested interests in a deferred compensation stock fund under the amended plan. The present value of the accumulated SERP benefit under the amended plan at March 14, 2012 was deemed to be invested in the deferred compensation stock fund, with the number of units being determined by the closing price of the Company s stock on March 14, 2012. The benefit was converted to 167,423 units in the deferred compensation stock fund at March 14, 2012. Distributions to the executive officer from the stock fund will be made solely in Company stock upon termination of employment. As a result of this conversion, the Company reversed its \$8.3 million pension liability related to the SERP, recorded the fully vested interests in the deferred compensation stock fund in equity for the same amount, and recognized expense of \$1.7 million in the consolidated statements of income for the six months ended June 30, 2012. The Company recognized total expense related to this SERP of \$1.9 million for the six months ended June 30, 2012. There was no expense recognized during the three months ended June 30, 2012. Expense for the three and six months ended June 30, 2011 was \$0.2 million and \$0.5 million, respectively.

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The Company also has a SERP covering three former executives of Pacific Bank, which the Company acquired in 2000. As of June 30, 2012, there was an unfunded pension liability for this SERP of \$2.3 million. Expense for the three months ended June 30, 2012 and 2011 was insignificant. Expense for the six months ended June 30, 2012 and 2011 was \$0.1 million and \$0.3 million, respectively.

### **Note 15. Contingencies**

In connection with the liquidation of an investment acquired in a previous bank merger, the Company has an outstanding long-term indemnity. The maximum liability under the indemnity is \$23.0 million, but the Company does not expect to make any payments of more than nominal amounts under the terms of this indemnity.

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**Note 15. Contingencies (Continued)**

In 2011, the Company received unfavorable judgments through arbitration on two legal claims totaling \$7.2 million. Approximately \$5.3 million of these judgments was covered by the Company's insurance policies and was received in full by the Company in 2011. Net charges of \$1.2 million were included in Other operating expense in the noninterest expense section of the consolidated statements of income for the six months ended June 30, 2011.

**Note 16. Variable Interest Entities**

The Company holds ownership interests in certain special-purpose entities formed to provide affordable housing. The Company evaluates its interest in these entities to determine whether they meet the definition of a VIE and whether the Company is required to consolidate these entities. The Company is not the primary beneficiary of the affordable housing VIEs in which it holds interests and is therefore not required to consolidate these entities. The investment in these entities is initially recorded at cost, which approximates the maximum exposure to loss as a result of the Company's involvement with these unconsolidated entities. Subsequently, the carrying value is amortized over the stream of available tax credits and benefits. The Company expects to recover its investments over time, primarily through realization of federal low-income housing tax credits. The balance of the investments in these entities was \$145.6 million and \$121.0 million at June 30, 2012 and December 31, 2011, respectively, and is included in Affordable housing investments in the consolidated balance sheets. Unfunded commitments for affordable housing investments were \$57.6 million at June 30, 2012. These unfunded commitments are recorded in Other liabilities in the consolidated balance sheets.

Of the affordable housing investments held as of June 30, 2012, the Company had a significant variable interest in four affordable housing partnerships. These interests were acquired at various times from 1998 to 2001. The Company's maximum exposure to loss as a result of its involvement with these entities is limited to the \$1.8 million aggregate carrying value of these investments at June 30, 2012. There were no unfunded commitments for these affordable housing investments at June 30, 2012.

The Company also has ownership interests in several private equity and alternative investment funds that are VIEs. The Company is not a primary beneficiary and, therefore, is not required to consolidate these VIEs. The investment in these entities is carried at cost and net of impairments, which approximates the maximum exposure to loss as a result of the Company's involvement with these entities. The Company expects to recover its investments over time, primarily through the allocation of fund income, gains or losses on the sale of fund assets, dividends or interest income. The balance in these entities was \$40.2 million and \$39.9 million at June 30, 2012 and December 31, 2011, respectively, and is included in Other assets in the consolidated balance sheets. Income associated with these investments is reported in Other noninterest income in the consolidated statements of income.

**Note 17. Noncontrolling Interest**

In accordance with ASC Topic 810, *Consolidation*, and EITF Topic D-98, *Classification and Measurement of Redeemable Securities* (Topic D-98), the Company reports noncontrolling interest in its majority-owned affiliates as either a separate component of equity in Noncontrolling interest in the consolidated balance sheets or as Redeemable noncontrolling interest in the mezzanine section between liabilities and equity in the consolidated financial statements. Topic D-98 specifies that securities that are redeemable at the option of the holder or outside the control of the

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issuer are not considered permanent equity and should be classified in the mezzanine section.

The Bank previously had two real estate investment trust subsidiaries that had issued preferred stock to third-party investors. The ownership interests of third-party investors were included in Noncontrolling interest in the equity section of the consolidated balance sheets. In July and August 2011, the Company liquidated or redeemed all outstanding shares of preferred stock held by noncontrolling interest owners.

### *Redeemable Noncontrolling Interest*

The Corporation holds a majority ownership interest in five investment management and wealth advisory affiliates that it consolidates. In general, the management of each majority-owned affiliate has a significant noncontrolling ownership position in its firm and supervises the day-to-day operations of the affiliate. The Corporation is in regular contact with each affiliate regarding its operations and is an active participant in the management of the affiliates through its position on each firm's board.



Table of Contents**Note 17. Noncontrolling Interest (Continued)**

The Corporation's investment in each affiliate is governed by operating agreements and other arrangements which provide the Corporation certain rights, benefits and obligations. The Corporation determines the appropriate method of accounting based upon these agreements and the factors contained therein. All majority-owned affiliates that have met the criteria for consolidation are included in the consolidated financial statements. All material intercompany balances and transactions are eliminated. The Company applies the equity method of accounting for certain investments where it holds a noncontrolling interest. For equity method investments, the Company's portion of income before taxes is included in Trust and investment fees in the consolidated statements of income.

As of June 30, 2012, affiliate noncontrolling owners held equity interests with an estimated fair value of \$41.9 million. This estimate reflects the maximum obligation to purchase equity interests in the affiliates. The events which would require the Company to purchase the equity interests may occur in the near term or over a longer period of time. The terms of the put provisions vary by agreement, but the value of the put is at the approximate fair value of the interests. The parent company carries key man life insurance policies to fund a portion of these conditional purchase obligations in the event of the death of certain key holders.

The following is a summary of activity for redeemable noncontrolling interest for the six months ended June 30, 2012 and 2011:

| (in thousands)                                      | For the six months ended |           |
|---|--------------------------|-----------|
|   | June 30,                 |           |
|   | 2012                     | 2011      |
| Balance, beginning of period                        | \$ 44,643                | \$ 45,676 |
| Net income  | 652                      | 1,120     |
| Distributions to redeemable noncontrolling interest | (867)                    | (1,163)   |
| Additions and redemptions, net                      | (1,737)                  | (1,379)   |
| Adjustments to fair value                           | (792)                    | 110       |
| Other   |                          | (627)     |
| Balance, end of period                              | \$ 41,899                | \$ 43,737 |

**Note 18. Segment Results**

The Company has three reportable segments: Commercial and Private Banking, Wealth Management and Other. The factors considered in determining whether individual operating segments could be aggregated include that the operating segments: (i) offer the same products and services, (ii) offer services to the same types of clients, (iii) provide services in the same manner and (iv) operate in the same regulatory environment. The management accounting process measures the performance of the operating segments based on the Company's management structure and is not necessarily comparable with similar information for other financial services companies. If the management structures and/or the allocation process changes, allocations, transfers and assignments may change.

The Commercial and Private Banking reportable segment is the aggregation of the Commercial and Private Banking, Real Estate, Entertainment, Corporate Banking and Core Branch Banking operating segments. The Commercial and Private Banking segment provides banking products and services, including commercial and mortgage loans, lines of credit, deposits, cash management services, international trade finance and letters of credit to small and medium-sized businesses, entrepreneurs and affluent individuals. This segment primarily serves clients in California, New

York, Nevada, Tennessee and Georgia.

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**Note 18. Segment Results (Continued)**

The Wealth Management segment includes the Corporation's investment advisory affiliates and the Bank's Wealth Management Services. The asset management affiliates and the Wealth Management division of the Bank make the following investment advisory and wealth management resources and expertise available to individual and institutional clients: investment management, wealth advisory services, brokerage, estate and financial planning and personal, business, custodial and employee trust services. The Wealth Management segment also advises and makes available mutual funds under the name of CNI Charter Funds. Both the asset management affiliates and the Bank's Wealth Management division provide proprietary and nonproprietary products to offer a full spectrum of investment solutions in all asset classes and investment styles, including fixed-income instruments, mutual funds, domestic and international equities and alternative investments such as hedge funds. This segment serves clients nationwide.

The Other segment includes all other subsidiaries of the Company, the corporate departments, including the Treasury Department and the Asset Liability Funding Center, that have not been allocated to the other segments, and inter-segment eliminations for revenue recognized in multiple segments for management reporting purposes. The Company uses traditional matched-maturity funds transfer pricing methodology. However, both positive and negative variances occur over time when transfer pricing non-maturing balance sheet items such as demand deposits. These variances, offset in the Funding Center, are evaluated annually by management and allocated back to the business segments as deemed necessary.

Business segment earnings are the primary measure of the segment's performance as evaluated by management. Business segment earnings include direct revenue and expenses of the segment as well as corporate and inter-company cost allocations. Allocations of corporate expenses, such as data processing and human resources, are calculated based on estimated activity levels for the fiscal year. Costs associated with intercompany support and services groups, such as Operational Services, are allocated to each business segment based on actual services used. Capital is allocated based on the estimated risk within each business segment. The methodology of allocating capital is based on each business segment's credit, market, and operational risk profile. If applicable, any provision for credit losses is allocated based on various credit factors, including but not limited to, credit risk ratings, credit rating fluctuation, charge-offs and recoveries and loan growth.

Income taxes are charged to the business segments at the statutory rate. The Other segment includes an adjustment to reconcile to the Company's overall effective tax rate.

Exposure to market risk is managed in the Company's Treasury department. Interest rate risk is mostly removed from the Commercial and Private Banking segment and transferred to the Funding Center through a fund transfer pricing (FTP) methodology and allocating model. The FTP model records a cost of funds or credit for funds using a combination of matched maturity funding for fixed term assets and liabilities and a blended rate for the remaining assets and liabilities with varying maturities.

The Bank's investment portfolio and unallocated equity are included in the Other segment. Amortization expense associated with customer-relationship intangibles is charged to the affected operating segments.

Selected financial information for each segment is presented in the following tables. Commercial and Private Banking includes all revenue and costs from products and services utilized by clients of Commercial and Private Banking, including both revenue and costs for Wealth

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Management products and services. The revenues and costs associated with Wealth Management products and services that are allocated to Commercial and Private Banking for management reporting purposes are eliminated in the Other segment. The current period reflects any changes made in the process or methodology for allocations to the reportable segments. Prior period segment results have been revised to conform with current period presentation.

Table of Contents**Note 18. Segment Results (Continued)**

| (in thousands)   | For the three months ended June 30, 2012 |                   |           |            | Consolidated Company |
|--|--|-------------------|-----------|------------|----------------------|
|  | Commercial and Private Banking           | Wealth Management | Other     |            |                      |
| <b>Earnings Summary:</b>   |  |                   |           |            |                      |
| Net interest income  | \$ 184,768                               | \$ 649            | \$ 31,062 | \$ 216,479 |                      |
| Provision for credit losses on loans and leases, excluding covered loans | 1,000                                    |                   |           | 1,000      |                      |
| Provision for losses on covered loans                                    | 13,293                                   |                   |           | 13,293     |                      |
| Noninterest income   | 50,311                                   | 39,966            | (15,509)  | 74,768     |                      |
| Depreciation and amortization  | 3,414                                    | 1,538             | 4,579     | 9,531      |                      |
| Noninterest expense  | 165,834                                  | 36,102            | (16,951)  | 184,985    |                      |
| Income before income taxes   | 51,538                                   | 2,975             | 27,925    | 82,438     |                      |
| Provision for income taxes   | 21,646                                   | 1,078             | 4,547     | 27,271     |                      |
| Net income   | 29,892                                   | 1,897             | 23,378    | 55,167     |                      |
| Less: Net income attributable to noncontrolling interest                 |  | 409               |           | 409        |                      |
| Net income attributable to City National Corporation                     | \$ 29,892                                | \$ 1,488          | \$ 23,378 | \$ 54,758  |                      |

**Selected Average Balances:**

|   |               |         |           |    |            |
|---|---------------|---------|-----------|----|------------|
| Loans and leases, excluding covered loans | \$ 13,073,029 | \$      | \$ 52,838 | \$ | 13,125,867 |
| Covered loans                             | 1,341,041     |         |           |    | 1,341,041  |
| Total assets                              | 14,728,913    | 530,179 | 9,103,454 |    | 24,362,546 |
| Deposits                                  | 20,379,604    | 96,839  | 471,803   |    | 20,948,246 |
| Goodwill                                  | 370,333       | 162,813 |           |    | 533,146    |
| Customer-relationship intangibles, net    | 8,129         | 25,714  |           |    | 33,843     |

|   | For the three months ended June 30, 2011 |                      |           |                         |  |
|---|--|----------------------|-----------|-------------------------|--|
| (in thousands)  | Commercial and<br>Private Banking        | Wealth<br>Management | Other     | Consolidated<br>Company |  |
| <b>Earnings Summary:</b>                                    |  |                      |           |                         |  |
| Net interest income   | \$ 181,034                               | \$ 531               | \$ 9,262  | \$ 190,827              |  |
| Provision for losses on covered loans                       | 1,716                                    |                      |           | 1,716                   |  |
| Noninterest income  | 60,121                                   | 41,065               | (9,249)   | 91,937                  |  |
| Depreciation and amortization                               | 3,654                                    | 1,498                | 3,856     | 9,008                   |  |
| Noninterest expense   | 178,690                                  | 39,551               | (15,417)  | 202,824                 |  |
| Income before income taxes                                  | 57,095                                   | 547                  | 11,574    | 69,216                  |  |
| Provision (benefit) for income taxes                        | 23,980                                   | (6)                  | (3,324)   | 20,650                  |  |
| Net income  | 33,115                                   | 553                  | 14,898    | 48,566                  |  |
| Less: Net income attributable to noncontrolling interest    |  | 562                  | 533       | 1,095                   |  |
| Net income (loss) attributable to City National Corporation | \$ 33,115                                | \$ (9)               | \$ 14,365 | \$ 47,471               |  |

**Selected Average Balances:**

|   |               |         |           |    |            |
|---|---------------|---------|-----------|----|------------|
| Loans and leases, excluding covered loans | \$ 11,453,329 | \$      | \$ 62,660 | \$ | 11,515,989 |
| Covered loans                             | 1,770,377     |         |           |    | 1,770,377  |
| Total assets                              | 13,733,704    | 553,839 | 7,722,206 |    | 22,009,749 |
| Deposits                                  | 18,348,651    | 61,393  | 374,404   |    | 18,784,448 |
| Goodwill                                  | 324,762       | 161,635 |           |    | 486,397    |
| Customer-relationship intangibles, net    | 12,511        | 28,164  |           |    | 40,675     |



Table of Contents**Note 18. Segment Results (Continued)**

| (in thousands)  | For the six months ended June 30, 2012 |                      |           |                         |
|---|--|----------------------|-----------|-------------------------|
|   | Commercial and<br>Private Banking      | Wealth<br>Management | Other     | Consolidated<br>Company |
| <b>Earnings Summary:</b>  |  |                      |           |                         |
| Net interest income   | \$ 356,568                             | \$ 1,265             | \$ 59,359 | \$ 417,192              |
| Provision for credit losses on loans and leases,<br>excluding covered loans | 1,000                                  |                      |           | 1,000                   |
| Provision for losses on covered loans                                       | 20,759                                 |                      |           | 20,759                  |
| Noninterest income  | 97,555                                 | 79,337               | (26,424)  | 150,468                 |
| Depreciation and amortization   | 6,996                                  | 2,984                | 8,865     | 18,845                  |
| Noninterest expense   | 337,322                                | 72,191               | (33,122)  | 376,391                 |
| Income before income taxes  | 88,046                                 | 5,427                | 57,192    | 150,665                 |
| Provision for income taxes  | 36,979                                 | 2,006                | 10,005    | 48,990                  |
| Net income  | 51,067                                 | 3,421                | 47,187    | 101,675                 |
| Less: Net income attributable to noncontrolling<br>interest                 |  | 652                  |           | 652                     |
| Net income attributable to City National<br>Corporation                     | \$ 51,067                              | \$ 2,769             | \$ 47,187 | \$ 101,023              |

**Selected Average Balances:**

|   |               |         |           |               |
|---|---------------|---------|-----------|---------------|
| Loans and leases, excluding covered loans | \$ 12,726,026 | \$      | \$ 53,054 | \$ 12,779,080 |
| Covered loans                             | 1,389,877     |         |           | 1,389,877     |
| Total assets                              | 14,433,156    | 533,956 | 9,036,610 | 24,003,722    |
| Deposits                                  | 20,050,801    | 97,937  | 434,083   | 20,582,821    |
| Goodwill                                  | 347,547       | 162,367 |           | 509,914       |
| Customer-relationship intangibles, net    | 8,568         | 26,103  |           | 34,671        |

| (in thousands)  | For the six months ended June 30, 2011 |                      |           |                         |
|---|--|----------------------|-----------|-------------------------|
|   | Commercial and<br>Private Banking      | Wealth<br>Management | Other     | Consolidated<br>Company |
| <b>Earnings Summary:</b>                                    |  |                      |           |                         |
| Net interest income   | \$ 353,719                             | \$ 1,099             | \$ 17,299 | \$ 372,117              |
| Provision for losses on covered loans                       | 20,832                                 |                      |           | 20,832                  |
| Noninterest income  | 123,332                                | 82,941               | (20,443)  | 185,830                 |
| Depreciation and amortization                               | 7,287                                  | 2,947                | 7,690     | 17,924                  |
| Noninterest expense   | 344,195                                | 77,735               | (30,625)  | 391,305                 |
| Income before income taxes                                  | 104,737                                | 3,358                | 19,791    | 127,886                 |
| Provision (benefit) for income taxes                        | 43,990                                 | 940                  | (6,394)   | 38,536                  |
| Net income  | 60,747                                 | 2,418                | 26,185    | 89,350                  |
| Less: Net income attributable to noncontrolling<br>interest |  | 1,120                | 1,067     | 2,187                   |
| Net income attributable to City National<br>Corporation     | \$ 60,747                              | \$ 1,298             | \$ 25,118 | \$ 87,163               |

**Selected Average Balances:**

|   |               |         |           |               |
|---|---------------|---------|-----------|---------------|
| Loans and leases, excluding covered loans | \$ 11,326,163 | \$      | \$ 60,494 | \$ 11,386,657 |
| Covered loans                             | 1,790,569     |         |           | 1,790,569     |
| Total assets                              | 13,634,595    | 553,547 | 7,507,430 | 21,695,572    |
| Deposits                                  | 18,051,444    | 54,020  | 380,205   | 18,485,669    |
| Goodwill                                  | 324,985       | 161,638 |           | 486,623       |
| Customer-relationship intangibles, net    | 12,461        | 28,551  |           | 41,012        |





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**Note 19. Subsequent Event**

On July 2, 2012, the Company acquired Rochdale Investment Management ( Rochdale ), a \$4.89 billion New York City-based investment firm that manages assets for affluent and high-net-worth clients and their financial advisors across the nation. Rochdale will combine with City National Asset Management to become City National Rochdale Investments, a registered investment advisor which will operate as a wholly owned subsidiary of the Bank. It will offer a wide array of equity, fixed income and non-traditional investment alternatives. The Company expects the integration of the two firms to be completed early next year. At the issuance date of these financial statements, the Company had not completed its initial accounting for this business combination.

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

**CAUTIONARY STATEMENT FOR PURPOSES OF THE SAFE HARBOR PROVISIONS  
OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995**

We have made forward-looking statements in this document about the Company, for which the Company claims the protection of the safe harbor provisions contained in the Private Securities Litigation Reform Act of 1995.

A number of factors, many of which are beyond the Company's ability to control or predict, could cause future results to differ materially from those contemplated by such forward looking statements. These factors include (1) changes in general economic, political, or industry conditions and the related credit and market conditions and the impact they have on the Company and its customers, (2) the impact on financial markets and the economy of the level of U.S. and European debt, (3) changes in the pace of economic recovery and related changes in employment levels, (4) the effect of the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 and the new rules and regulations to be promulgated by supervisory and oversight agencies implementing the new legislation, taking into account that the precise timing, extent and nature of such rules and regulations and the impact on the Company is uncertain, (5) significant changes in applicable laws and regulations, including those concerning taxes, banking and securities, (6) volatility in the municipal bond market, (7) changes in the level of nonperforming assets, charge-offs, other real estate owned and provision expense, (8) incorrect assumptions in the value of the loans acquired in FDIC-assisted acquisitions resulting in greater than anticipated losses in the acquired loan portfolios exceeding the losses covered by the loss-sharing agreements with the FDIC, (9) the effects of and changes in trade and monetary and fiscal policies and laws, including the interest rate policies of the Federal Reserve Board, (10) changes in inflation, interest rates, and market liquidity which may impact interest margins and impact funding sources, (11) adequacy of the Company's enterprise risk management framework, (12) the Company's ability to increase market share and control expenses, (13) the Company's ability to attract new employees and retain and motivate existing employees, (14) increased competition in the Company's markets, (15) changes in the financial performance and/or condition of the Company's borrowers, including adverse impact on loan utilization rates, delinquencies, defaults and customers' ability to meet certain credit obligations, changes in customers' suppliers, and other counterparties' performance and creditworthiness, (16) a substantial and permanent loss of either client accounts and/or assets under management at the Company's investment advisory affiliates or its wealth management division, (17) changes in consumer spending, borrowing and savings habits, (18) soundness of other financial institutions which could adversely affect the Company, (19) protracted labor disputes in the Company's markets, (20) earthquake, fire or other natural disasters affecting the condition of real estate collateral, (21) the effect of acquisitions and integration of acquired businesses and de novo branching efforts, (22) the impact of changes in regulatory, judicial or legislative tax treatment of business transactions, (23) changes in accounting policies or procedures as may be required by the Financial Accounting Standards Board or regulatory agencies, (24) security breaches and disruptions to the Company's information systems, and (25) the success of the Company at managing the risks involved in the foregoing.

Forward-looking statements speak only as of the date they are made, and the Company does not undertake to update forward-looking statements to reflect circumstances or events that occur after the date the statements are made, or to update earnings guidance, including the factors that influence earnings.

For a more complete discussion of these risks and uncertainties, see the Company's Annual Report on Form 10-K for the year ended December 31, 2011 and particularly, Item 1A, titled "Risk Factors."



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## CITY NATIONAL CORPORATION

## FINANCIAL HIGHLIGHTS

| (in thousands, except per share amounts)                     | At or for the three months ended |                                  |                                 | Percent change                          |                  |
|--|----------------------------------|----------------------------------|---------------------------------|---|------------------|
|  | June 30,<br>2012<br>(Unaudited)  | March 31,<br>2012<br>(Unaudited) | June 30,<br>2011<br>(Unaudited) | June 30, 2012 from<br>March 31,<br>2012 | June 30,<br>2011 |
| <b>For The Quarter</b>                                       |                                  |                                  |                                 |   |                  |
| Net income attributable to City National Corporation         | \$ 54,758                        | \$ 46,265                        | \$ 47,471                       | 18%                                     | 15%              |
| Net income per share, basic                                  | 1.02                             | 0.86                             | 0.89                            | 19                                      | 15               |
| Net income per share, diluted                                | 1.01                             | 0.86                             | 0.88                            | 17                                      | 15               |
| Dividends per share  | 0.25                             | 0.25                             | 0.20                            |   | 25               |
| <b>At Quarter End</b>  |                                  |                                  |                                 |   |                  |
| Assets   | \$ 24,801,973                    | \$ 24,038,489                    | \$ 22,526,089                   | 3                                       | 10               |
| Securities   | 8,028,695                        | 7,917,912                        | 6,473,884                       | 1                                       | 24               |
| Loans and leases, excluding covered loans                    | 13,507,209                       | 12,747,902                       | 11,663,123                      | 6                                       | 16               |
| Covered loans (1)  | 1,260,135                        | 1,397,156                        | 1,724,634                       | (10)                                    | (27)             |
| Deposits   | 21,109,052                       | 20,787,737                       | 19,265,120                      | 2                                       | 10               |
| Shareholders' equity   | 2,255,365                        | 2,199,565                        | 2,058,921                       | 3                                       | 10               |
| Total equity   | 2,255,365                        | 2,199,565                        | 2,084,010                       | 3                                       | 8                |
| Book value per share   | 42.70                            | 41.77                            | 39.24                           | 2                                       | 9                |
| <b>Average Balances</b>                                      |                                  |                                  |                                 |   |                  |
| Assets   | \$ 24,362,546                    | \$ 23,644,899                    | \$ 22,009,749                   | 3                                       | 11               |
| Securities   | 7,755,330                        | 7,929,312                        | 6,224,348                       | (2)                                     | 25               |
| Loans and leases, excluding covered loans                    | 13,125,867                       | 12,432,292                       | 11,515,989                      | 6                                       | 14               |
| Covered loans (1)  | 1,341,041                        | 1,438,714                        | 1,770,377                       | (7)                                     | (24)             |
| Deposits   | 20,948,246                       | 20,217,395                       | 18,784,448                      | 4                                       | 12               |
| Shareholders' equity   | 2,234,411                        | 2,168,748                        | 2,028,357                       | 3                                       | 10               |
| Total equity   | 2,234,411                        | 2,168,748                        | 2,053,447                       | 3                                       | 9                |
| <b>Selected Ratios</b>                                       |                                  |                                  |                                 |   |                  |
| Return on average assets (annualized)                        | 0.90%                            | 0.79%                            | 0.87%                           | 14                                      | 3                |
| Return on average shareholders' equity (annualized)          | 9.86                             | 8.58                             | 9.39                            | 15                                      | 5                |
| Corporation's tier 1 leverage                                | 6.74                             | 6.98                             | 7.09                            | (3)                                     | (5)              |
| Corporation's tier 1 risk-based capital                      | 9.58                             | 10.20                            | 10.66                           | (6)                                     | (10)             |
| Corporation's total risk-based capital                       | 12.91                            | 12.71                            | 13.34                           | 2                                       | (3)              |
| Period-end shareholders' equity to period-end assets         | 9.09                             | 9.15                             | 9.14                            | (1)                                     | (1)              |
| Period-end equity to period-end assets                       | 9.09                             | 9.15                             | 9.25                            | (1)                                     | (2)              |
| Dividend payout ratio, per share                             | 24.57                            | 28.91                            | 22.40                           | (15)                                    | 10               |
| Net interest margin  | 3.91                             | 3.74                             | 3.85                            | 5                                       | 2                |
| Expense to revenue ratio (2)                                 | 63.28                            | 67.27                            | 66.24                           | (6)                                     | (4)              |
| <b>Asset Quality Ratios (3)</b>                              |                                  |                                  |                                 |   |                  |
| Nonaccrual loans to total loans and leases                   | 0.73%                            | 0.88%                            | 1.14%                           | (17)                                    | (36)             |
| Nonaccrual loans and OREO to total loans and leases and OREO | 0.98                             | 1.11                             | 1.54                            | (12)                                    | (36)             |
|  | 2.00                             | 2.09                             | 2.28                            | (4)                                     | (12)             |

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|   |        |        |        |      |      |
|---|--------|--------|--------|------|------|
| Allowance for loan and lease losses to total loans and leases |        |        |        |      |      |
| Allowance for loan and lease losses to nonaccrual loans       | 273.21 | 235.87 | 200.25 | 16   | 36   |
| Net recoveries to average total loans and leases (annualized) | 0.08   | 0.15   | 0.15   | (47) | (47) |

**At Quarter End**

|   |    |            |    |            |    |            |     |      |
|---|----|------------|----|------------|----|------------|-----|------|
| Assets under management (4)                   | \$ | 32,105,076 | \$ | 32,535,021 | \$ | 36,407,304 | (1) | (12) |
| Assets under management or administration (4) |    | 57,984,361 |    | 57,837,897 |    | 58,502,035 | 0   | (1)  |

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(1) Covered loans represent acquired loans that are covered under loss-sharing agreements with the Federal Deposit Insurance Corporation ( FDIC ).

(2) The expense to revenue ratio is defined as noninterest expense excluding other real estate owned ( OREO ) expense divided by total revenue (net interest income on a fully taxable-equivalent basis and noninterest income).

(3) Excludes covered assets, which consist of acquired loans and OREO that are covered under loss-sharing agreements with the FDIC.

(4) Excludes \$18.39 billion, \$18.48 billion and \$19.54 billion of assets under management for asset managers in which the Company held a noncontrolling ownership interest as of June 30, 2012, March 31, 2012 and June 30, 2011, respectively.

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**CRITICAL ACCOUNTING POLICIES**

The accounting and reporting policies of the Company conform with U.S. generally accepted accounting principles. The Company's accounting policies are fundamental to understanding management's discussion and analysis of results of operations and financial condition. The Company has identified 11 policies as being critical because they require management to make estimates, assumptions and judgments that affect the reported amount of assets and liabilities, contingent assets and liabilities, and revenues and expenses included in the consolidated financial statements. The judgments and assumptions used by management are based on historical experience and other factors, which are believed to be reasonable under the circumstances. Circumstances and events that differ significantly from those underlying the Company's estimates, assumptions and judgments could cause the actual amounts reported to differ significantly from these estimates.

The Company's critical accounting policies include those that address accounting for business combinations, financial assets and liabilities reported at fair value, securities, acquired impaired loans, allowance for loan and lease losses and reserve for off-balance sheet credit commitments, OREO, goodwill and other intangible assets, noncontrolling interest, share-based compensation plans, income taxes, and derivatives and hedging activities. The Company has not made any significant changes in its critical accounting policies or its estimates and assumptions from those disclosed in its 2011 Annual Report. Management has applied its critical accounting policies and estimation methods consistently in all periods presented in these financial statements.

**RECENT DEVELOPMENTS**

On April 30, 2012, the Company acquired First American Equipment Finance (FAEF), a privately owned, full-service mid-ticket equipment leasing company. Headquartered in Rochester, New York, FAEF leases technology and office equipment nationwide. Its clients include educational institutions, hospitals and health systems, large law firms, insurance underwriters, enterprise businesses, professional service businesses and nonprofit organizations. The acquisition significantly expands the Company's equipment leasing and finance capabilities and provides a platform for future growth. FAEF operates as a wholly owned subsidiary of the Bank. Excluding the effects of acquisition accounting adjustments, the Company acquired approximately \$343.0 million in assets and assumed \$325.0 million in liabilities. The Company acquired lease receivables with a fair value of \$318.3 million and assumed borrowings and nonrecourse debt with a fair value of \$320.9 million.

On June 20, 2012, the Bank completed an offering of \$150.0 million of 10-year subordinated debt securities with a fixed interest rate of 5.375 percent. The Company will use the proceeds for general corporate purposes.

On July 2, 2012, the Company acquired Rochdale Investment Management (Rochdale), a New York City-based investment firm that manages \$4.89 billion of assets for affluent and high-net-worth clients and their financial advisors across the nation. Rochdale will combine with City National Asset Management to become City National Rochdale Investments, a registered investment advisor which will operate as a wholly owned subsidiary of the Bank. It will offer a wide array of equity, fixed income and non-traditional investment alternatives. The Company expects the integration of the two firms to be completed early next year.

**HIGHLIGHTS**

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- For the quarter ended June 30, 2012, consolidated net income attributable to City National Corporation was \$54.8 million, or \$1.01 per diluted share, compared to \$47.5 million, or \$0.88 per diluted share, for the year-earlier quarter. During the six month period ended June 30, 2012, consolidated net income attributable to City National Corporation was \$101.0 million, or \$1.87 per diluted share, compared to \$87.2 million, or \$1.62 per diluted share, for the year-earlier period. The growth in net income was primarily attributable to an increase in net interest income as a result of higher interest income from securities and covered loans and lower interest expense on deposits. The increase in net interest income, combined with lower noninterest expense, was partially offset by lower noninterest income. Earnings for the second quarter of 2012 also included a net income statement impact of \$5.9 million from the recovery of a previously charged-off loan and \$2.8 million of transaction costs related to the acquisitions of Rochdale and FAEF.

- Revenue, which consists of net interest income and noninterest income, was \$291.2 million for the second quarter of 2012, up 5 percent from \$276.4 million in the first quarter of 2012 and 3 percent from \$282.8 million in the year-earlier quarter.

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- Fully taxable-equivalent net interest income, including dividend income, amounted to \$221.4 million for the second quarter of 2012, up 8 percent from the first quarter of 2012 and 13 percent from the year-earlier period.
- The Company's net interest margin in the second quarter of 2012 was 3.91 percent, up from 3.74 percent in the first quarter of 2012 and 3.85 percent in the second quarter of 2011.
- Noninterest income was \$74.8 million for the second quarter of 2012, down 1 percent from the first quarter of 2012 and 19 percent from the year-earlier quarter. The year-over-year decrease was due largely to lower net gains on both the sale of covered OREO and transfer of covered loans to OREO. Noninterest income for the second quarter of 2011 also included an \$8.2 million gain from an FDIC-assisted acquisition.
- Noninterest expense for the second quarter of 2012 was \$194.5 million, down 3 percent from the first quarter of 2012 and 8 percent from the year-earlier quarter. The year-over-year decline was due largely to lower OREO expenses and FDIC assessments. Legal and professional fees were also down due to the reimbursement of legal expenses related to a recovery of a previously charged-off loan. This decline was partly offset by transaction costs related to the acquisition of Rochdale and FAEF.
- The Company's effective tax rate was 33.1 percent for the second quarter of 2012 compared with 31.8 percent for the first quarter of 2012 and 29.8 percent from the year-earlier period.
- Total assets were \$24.80 billion at June 30, 2012, up 3 percent from \$24.04 billion at March 31, 2012 and 10 percent from \$22.53 billion at June 30, 2011. Total average assets were \$24.36 billion for the second quarter of 2012, compared to \$23.64 billion for the first quarter of 2012 and \$22.01 billion for the second quarter of 2011.
- Loans and leases, excluding covered loans, were \$13.51 billion at June 30, 2012, an increase of 6 percent from March 31, 2012 and 16 percent from June 30, 2011. Average loans for the second quarter of 2012, excluding covered loans, were \$13.13 billion, up 6 percent from the first quarter of 2012 and 14 percent from the same period of last year. Average commercial loan balances grew 10 percent from the first quarter of 2012 and 25 percent from the year-earlier period.
- Excluding covered loans, results for the second quarter of 2012 included a \$1.0 million provision for loan and lease losses. The Company recorded no provision in the first quarter of 2012 and second quarter of 2011. The allowance for loan and lease losses on non-covered loans was \$269.5 million at June 30, 2012, compared with \$266.1 million at March 31, 2012 and \$265.9 million at June 30, 2011. The Company remains adequately reserved at 2.00 percent of total loans and leases, excluding covered loans, at June 30, 2012, compared with 2.09 percent at March 31, 2012 and 2.28 percent at June 30, 2011.
- In the second quarter of 2012, net loan recoveries totaled \$2.7 million, or 0.08 percent of average total loans and leases, excluding covered loans, on an annualized basis, compared with net recoveries of \$4.5 million, or 0.15 percent, for the first quarter of 2012, and net recoveries of



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\$4.2 million, or 0.15 percent, in the year-earlier quarter. Nonaccrual loans, excluding covered loans, totaled \$98.7 million at June 30, 2012, down from \$112.8 million at March 31, 2012 and \$132.8 million at June 30, 2011. At June 30, 2012, nonperforming assets, excluding covered assets, were \$133.3 million, down from \$141.9 million at March 31, 2012 and \$180.4 million at June 30, 2011.

- Average securities for the second quarter of 2012 totaled \$7.76 billion, down 2 percent from the first quarter of 2012, but up 25 percent from the second quarter of 2011, as deposit growth outpaced loan growth.
- Period-end deposits at June 30, 2012 were \$21.11 billion, up 2 percent from \$20.79 billion at March 31, 2012 and 10 percent from \$19.27 billion at June 30, 2011. Average deposit balances for the second quarter of 2012 grew to \$20.95 billion, up 4 percent from \$20.22 billion for the first quarter of 2012 and 12 percent from \$18.78 billion for the second quarter of 2011. Average core deposits, which equal 97 percent of total deposit balances, were up 4 percent from the first quarter of 2012 and 13 percent from the second quarter of 2011.
- The Company's ratio of Tier 1 common shareholders' equity to risk-based assets was 9.6 percent at June 30, 2012 compared with 10.2 percent at March 31, 2012 and 10.5 percent at June 30, 2011. Refer to the "Capital" section of Management's Discussion and Analysis for further discussion of this non-GAAP measure.

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**OUTLOOK**

The Company's management continues to anticipate net income growth throughout 2012, as loans and deposits continue to increase and credit quality remains stable. This outlook reflects management's expectations for modest economic growth, and low interest rates for the remainder of the year. Management also anticipates modest loan loss provisions driven primarily by loan growth.

**RESULTS OF OPERATIONS**

**Net Interest Income**

Net interest income is the difference between interest income (which includes yield-related loan fees) and interest expense. Net interest income on a fully taxable-equivalent basis expressed as a percentage of average total earning assets is referred to as the net interest margin, which represents the average net effective yield on earning assets. The following tables present the components of net interest income on a fully taxable-equivalent basis for the three and six months ended June 30, 2012 and 2011:

Table of Contents**Net Interest Income Summary**

| (in thousands) (1)  | For the three months ended<br>June 30, 2012 |                                       |                             | For the three months ended<br>June 30, 2011 |                                       |                             |
|---|---|---------------------------------------|-----------------------------|---|---------------------------------------|-----------------------------|
|   | Average<br>balance                          | Interest<br>income/<br>expense (2)(4) | Average<br>interest<br>rate | Average<br>balance                          | Interest<br>income/<br>expense (2)(4) | Average<br>interest<br>rate |
| <b>Assets</b>   |   |                                       |                             |   |                                       |                             |
| Interest-earning assets   |   |                                       |                             |   |                                       |                             |
| Loans and leases  |   |                                       |                             |   |                                       |                             |
| Commercial  | \$ 5,844,586                                | \$ 60,333                             | 4.15%                       | \$ 4,693,254                                | \$ 49,411                             | 4.22%                       |
| Commercial real estate mortgages  | 2,294,830                                   | 26,801                                | 4.70                        | 1,903,480                                   | 26,909                                | 5.67                        |
| Residential mortgages   | 3,815,144                                   | 40,812                                | 4.28                        | 3,663,003                                   | 43,805                                | 4.78                        |
| Real estate construction  | 310,631                                     | 3,331                                 | 4.31                        | 395,227                                     | 5,030                                 | 5.10                        |
| Equity lines of credit  | 731,105                                     | 6,417                                 | 3.53                        | 729,885                                     | 6,540                                 | 3.59                        |
| Installment   | 129,571                                     | 1,559                                 | 4.84                        | 131,140                                     | 1,597                                 | 4.88                        |
| Total loans and leases, excluding covered loans (3)                     | 13,125,867                                  | 139,253                               | 4.27                        | 11,515,989                                  | 133,292                               | 4.64                        |
| Covered loans   | 1,341,041                                   | 48,648                                | 14.51                       | 1,770,377                                   | 38,527                                | 8.70                        |
| Total loans and leases  | 14,466,908                                  | 187,901                               | 5.22                        | 13,286,366                                  | 171,819                               | 5.19                        |
| Due from banks - interest-bearing                                       | 293,272                                     | 173                                   | 0.24                        | 526,405                                     | 407                                   | 0.31                        |
| Federal funds sold and securities purchased under resale agreements     | 136,773                                     | 96                                    | 0.28                        | 142,398                                     | 98                                    | 0.28                        |
| Securities  | 7,755,330                                   | 45,927                                | 2.37                        | 6,224,348                                   | 41,386                                | 2.66                        |
| Other interest-earning assets   | 116,861                                     | 694                                   | 2.39                        | 134,840                                     | 703                                   | 2.09                        |
| Total interest-earning assets   | 22,769,144                                  | 234,791                               | 4.15                        | 20,314,357                                  | 214,413                               | 4.23                        |
| Allowance for loan and lease losses                                     | (331,090)                                   |                                       |                             | (343,581)                                   |                                       |                             |
| Cash and due from banks   | 148,106                                     |                                       |                             | 184,218                                     |                                       |                             |
| Other non-earning assets  | 1,776,386                                   |                                       |                             | 1,854,755                                   |                                       |                             |
| Total assets  | \$ 24,362,546                               |                                       |                             | \$ 22,009,749                               |                                       |                             |
| <b>Liabilities and Equity</b>   |   |                                       |                             |   |                                       |                             |
| Interest-bearing deposits   |   |                                       |                             |   |                                       |                             |
| Interest checking accounts  | \$ 1,890,174                                | \$ 456                                | 0.10                        | \$ 1,706,556                                | \$ 743                                | 0.17                        |
| Money market accounts   | 5,855,607                                   | 1,876                                 | 0.13                        | 6,682,870                                   | 7,175                                 | 0.43                        |
| Savings deposits  | 360,222                                     | 127                                   | 0.14                        | 327,363                                     | 263                                   | 0.32                        |
| Time deposits - under \$100,000   | 228,172                                     | 285                                   | 0.50                        | 307,938                                     | 376                                   | 0.49                        |
| Time deposits - \$100,000 and over                                      | 733,029                                     | 822                                   | 0.45                        | 833,070                                     | 1,459                                 | 0.70                        |
| Total interest-bearing deposits   | 9,067,204                                   | 3,566                                 | 0.16                        | 9,857,797                                   | 10,016                                | 0.41                        |
| Federal funds purchased and securities sold under repurchase agreements | 3,511                                       | 1                                     | 0.11                        | 10,528                                      | 2                                     | 0.07                        |
| Other borrowings  | 797,321                                     | 9,843                                 | 4.97                        | 854,777                                     | 9,291                                 | 4.36                        |
| Total interest-bearing liabilities                                      | 9,868,036                                   | 13,410                                | 0.55                        | 10,723,102                                  | 19,309                                | 0.72                        |
| Noninterest-bearing deposits  | 11,881,042                                  |                                       |                             | 8,926,651                                   |                                       |                             |
| Other liabilities   | 379,057                                     |                                       |                             | 306,549                                     |                                       |                             |
| Total equity  | 2,234,411                                   |                                       |                             | 2,053,447                                   |                                       |                             |
| Total liabilities and equity  | \$ 24,362,546                               |                                       |                             | \$ 22,009,749                               |                                       |                             |
| Net interest spread   |   |                                       | 3.60%                       |   |                                       | 3.51%                       |
| Fully taxable-equivalent net interest and dividend income               |   | \$ 221,381                            |                             |   | \$ 195,104                            |                             |
| Net interest margin   |   |                                       | 3.91%                       |   |                                       | 3.85%                       |
| Less: Dividend income included in other income                          |   | 694                                   |                             |   | 703                                   |                             |

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|  |    |         |    |         |
|--|----|---------|----|---------|
| Fully taxable-equivalent net interest income | \$ | 220,687 | \$ | 194,401 |
|--|----|---------|----|---------|

- 
- (1) Certain prior period balances have been reclassified to conform to the current period presentation.
  - (2) Net interest income is presented on a fully taxable-equivalent basis.
  - (3) Includes average nonaccrual loans of \$107,713 and \$143,881 for 2012 and 2011, respectively.
  - (4) Loan income includes loan fees of \$7,252 and \$6,410 for 2012 and 2011, respectively.

Table of Contents**Net Interest Income Summary**

| (in thousands) (1)  | For the six months ended<br>June 30, 2012 |                                       |                             | For the six months ended<br>June 30, 2011 |                                       |                             |
|---|---|---------------------------------------|-----------------------------|---|---------------------------------------|-----------------------------|
|   | Average<br>balance                        | Interest<br>income/<br>expense (2)(4) | Average<br>interest<br>rate | Average<br>balance                        | Interest<br>income/<br>expense (2)(4) | Average<br>interest<br>rate |
| <b>Assets</b>   |   |                                       |                             |   |                                       |                             |
| Interest-earning assets   |   |                                       |                             |   |                                       |                             |
| Loans and leases  |   |                                       |                             |   |                                       |                             |
| Commercial  | \$ 5,581,619                              | \$ 112,403                            | 4.05%                       | \$ 4,565,917                              | \$ 96,410                             | 4.26%                       |
| Commercial real estate mortgages  | 2,230,380                                 | 53,035                                | 4.78                        | 1,913,914                                 | 53,276                                | 5.61                        |
| Residential mortgages   | 3,796,402                                 | 81,960                                | 4.32                        | 3,613,042                                 | 86,680                                | 4.80                        |
| Real estate construction  | 312,156                                   | 7,490                                 | 4.83                        | 421,512                                   | 10,064                                | 4.81                        |
| Equity lines of credit  | 729,035                                   | 12,881                                | 3.55                        | 731,497                                   | 13,000                                | 3.58                        |
| Installment   | 129,488                                   | 3,139                                 | 4.87                        | 140,775                                   | 3,382                                 | 4.85                        |
| Total loans and leases, excluding covered loans (3)                     | 12,779,080                                | 270,908                               | 4.26                        | 11,386,657                                | 262,812                               | 4.65                        |
| Covered loans   | 1,389,877                                 | 86,872                                | 12.50                       | 1,790,569                                 | 73,767                                | 8.24                        |
| Total loans and leases  | 14,168,957                                | 357,780                               | 5.08                        | 13,177,226                                | 336,579                               | 5.15                        |
| Due from banks - interest-bearing                                       | 230,209                                   | 266                                   | 0.23                        | 508,478                                   | 705                                   | 0.28                        |
| Federal funds sold and securities purchased under resale agreements     | 75,659                                    | 106                                   | 0.28                        | 186,653                                   | 252                                   | 0.27                        |
| Securities  | 7,842,321                                 | 93,511                                | 2.38                        | 5,960,301                                 | 80,539                                | 2.70                        |
| Other interest-earning assets   | 118,774                                   | 1,385                                 | 2.34                        | 136,895                                   | 1,403                                 | 2.07                        |
| Total interest-earning assets   | 22,435,920                                | 453,048                               | 4.06                        | 19,969,553                                | 419,478                               | 4.24                        |
| Allowance for loan and lease losses                                     | (332,968)                                 |                                       |                             | (336,250)                                 |                                       |                             |
| Cash and due from banks   | 144,771                                   |                                       |                             | 192,583                                   |                                       |                             |
| Other non-earning assets  | 1,755,999                                 |                                       |                             | 1,869,686                                 |                                       |                             |
| Total assets  | \$ 24,003,722                             |                                       |                             | \$ 21,695,572                             |                                       |                             |
| <b>Liabilities and Equity</b>   |   |                                       |                             |   |                                       |                             |
| Interest-bearing deposits   |   |                                       |                             |   |                                       |                             |
| Interest checking accounts  | \$ 1,921,178                              | \$ 980                                | 0.10                        | \$ 1,738,960                              | \$ 1,557                              | 0.18                        |
| Money market accounts   | 5,936,604                                 | 4,078                                 | 0.14                        | 6,568,195                                 | 14,328                                | 0.44                        |
| Savings deposits  | 359,158                                   | 254                                   | 0.14                        | 315,247                                   | 520                                   | 0.33                        |
| Time deposits - under \$100,000   | 235,202                                   | 582                                   | 0.50                        | 316,631                                   | 825                                   | 0.53                        |
| Time deposits - \$100,000 and over                                      | 714,841                                   | 1,705                                 | 0.48                        | 827,796                                   | 2,976                                 | 0.72                        |
| Total interest-bearing deposits   | 9,166,983                                 | 7,599                                 | 0.17                        | 9,766,829                                 | 20,206                                | 0.42                        |
| Federal funds purchased and securities sold under repurchase agreements | 84,935                                    | 32                                    | 0.08                        | 5,293                                     | 2                                     | 0.07                        |
| Other borrowings  | 746,969                                   | 18,658                                | 5.02                        | 856,653                                   | 18,621                                | 4.38                        |
| Total interest-bearing liabilities                                      | 9,998,887                                 | 26,289                                | 0.53                        | 10,628,775                                | 38,829                                | 0.74                        |
| Noninterest-bearing deposits  | 11,415,838                                |                                       |                             | 8,718,840                                 |                                       |                             |
| Other liabilities   | 387,418                                   |                                       |                             | 322,077                                   |                                       |                             |
| Total equity  | 2,201,579                                 |                                       |                             | 2,025,880                                 |                                       |                             |
| Total liabilities and equity  | \$ 24,003,722                             |                                       |                             | \$ 21,695,572                             |                                       |                             |
| Net interest spread   |   |                                       | 3.53%                       |   |                                       | 3.50%                       |
| Fully taxable-equivalent net interest and dividend income               |   | \$ 426,759                            |                             |   | \$ 380,649                            |                             |
| Net interest margin   |   | 1,385                                 | 3.83%                       |   | 1,403                                 | 3.84%                       |

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Less: Dividend income included in  
other income

Fully taxable-equivalent net interest  
income

\$ 425,374

\$ 379,246

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(1) Certain prior period balances have been reclassified to conform to the current period presentation.

(2) Net interest income is presented on a fully taxable-equivalent basis.

(3) Includes average nonaccrual loans of \$111,201 and \$157,479 for 2012 and 2011, respectively.

(4) Loan income includes loan fees of \$12,291 and \$10,651 for 2012 and 2011, respectively.

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Net interest income is impacted by the volume (changes in volume multiplied by prior rate), interest rate (changes in rate multiplied by prior volume), and mix of interest-earning assets and interest-bearing liabilities. The following table provides a breakdown of the changes in net interest income on a fully taxable-equivalent basis and dividend income due to volume and rate between the second quarter and first six months of 2012 and 2011. The impact of interest rate swaps, which affect interest income on loans and leases and interest expense on deposits and borrowings, is included in rate changes.

**Changes In Net Interest Income**

| (in thousands) (1)  | For the three months ended June 30,<br>2012 vs 2011 |          |                               | For the three months ended June 30,<br>2011 vs 2010 |          |                               |
|---|---|----------|-------------------------------|---|----------|-------------------------------|
|   | Increase (decrease)<br>due to                       |          | Net<br>increase<br>(decrease) | Increase (decrease)<br>due to                       |          | Net<br>increase<br>(decrease) |
|   | Volume  | Rate     |                               | Volume  | Rate     |                               |
| Interest earned on:   |   |          |                               |   |          |                               |
| Total loans and leases (2)  | \$ 14,891   | \$ 1,191 | \$ 16,082                     | \$ (4,015)  | \$ 325   | \$ (3,690)                    |
| Securities  | 9,374   | (4,833)  | 4,541                         | 13,933  | (6,882)  | 7,051                         |
| Due from banks -<br>interest-bearing                                      | (152)   | (82)     | (234)                         | (121)   | 104      | (17)                          |
| Federal funds sold and<br>securities purchased under<br>resale agreements | (5)   | 3        | (2)                           | (51)  | 14       | (37)                          |
| Other interest-earning assets   | (101)   | 92       | (9)                           | (62)  | 102      | 40                            |
| Total interest-earning assets   | 24,007  | (3,629)  | 20,378                        | 9,684   | (6,337)  | 3,347                         |
| Interest paid on:   |   |          |                               |   |          |                               |
| Interest checking deposits  | 73  | (360)    | (287)                         | (329)   | (341)    | (670)                         |
| Money market deposits   | (796)   | (4,503)  | (5,299)                       | 1,646   | (2,102)  | (456)                         |
| Savings deposits  | 24  | (160)    | (136)                         | 28  | (103)    | (75)                          |
| Time deposits   | (260)   | (468)    | (728)                         | (754)   | (613)    | (1,367)                       |
| Total borrowings  | (726)   | 1,277    | 551                           | (1,509)   | (2,419)  | (3,928)                       |
| Total interest-bearing<br>liabilities                                     | (1,685)   | (4,214)  | (5,899)                       | (918)   | (5,578)  | (6,496)                       |
|   | \$ 25,692   | \$ 585   | \$ 26,277                     | \$ 10,602   | \$ (759) | \$ 9,843                      |

(1) Certain prior period balances have been reclassified to conform to current period presentation.

(2) Includes covered loans.

**Changes In Net Interest Income**

| (in thousands) (1)  | For the six months ended June 30,<br>2012 vs 2011 |      |                               | For the six months ended June 30,<br>2011 vs 2010 |      |                               |
|---------------------|---|------|-------------------------------|---|------|-------------------------------|
|                     | Increase (decrease)<br>due to                     |      | Net<br>increase<br>(decrease) | Increase (decrease)<br>due to                     |      | Net<br>increase<br>(decrease) |
|                     | Volume  | Rate |                               | Volume  | Rate |                               |
| Interest earned on: |   |      |                               |   |      |                               |

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|   |    |         |    |          |    |          |    |          |    |          |    |          |
|---|----|---------|----|----------|----|----------|----|----------|----|----------|----|----------|
| Total loans and leases (2)  | \$ | 25,886  | \$ | (4,685)  | \$ | 21,201   | \$ | (12,986) | \$ | 3,326    | \$ | (9,660)  |
| Securities  |    | 23,179  |    | (10,207) |    | 12,972   |    | 25,961   |    | (13,395) |    | 12,566   |
| Due from banks - interest-bearing                                   |    | (335)   |    | (104)    |    | (439)    |    | 30       |    | (95)     |    | (65)     |
| Federal funds sold and securities purchased under resale agreements |    | (156)   |    | 10       |    | (146)    |    | 74       |    | 21       |    | 95       |
| Other interest-earning assets                                       |    | (197)   |    | 179      |    | (18)     |    | (97)     |    | 201      |    | 104      |
| Total interest-earning assets                                       |    | 48,377  |    | (14,807) |    | 33,570   |    | 12,982   |    | (9,942)  |    | 3,040    |
| Interest paid on:   |    |         |    |          |    |          |    |          |    |          |    |          |
| Interest checking deposits  |    | 151     |    | (728)    |    | (577)    |    | (583)    |    | (593)    |    | (1,176)  |
| Money market deposits   |    | (1,261) |    | (8,989)  |    | (10,250) |    | 3,639    |    | (4,386)  |    | (747)    |
| Savings deposits  |    | 65      |    | (331)    |    | (266)    |    | (73)     |    | (374)    |    | (447)    |
| Time deposits   |    | (578)   |    | (937)    |    | (1,515)  |    | (1,936)  |    | (1,236)  |    | (3,172)  |
| Other borrowings  |    | (661)   |    | 729      |    | 68       |    | (4,362)  |    | (3,633)  |    | (7,995)  |
| Total interest-bearing liabilities                                  |    | (2,284) |    | (10,256) |    | (12,540) |    | (3,315)  |    | (10,222) |    | (13,537) |
|   | \$ | 50,661  | \$ | (4,551)  | \$ | 46,110   | \$ | 16,297   | \$ | 280      | \$ | 16,577   |

(1) Certain prior period balances have been reclassified to conform to the current period presentation.

(2) Includes covered loans.



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Net interest income was \$216.5 million for the second quarter of 2012, an increase from \$200.7 million for the first quarter of 2012 and \$190.8 million for the second quarter of 2011. The increase from the first quarter of 2012 was primarily the result of higher interest income on total loans. The increase from the year-earlier quarter was largely due to higher interest income on total loans and lower interest expense on deposits.

Interest income on total loans was \$186.1 million for the second quarter of 2012, up 11 percent from the first quarter of 2012 and 9 percent from the year-earlier quarter. The growth from both prior periods was primarily due to higher income from the net accelerated accretable yield recognition on covered loans that were paid off or fully charged off in the second quarter of 2012. Income from net accelerated accretable yield recognition during the second quarter of 2012 was \$27.4 million, compared to \$15.7 million in the first quarter of 2012 and \$11.1 million in the year-earlier quarter. The growth in loan interest income during the second quarter of 2012 was also a result of interest income recognized on lease financing loans that were acquired in the acquisition of FAEF in April 2012 and the recognition of \$2.3 million in interest income from the recovery of a previously charged-off loan.

Interest income on securities was \$43.5 million for the second quarter of 2012, a 4 percent decrease from \$45.4 million for the first quarter of 2012 and a 10 percent increase from \$39.6 million for the second quarter of 2011. The decrease in securities income from the first quarter of 2012 is due to a 2 percent decrease in average securities and lower yields. The growth in securities income from the second quarter of 2011 is a result of a 25 percent growth in average securities.

Total interest expense was \$13.4 million for the second quarter of 2012, up from \$12.9 million for the first quarter of 2012, but down from \$19.3 million for the second quarter of 2011. Interest expense on deposits was \$3.6 million for the second quarter of 2012, down 12 percent from \$4.0 million for the first quarter of 2012 and 64 percent from \$10.0 million for the year-earlier quarter, primarily as a result of lower interest rates. Interest expense on borrowings was \$9.8 million for the second quarter of 2012, up 11 percent from the first quarter of 2012 and 6 percent from the same period in 2011. The growth in interest expense on borrowings was primarily attributable to debt assumed in the acquisition of FAEF.

The net settlement of interest-rate swaps increased net interest income by \$2.1 million for the second quarter of 2012, compared to \$2.1 million for the first quarter of 2012 and \$4.5 million for the year-earlier quarter.

The fully taxable net interest margin was 3.91 percent for the second quarter of 2012, up from 3.74 percent for the first quarter of 2012 and 3.85 percent for the second quarter of 2011. The average yield on earning assets for the second quarter of 2012 was 4.15 percent, up 18 basis points from 3.97 percent for the first quarter of 2012 and down 8 basis points from 4.23 percent for the year-earlier quarter. The average cost of interest-bearing liabilities was 0.55 percent, up 4 basis points from 0.51 percent for the first quarter of 2012, but down 17 basis points from 0.72 percent for the same period in 2011. Fully taxable-equivalent net interest income, which includes amounts to convert nontaxable income to fully taxable-equivalent amounts, was \$220.7 million for the second quarter of 2012 compared to \$204.7 million for the first quarter of 2012 and \$194.4 million for the second quarter of 2011. Fully taxable-equivalent net interest income and dividend income was \$221.4 million for the second quarter of 2012 compared with \$205.4 million for the first quarter of 2012 and \$195.1 million for the same period in 2011. The \$26.3 million increase in fully taxable-equivalent net interest and dividend income from the year-ago quarter was primarily generated through income from the payoff and full charge off of covered loans, loans and securities growth (volume variance), and lower rates on interest-bearing deposits, partially offset by lower yields on securities (rate variance).

Average loans and leases, excluding covered loans, totaled \$13.13 billion for the second quarter of 2012, an increase of 6 percent from \$12.43 billion for the first quarter of 2012 and 14 percent from \$11.52 billion for the second quarter of 2011. The increases were primarily driven by a growth in commercial loans, which grew 10 percent and 25 percent from the first quarter of 2012 and year-earlier quarter, respectively, and commercial real estate loans, which grew 6 percent and 21 percent for the same periods. The growth in commercial loans was partly a result of

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lease financing loans that were acquired in the FAEF acquisition during the second quarter of 2012. Average covered loans were \$1.34 billion for the second quarter of 2012, a decrease of 7 percent from \$1.44 billion in the first quarter of 2012 and 24 percent from \$1.77 billion for the year-ago quarter.

Average total securities, which include trading securities, were \$7.76 billion for the second quarter of 2012, up 25 percent from the second quarter of 2011 as deposit growth outpaced loan growth. Average securities were down 2 percent from the first quarter of this year, reflecting stronger loan growth in the second quarter of 2012.

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Average deposits were \$20.95 billion for the second quarter of 2012, a 4 percent increase from \$20.22 billion for the first quarter of 2012 and a 12 percent increase from \$18.78 billion for the second quarter of 2011. Average core deposits, which do not include certificates of deposits of \$100,000 or more, were \$20.22 billion for the second quarter of 2012 and represented 97 percent of the total average deposit balance, compared to \$19.52 billion and 97 percent in the first quarter of 2012 and \$17.95 billion and 96 percent for the year-earlier quarter. Average interest-bearing deposits were \$9.07 billion for the second quarter of 2012, down 2 percent from the first quarter of 2012 and 8 percent from the year-earlier quarter. Average noninterest-bearing deposits were \$11.88 billion, up 9 percent from the first quarter of 2012 and 33 percent from the second quarter of 2011.

**Provision for Credit Losses**

The Company accounts for the credit risk associated with lending activities through its allowance for loan and lease losses, reserve for off-balance sheet credit commitments and provision for credit losses. The provision for credit losses on loans and leases, excluding covered loans, is the expense recognized in the consolidated statements of income to adjust the allowance and the reserve for off-balance sheet credit commitments to the levels deemed appropriate by management, as determined through application of the Company's allowance methodology procedures. See Critical Accounting Policies Allowance for Loan and Lease Losses and Reserve for Off-Balance Sheet Credit Commitments in the Company's Form 10-K for the year ended December 31, 2011.

The Company recorded expense of \$1.0 million through the provision for credit losses on loans and leases, excluding covered loans, for the three and six months ended June 30, 2012. The Company recorded no provision for credit losses on loans and leases, excluding covered loans, for the same periods in 2011. The provision reflects management's continuing assessment of the credit quality of the Company's loan portfolio, which is affected by a broad range of economic factors. Additional factors affecting the provision include net loan charge-offs, nonaccrual loans, specific reserves, risk rating migration and changes in the portfolio size and composition. See Balance Sheet Analysis Allowance for Loan and Lease Losses and Reserve for Off-Balance Sheet Credit Commitments for further information on factors considered by the Company in assessing the credit quality of the loan portfolio and establishing the allowance for loan and lease losses.

Covered loans represent loans acquired from the FDIC that are subject to loss-sharing agreements, and are primarily accounted for as acquired impaired loans under ASC Topic 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality* (ASC 310-30). The provision for losses on covered loans is the expense recognized in the consolidated statements of income related to impairment losses resulting from the Company's quarterly review and update of cash flow projections on its covered loan portfolio. The Company recorded provision for losses on covered loans of \$13.3 million during the second quarter of 2012, compared to \$7.5 million in the first quarter of 2012 and \$1.7 million in the second quarter of 2011. The provision for losses on covered loans is the result of changes in expected cash flows, both amount and timing, due to loan payments and the Company's revised loss forecasts. The revisions of the loss forecasts were based on the results of management's review of the credit quality of the outstanding covered loans and the analysis of the loan performance data since the acquisition of covered loans. The Company will continue updating cash flow projections on covered loans on a quarterly basis. Due to the uncertainty in the future performance of the covered loans, additional impairments may be recognized in the future.

Credit quality will be influenced by underlying trends in the economic cycle, particularly in California and Nevada, and other factors which are beyond management's control. Consequently, no assurances can be given that the Company will not sustain loan or lease losses, in any particular period, that are sizable in relation to the allowance for loan and lease losses.

Refer to Loans and Leases Asset Quality on page 74 for further discussion of credit quality.

**Noninterest Income**

Noninterest income was \$74.8 million in the second quarter of 2012, a decrease of 1 percent from the first quarter of 2012 and 19 percent from the second quarter of 2011. The decrease from the prior quarters was largely a result of lower net gains on both the sale of covered OREO and transfer of covered loans to OREO. Noninterest income for the second quarter of 2011 also included an \$8.2 million gain from an FDIC-assisted acquisition. Noninterest income represented 26 percent of the Company's revenue in the second quarter of 2012, a decrease from 27 percent in the first quarter of 2012 and 33 percent in the year-earlier quarter.

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A following table provides a summary of noninterest income by category:

| (in thousands)                                  | For the three months ended |                   |                  |
|---|----------------------------|-------------------|------------------|
|   | June 30,<br>2012           | March 31,<br>2012 | June 30,<br>2011 |
| Trust and investment fees                       | \$ 34,067                  | \$ 33,654         | \$ 36,687        |
| Brokerage and mutual fund fees                  | 5,293                      | 5,028             | 4,864            |
| Total wealth management fees                    | 39,360                     | 38,682            | 41,551           |
| Cash management and deposit transaction charges | 11,475                     | 11,168            | 10,905           |
| International services                          | 10,017                     | 8,785             | 9,015            |
| FDIC loss sharing (expense) income, net         | (6,026)                    | 866               | (10,684)         |
| Other noninterest income                        | 17,388                     | 13,559            | 23,169           |
| Total noninterest income before gain (loss)     | 72,214                     | 73,060            | 73,956           |
| Gain on disposal of assets                      | 3,011                      | 2,191             | 8,422            |
| (Loss) gain on sale of securities               | (279)                      | 449               | 1,689            |
| Impairment loss on securities                   | (178)                      |                   | (294)            |
| Gain on acquisition                             |                            |                   | 8,164            |
| Total noninterest income                        | \$ 74,768                  | \$ 75,700         | \$ 91,937        |

## Wealth Management

The Company provides various trust, investment and wealth advisory services to its individual and business clients. The Company delivers these services through the Bank's wealth management division as well as through its wealth management affiliates. Trust services are provided only by the Bank. Trust and investment fee revenue includes fees from trust, investment and asset management, and other wealth advisory services. The majority of these fees are based on the market value of client assets managed, advised, administered or held in custody. The remaining portion of these fees is based on the specific service provided, such as estate and financial planning services, or may be fixed fees. For those fees based on market valuations, the mix of assets held in client accounts, as well as the type of managed account, impacts how closely changes in trust and investment fee income correlate with changes in the financial markets. Changes in market valuations are reflected in fee income primarily on a trailing-quarter basis. Also included in total trust and investment fees is the Company's portion of income from certain investments accounted for under the equity method. Trust and investment fees were \$34.1 million for the second quarter of 2012, an increase of 1 percent from \$33.7 million for the first quarter of 2012 and a decrease of 7 percent from \$36.7 million for the second quarter of 2011. The year-over-year decline in trust and investment fees was due primarily to the third-quarter 2011 divestiture of certain institutional assets by one of the Company's investment affiliates. Money market mutual fund and brokerage fees were \$5.3 million for the quarter, up 5 percent from \$5.0 million for the first quarter of 2012 and 9 percent from \$4.9 million for the year-earlier quarter.

Assets under management (AUM) include assets for which the Company makes investment decisions on behalf of its clients and assets under advisement for which the Company receives advisory fees from its clients. Assets under administration (AUA) are assets the Company holds in a fiduciary capacity or for which it provides non-advisory services. The table below provides a summary of AUM and AUA for the dates indicated:

| (in millions)                      | June 30,  |           | %<br>Change | March 31, |  | %<br>Change |
|------------------------------------|-----------|-----------|-------------|-----------|--|-------------|
|                                    | 2012      | 2011      |             | 2012      |  |             |
| <b>Assets Under Management</b>     | \$ 32,105 | \$ 36,407 | (12)        | 32,535    |  | (1)         |
| <b>Assets Under Administration</b> |           |           |             |           |  |             |

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|   |           |           |     |           |     |
|---|-----------|-----------|-----|-----------|-----|
| Brokerage                                       | 5,357     | 5,519     | (3) | 5,560     | (4) |
| Custody and other fiduciary                     | 20,522    | 16,576    | 24  | 19,743    | 4   |
| Subtotal  | 25,879    | 22,095    | 17  | 25,303    | 2   |
| Total assets under management or administration |           |           |     |           |     |
| (1)   | \$ 57,984 | \$ 58,502 | (1) | \$ 57,838 | 0   |

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(1) Excludes \$18.39 billion, \$18.48 billion and \$19.54 billion of assets under management for asset managers in which the Company held a noncontrolling ownership interest as of June 30, 2012, March 31, 2012 and June 30, 2011, respectively.

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AUM totaled \$32.11 billion as of June 30, 2012, down 12 percent from the year-earlier quarter and 1 percent from the first quarter of 2012. Assets under management or administration were \$57.98 billion at June 30, 2012, down 1 percent from the year-earlier quarter and virtually unchanged from the first quarter of 2012. The decline in AUM from the year-earlier quarter was primarily attributable to the divestiture of certain institutional assets by one of the Company's wealth management affiliates in the third quarter of 2011.

A distribution of AUM by type of investment is provided in the following table:

| Investment                | June 30,<br>2012 | % of AUM<br>March 31,<br>2012 | June 30,<br>2011 |
|---------------------------|------------------|-------------------------------|------------------|
| Equities                  | 40%              | 41%                           | 40%              |
| U.S. fixed income         | 26               | 26                            | 25               |
| Cash and cash equivalents | 21               | 20                            | 21               |
| Other (1)                 | 13               | 13                            | 14               |
|                           | 100%             | 100%                          | 100%             |

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(1) Includes private equity and other alternative investments.

*Other Noninterest Income*

Cash management and deposit transaction fees for the second quarter of 2012 were \$11.5 million, up 3 percent from the first quarter of 2012 and 5 percent from the second quarter of 2011.

International services income for the second quarter of 2012 was \$10.0 million, up 14 percent from the first quarter of 2012 and 11 percent from the second quarter of 2011. International services income includes foreign exchange fees, fees on commercial letters of credit and standby letters of credit, foreign collection fees and gains and losses associated with fluctuations in foreign currency exchange rates. The increases were due primarily to increased client activity and the addition of new clients.

Net FDIC loss sharing expense was \$6.0 million for the second quarter of 2012, compared to net FDIC loss sharing income of \$0.9 million for the first quarter of 2012 and a net FDIC loss sharing expense of \$10.7 million for the year-earlier quarter. See *Noninterest Income and Expense Related to Covered Assets* for further discussion of FDIC loss sharing income and expense.

Net gain on disposal of assets was \$3.0 million in the second quarter of 2012, compared with net gains of \$2.2 million in the first quarter of 2012 and \$8.4 million in the year-earlier quarter. The net gain is primarily due to gains recognized on the sale of covered and non-covered OREO.

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The Company recognized \$0.3 million of net loss on the sale of securities in the second quarter of 2012, compared with net gains of \$0.4 million for the first quarter of 2012 and \$1.7 million for the second quarter of 2011.

Impairment losses on securities available-for-sale recognized in earnings were \$0.2 million for the second quarter of 2012, compared with \$0.3 million for the year-earlier quarter. The Company did not recognize impairment losses on securities in earnings for the first quarter of 2012. See [Balance Sheet Analysis Securities](#) for a discussion of impairment on securities available-for-sale.

Other income for the second quarter of 2012 was \$17.4 million, an increase of 28 percent from \$13.6 million for the first quarter of 2012, but down 25 percent from \$23.2 million for the second quarter of 2011. The increase in other income from the first quarter of 2012 was primarily attributable to higher net gains on the transfer of covered loans to OREO and an increase in lease income from the acquisition of FAEF. The decrease in other income from the second quarter of 2011 was a result of lower net gains on the transfer of covered loans to OREO, which was partially offset by an increase in lease income from the acquisition of FAEF.



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Other income related to covered assets consists primarily of net gain on transfers of covered loans to OREO, the amortization of fair value on acquired unfunded loan commitments and OREO income. Refer to the table on page 67 for additional detail on these components. Other income related to covered assets was \$7.0 million in the second quarter of 2012, compared to \$2.9 million in the first quarter of 2012 and \$13.5 million in the year-earlier quarter. The fluctuations from prior quarters was primarily attributable to changes in net gain recognized on the transfers of covered loans to OREO, which was \$6.9 million in the second quarter of 2012, \$2.5 million in the first quarter of 2012 and \$12.8 million in the year-earlier quarter. The gain or loss recognized on transfer of covered loans to OREO is calculated as the difference between the carrying value of the covered loan and the fair value of the underlying foreclosed collateral.

***Noninterest Expense***

Noninterest expense was \$194.5 million for the second quarter of 2012, a decrease of 3 percent from \$200.7 million for the first quarter of 2012 and 8 percent from \$211.8 million for the second quarter of 2011. The decrease from the year-earlier quarter was due largely to lower OREO expenses, FDIC assessments, and legal and professional fees. The decrease in noninterest expense from the first quarter of 2012 was primarily a result of lower salaries and employee benefits and lower OREO expenses.

The following table provides a summary of noninterest expense by category:

| (in thousands)                 | For the three months ended |                   |                  |
|--------------------------------|----------------------------|-------------------|------------------|
|                                | June 30,<br>2012           | March 31,<br>2012 | June 30,<br>2011 |
| Salaries and employee benefits | \$ 115,035                 | \$ 120,245        | \$ 112,139       |
| All other:                     |                            |                   |                  |
| Net occupancy of premises      | 14,056                     | 13,686            | 13,665           |
| Legal and professional fees    | 11,359                     | 11,880            | 14,790           |
| Information services           | 8,539                      | 8,149             | 8,335            |
| Depreciation and amortization  | 8,013                      | 7,428             | 6,904            |
| Amortization of intangibles    | 1,518                      | 1,886             | 2,104            |
| Marketing and advertising      | 7,597                      | 6,816             | 7,626            |
| Office services and equipment  | 4,492                      | 3,948             | 4,672            |
| Other real estate owned        | 7,541                      | 12,094            | 22,162           |
| FDIC assessments               | 4,523                      | 4,479             | 8,524            |
| Other operating                | 11,843                     | 10,109            | 10,911           |
| Total all other                | 79,481                     | 80,475            | 99,693           |
| Total noninterest expense      | \$ 194,516                 | \$ 200,720        | \$ 211,832       |

Salaries and employee benefits expense was \$115.0 million for the second quarter of 2012, down 4 percent from \$120.2 million for the first quarter of 2012 and up 3 percent from \$112.1 million for the year-earlier quarter. The decrease in salaries and employee benefits from the first quarter of 2012 was primarily due to the recognition of seasonally higher personnel cost, including higher employer taxes, and a one-time expense affiliated with an executive's supplemental employee retirement plan ( SERP ) during the first quarter of 2012. See Note 14, *Employee Benefit Plans*, for further discussion of the SERP expense. Full-time equivalent staff was 3,330 at June 30, 2012, up from 3,235 at March 31, 2012 and slightly higher than 3,328 at June 30, 2011. The increase in staff from the first quarter of 2012 was primarily attributable to the acquisition of FAEF.

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Salaries and employee benefits expense for the second quarter of 2012 includes \$4.3 million of share-based compensation expense compared with \$4.7 million for the first quarter of 2012 and \$4.8 million for the year-earlier quarter. At June 30, 2012, there was \$16.0 million of unrecognized compensation cost related to unvested stock options granted under the Company's plans. That cost is expected to be recognized over a weighted average period of 2.7 years. At June 30, 2012, there was \$24.3 million of unrecognized compensation cost related to restricted shares granted under the Company's plans. That cost is expected to be recognized over a weighted average period of 3.3 years. In February 2012, the Company granted cash-settled restricted stock units to employees. Cash-settled restricted stock units are initially valued at the closing price of the Company's stock on the date of award and subsequently remeasured at each reporting date until settlement. See Note 11, *Share-Based Compensation*, of the Notes to the Unaudited Consolidated Financial Statements for further discussion.

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The remaining noninterest expense categories totaled \$79.5 million for the second quarter of 2012, down from \$80.5 million for the first quarter of 2012 and \$99.7 million for the second quarter of 2011. The decrease from the first quarter of 2012 was due primarily to lower OREO expense. The decrease from the year-earlier quarter was also attributable to lower OREO expense, as well as a decrease in FDIC assessments and legal and professional fees. OREO expense was \$7.5 million for the second quarter of 2012, down 38 percent and 66 percent from the first quarter of 2012 and year earlier quarter, respectively. OREO expense was comprised mostly of expense related to covered OREO. Of the qualified covered asset-related expenses, 80 percent is reimbursable by the FDIC and reflected in FDIC loss sharing income (expense), net in the noninterest income section of the consolidated statements of income.

The following table provides OREO expense for non-covered OREO and covered OREO:

| (in thousands)                        | For the three months ended<br>June 30, |           | For the six months ended<br>June 30, |           |
|---------------------------------------|--|-----------|--------------------------------------|-----------|
|                                       | 2012                                   | 2011      | 2012                                 | 2011      |
| <b>Non-covered OREO expense</b>       |  |           |                                      |           |
| Valuation write-downs                 | \$ 241                                 | \$ 1,592  | \$ 1,149                             | \$ 2,499  |
| Holding costs and foreclosure expense | 254                                    | 378       | 425                                  | 1,163     |
| Total non-covered OREO expense        | \$ 495                                 | \$ 1,970  | \$ 1,574                             | \$ 3,662  |
| <b>Covered OREO expense</b>           |  |           |                                      |           |
| Valuation write-downs                 | \$ 4,250                               | \$ 15,628 | \$ 12,058                            | \$ 23,932 |
| Holding costs and foreclosure expense | 2,796                                  | 4,564     | 6,003                                | 9,057     |
| Total covered OREO expense            | \$ 7,046                               | \$ 20,192 | \$ 18,061                            | \$ 32,989 |
| Total OREO expense                    | \$ 7,541                               | \$ 22,162 | \$ 19,635                            | \$ 36,651 |

Legal and professional fees were \$11.4 million for the second quarter of 2012, down 4 percent from \$11.9 million in the first quarter of 2012 and 23 percent from \$14.8 million in the year-earlier quarter. The decrease in legal and professional fees from the prior year quarters reflects the current quarter reimbursement of \$3.6 million in legal expenses related to the recovery of a previously charged-off loan, partially offset by \$2.8 million of acquisition-related transactions costs. Legal and professional fees associated with covered loans and OREO were approximately \$2.2 million for the second quarter of 2012, \$2.3 million for the first quarter of 2012 and \$2.8 million for the second quarter of 2011. Qualifying legal and professional fees for covered assets are also reimbursable by the FDIC at 80 percent.

Net income attributable to noncontrolling interest, representing noncontrolling ownership interests in the net income of affiliates, was \$0.4 million for the second quarter of 2012, compared to \$0.2 million for the first quarter of 2012 and \$1.1 million for the year-earlier quarter.

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

The following table summarizes the components of noninterest income and noninterest expense related to covered assets for the three and six months ended June 30, 2012 and 2011:

| (in thousands)   | For the three months ended<br>June 30, |           | For the six months ended<br>June 30, |           |
|--|--|-----------|--------------------------------------|-----------|
|  | 2012                                   | 2011      | 2012                                 | 2011      |
| <b><i>Noninterest income related to covered assets</i></b>                                   |  |           |                                      |           |
| <b>FDIC loss sharing expense, net</b>  |  |           |                                      |           |
| Gain on indemnification asset  | \$ 17,722                              | \$ 1,687  | \$ 28,561                            | \$ 16,735 |
| Indemnification asset accretion  | (4,133)                                | (4,126)   | (8,158)                              | (7,750)   |
| Net FDIC reimbursement for OREO and loan expenses  | 6,724                                  | 17,852    | 17,165                               | 28,971    |
| Removal of indemnification asset for loans paid-off or fully charged-off                     | (10,654)                               | (6,306)   | (17,170)                             | (9,819)   |
| Removal of indemnification asset for unfunded loan commitments and loans transferred to OREO | (4,773)                                | (8,855)   | (6,886)                              | (16,527)  |
| Removal of indemnification asset for OREO and net reimbursement to FDIC for OREO sales       | (1,189)                                | (7,219)   | (3,845)                              | (8,501)   |
| Loan recoveries shared with FDIC   | (9,226)                                | (3,197)   | (13,713)                             | (5,168)   |
| Increase in FDIC clawback liability  | (497)                                  | (503)     | (1,114)                              | (779)     |
| Other  |  | (17)      |                                      | 759       |
| Total FDIC loss sharing expense, net   | (6,026)                                | (10,684)  | (5,160)                              | (2,079)   |
| <b>Gain on disposal of assets</b>  |  |           |                                      |           |
| Net gain on sale of OREO   | 1,486                                  | 9,092     | 3,623                                | 10,720    |
| <b>Gain on acquisition</b>   |  |           |                                      |           |
|  |  | 8,164     |                                      | 8,164     |
| <b>Other income</b>  |  |           |                                      |           |
| Net gain on transfers of covered loans to OREO   | 6,864                                  | 12,817    | 9,347                                | 23,147    |
| Amortization of fair value on acquired unfunded loan commitments                             | 413                                    | 766       | 972                                  | 1,459     |
| OREO income  | 615                                    | 637       | 1,520                                | 1,297     |
| Other  | (864)                                  | (690)     | (1,882)                              | (661)     |
| Total other income   | 7,028                                  | 13,530    | 9,957                                | 25,242    |
| <b>Total noninterest income related to covered assets</b>                                    |  |           |                                      |           |
|  | \$ 2,488                               | \$ 20,102 | \$ 8,420                             | \$ 42,047 |
| <b><i>Noninterest expense related to covered assets (I)</i></b>                              |  |           |                                      |           |
| <b>Other real estate owned</b>   |  |           |                                      |           |
| Valuation write-downs  | \$ 4,250                               | \$ 15,628 | \$ 12,058                            | \$ 23,932 |
| Holding costs and foreclosure expense  | 2,796                                  | 4,564     | 6,003                                | 9,057     |
| Total other real estate owned  | 7,046                                  | 20,192    | 18,061                               | 32,989    |
| <b>Legal and professional fees</b>   |  |           |                                      |           |
|  | 2,200                                  | 2,832     | 4,478                                | 4,651     |

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**Other operating expense**

|                              |    |      |    |    |
|------------------------------|----|------|----|----|
| Other covered asset expenses | 31 | (70) | 40 | 22 |
|------------------------------|----|------|----|----|

**Total noninterest expense related to covered**

|                   |    |       |    |        |    |        |    |        |
|-------------------|----|-------|----|--------|----|--------|----|--------|
| <b>assets (2)</b> | \$ | 9,277 | \$ | 22,954 | \$ | 22,579 | \$ | 37,662 |
|-------------------|----|-------|----|--------|----|--------|----|--------|

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(1) OREO, legal and professional fees and other expenses related to covered assets must meet certain FDIC criteria in order for the expense amounts to be reimbursed. Certain amounts reflected in these categories may not be reimbursed by the FDIC.

(2) Excludes personnel and other corporate overhead expenses that the Company incurs to service covered assets and costs associated with the branches acquired in FDIC-assisted acquisitions.

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*Noninterest Income*

Income and expense from FDIC loss-sharing agreements is reflected in FDIC loss sharing income (expense), net. This balance includes FDIC indemnification asset accretion or amortization, gain or loss on the FDIC indemnification asset, and expense from the reduction of the FDIC indemnification asset upon the removal of loans, OREO and unfunded loan commitments. Loans are removed when they have been fully paid off, fully charged off, sold or transferred to OREO. Net FDIC loss sharing income (expense) also includes income recognized on the portion of expenses related to covered assets that are reimbursable by the FDIC, net of income due to the FDIC, as well as the income statement effects of other loss-share transactions.

Net FDIC loss sharing expense was \$6.0 million for the second quarter of 2012, compared to net FDIC loss sharing income of \$0.9 million in the first quarter of 2012 and net FDIC loss sharing expense of \$10.7 million in the year-earlier quarter. The change in net FDIC loss sharing income to expense from the first quarter of 2012 was primarily attributable to an increase in net expense from the removal of the indemnification asset for loans paid-off or fully charged-off, as well as increased loan recoveries on loans paid-off or fully charged-off that are shared with the FDIC. It also reflects lower FDIC reimbursement for covered OREO and loan expenses, due to lower levels of OREO and loan expense recognized in the current quarter. The higher net FDIC loss sharing expense was partially offset by a higher gain on the indemnification asset from the revision of the Company's projected cash flows forecast on its covered loans.

The Company recognized a net gain on sales of covered OREO of \$1.5 million in the second quarter of 2012 compared to \$2.1 million in the first quarter of 2012 and \$9.1 million in the first quarter of 2011. Other income related to covered assets was \$7.0 million in the current quarter and consists primarily of net gain on transfers of covered loans to OREO, the amortization of fair value on acquired unfunded loan commitments and OREO income. Total other income increased from \$2.9 million in the first quarter of 2012 primarily because of higher net gains on the transfers of covered loans to OREO, but decreased from \$13.5 million in the year-earlier quarter because of lower net gains on transfers of covered loans to OREO. Refer to the above table for additional information on the components of other income related to covered assets for the three and six months ending June 30, 2012, and 2011.

*Noninterest Expense*

Noninterest expense related to covered assets includes OREO expense, legal and professional expense and other covered asset-related expenses, and may be subject to FDIC reimbursement. Expenses must meet certain FDIC criteria in order for the expense amounts to be reimbursed. Certain amounts reflected in these balances may not be reimbursed by the FDIC if they do not meet the criteria. Total covered OREO expense, which includes valuation write-downs, holding costs and foreclosure expenses was \$7.0 million for the second quarter of 2012, down from \$11.0 million for the first quarter of 2012 and \$20.2 million for the year-earlier quarter.

*Segment Operations*

The Company's reportable segments are Commercial and Private Banking, Wealth Management and Other. For a more complete description of the segments, including summary financial information, see Note 18 to the Unaudited Consolidated Financial Statements.

*Commercial and Private Banking*

Net income for the Commercial and Private Banking segment decreased to \$29.9 million for the second quarter of 2012 from \$33.1 million for the second quarter of 2011. Net income for the six months ended June 30, 2012 was \$51.1 million, down from \$60.7 million for the year-earlier period. The decrease in net income from the prior-year quarter was due to a decrease in noninterest income and an increase in provision for losses on covered loans, partially offset by lower noninterest expense. The decrease in net income for the six months ended June 30, 2012 was primarily attributable to a decrease in noninterest income from covered assets. Net interest income increased to \$184.8 million for the second quarter of 2012 from \$181.0 million for the year-earlier quarter. Net interest income for the six months ended June 30, 2012 was \$356.6 million compared to \$353.7 million for the same period in 2011. The growth in net interest income was a result of higher accelerated yield recognition on covered loans that were paid off or charged off and the recognition of \$2.3 million in interest income from the recovery of a previously charged-off loan, partially offset by lower funds transfer pricing income on deposits. See *Other* below for a discussion of funds transfer pricing. Average loans, excluding covered loans, increased to \$13.07 billion, or by 14 percent, for the second quarter of 2012 compared with the year-earlier quarter.

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Average loans, excluding covered loans, for the six months ended June 30, 2012 increased 12 percent to \$12.73 billion. Average covered loans were \$1.34 billion for the second quarter of 2012 compared to \$1.77 billion for the second quarter of 2011, and \$1.39 billion for the six months of 2012 compared to \$1.79 billion for the same period in 2011. Average deposits increased by 11 percent to \$20.38 billion for the second quarter of 2012 from \$18.35 billion for the year-earlier quarter. Average deposits increased by 11 percent to \$20.05 billion for the six months ended June 30, 2012 from \$18.05 billion for the same period in 2011. The growth in average deposits compared with the prior-year period was driven by new client relationships and growth in deposits of existing clients.

Provision for credit losses on loans and leases, excluding covered loans, was \$1.0 million for the three months and six months ended June 30, 2012, compared to no provision for the same periods in 2011. Provision for losses on covered loans was \$13.3 million and \$20.8 million for the three months and six months ended June 30, 2012, compared to \$1.7 million and \$20.8 million for both respective periods in 2011. Refer to Results of Operations Provision for Credit Losses for further discussion of the provision.

Noninterest income for the second quarter of 2012 was \$50.3 million, down 16 percent from \$60.1 million for the prior-year quarter. Noninterest income for the six months ended June 30, 2012 decreased 21 percent to \$97.6 million compared to \$123.3 million for the year-earlier period. The decrease from the prior-year periods was primarily due to lower net gains on both the sale of covered OREO and transfer of covered loans to OREO. Noninterest income for the second quarter of 2011 also included an \$8.2 million gain from an FDIC-assisted acquisition. Noninterest expense, including depreciation and amortization, decreased to \$169.2 million, or by 7 percent, for the second quarter of 2012 from \$182.3 million for the year-earlier quarter. Noninterest expense, including depreciation and amortization, decreased to \$344.3 million, or by 2 percent, for the first half of 2012 from \$351.5 million for the same period in 2011. Noninterest expense decreased from the prior-year periods primarily as a result of lower expense related to covered assets, lower FDIC assessment expense, and the reimbursement of legal expenses related to the recovery of a previously charged-off loan, which were partially offset by higher personnel costs.

*Wealth Management*

The Wealth Management segment had net income attributable to City National Corporation ( CNC ) of \$1.5 million for the second quarter of 2012, an increase from a net loss of \$9 thousand for the year-earlier quarter. Net income attributable to CNC for the six months ended June 30, 2012 was \$2.8 million compared to \$1.3 million for the year-earlier period. Noninterest income decreased to \$40.0 million, or by 3 percent, for the second quarter of 2012 from \$41.1 million for the year-earlier quarter, and to \$79.3 million, or by 4 percent, for the six months ended June 30, 2012 from \$82.9 million for the year-earlier period. Refer to Results of Operations Noninterest Income Wealth Management for a discussion of the factors impacting fee income for the Wealth Management segment. Noninterest expense, including depreciation and amortization, was \$37.6 million for the second quarter of 2012, down by 8 percent from \$41.0 million for the year-earlier quarter. Noninterest expense, including depreciation and amortization, decreased 7 percent to \$75.2 million in the first six months of 2012 from \$80.7 million in the year-earlier period. The reduction in expense compared with the year-earlier quarter was primarily due to lower personnel costs and professional fees.

*Other*

Net income attributable to CNC for the Other segment increased to \$23.4 million for the second quarter of 2012, from \$14.4 million for the second quarter of 2011. Net income attributable to CNC increased to \$47.2 million for the six months ended June 30, 2012, from \$25.1 million for the same period in 2011. The Asset Liability Funding Center, which is included in the Other segment, is used for funds transfer pricing. The Funding Center charges the business line units for loans and pays them for generating deposits. In general, net interest income decreases in the Funding Center when loan and securities balances decrease or when deposit balances increase. However, in periods of extremely low interest



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rates, the funding credit given on deposits declines considerably which may cause net interest income in the Funding Center to increase. Net interest income was \$31.1 million and \$59.4 million for the three and six months ended June 30, 2012, respectively, an increase from \$9.3 million and \$17.3 million for the three and six months ended June 30, 2011, respectively. The increase in net interest income was due to higher funds transfer income due to loan and securities portfolio growth, and to a reduction in the funds transfer rate paid to business line units on deposit balances. Although deposits have increased from the prior-year quarter, the transfer pricing rate paid on deposits declined as a result of the continuing low interest rate environment. Noninterest income (loss) was (\$15.5) million for the current quarter compared with (\$9.2) million for the year-earlier quarter.

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Noninterest income (loss) was (\$26.4) million for the six months ended June 30, 2012 compared with (\$20.4) million for the year-earlier period. The change in noninterest income (loss) compared with the year-earlier periods was due to lower gains on the sale of securities in 2012 and life insurance death benefits recognized in 2011.

**Income Taxes**

The Company recognized income tax expense of \$27.3 million during the second quarter of 2012, compared with tax expense of \$21.7 million in the first quarter of 2012 and \$20.7 million in the year-earlier quarter. The effective tax rate was 33.1 percent of pretax income for the second quarter of 2012, compared with 31.8 percent for the first quarter of 2012 and 29.8 percent for the year-earlier quarter. The effective tax rates differ from the applicable statutory federal and state tax rates due to various factors, including tax benefits from investments in affordable housing partnerships, tax-exempt income on municipal bonds, bank-owned life insurance and other adjustments.

The Company recognizes accrued interest and penalties relating to uncertain tax positions as an income tax provision expense. The Company recognized interest and penalties expense of approximately \$0.1 million and \$0.3 million for the six months ended June 30, 2012 and 2011, respectively. The Company had approximately \$3.3 million, \$3.2 million and \$3.2 million of accrued interest and penalties as of June 30, 2012, December 31, 2011 and June 30, 2011.

The Company and its subsidiaries file a consolidated federal income tax return and also file income tax returns in various state jurisdictions. The Company is currently being audited by the Internal Revenue Service for 2011 and 2012. The Company is also currently under audit with the California Franchise Tax Board for the tax years 2005 to 2007. The potential financial statement impact, if any, resulting from completion of these audits is expected to be minimal.

From time to time, there may be differences in opinion with respect to the tax treatment of certain transactions. If a tax position which was previously recognized on the consolidated financial statements is no longer more likely than not to be sustained upon a challenge from the taxing authorities, the tax benefit from the tax position will be derecognized. The Company did not have any tax positions for which previously recognized benefits were derecognized during the six months June 30, 2012.

See Note 13 to the Consolidated Financial Statements for further discussion of income taxes.

**BALANCE SHEET ANALYSIS**

Total assets were \$24.80 billion at June 30, 2012, an increase of 10 percent from \$22.53 billion at June 30, 2011 and 5 percent from \$23.67 billion at December 31, 2011. Average assets for the second quarter of 2012 increased to \$24.36 billion from \$22.01 billion for the second quarter of 2011. The increase in period-end and average assets from the year-earlier quarter reflects the growth in loans and securities.

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Total average interest-earning assets for the second quarter of 2012 were \$22.77 billion, up from \$20.31 billion for the second quarter of 2011.

### *Securities*

At June 30, 2012, the Company had total securities of \$8.03 billion, comprised of securities available-for-sale at fair value of \$6.87 billion, securities held-to-maturity at amortized cost of \$1.10 billion and trading securities at fair value of \$62.6 million. The Company had total securities of \$8.10 billion at December 31, 2011, comprised of securities available-for-sale at fair value of \$7.57 billion, securities held-to-maturity at amortized cost of \$467.7 million and trading securities at fair value of \$62.0 million. At June 30, 2011, the Company had total securities of \$6.47 billion, comprised of securities available-for-sale at fair value of \$6.35 billion and trading securities at fair value of \$125.8 million.

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The following is a summary of amortized cost and estimated fair value for the major categories of securities available-for-sale and held-to-maturity:

| (in thousands)                           | June 30, 2012  |              | December 31, 2011 |              | June 30, 2011  |              |
|--|----------------|--------------|-------------------|--------------|----------------|--------------|
|  | Amortized Cost | Fair Value   | Amortized Cost    | Fair Value   | Amortized Cost | Fair Value   |
| <b>Securities available-for-sale:</b>    |                |              |                   |              |                |              |
| U.S. Treasury                            | \$ 17,223      | \$ 17,208    | \$ 19,163         | \$ 19,182    | \$ 13,036      | \$ 13,076    |
| Federal agency - Debt                    | 994,268        | 999,207      | 1,967,928         | 1,973,862    | 1,841,579      | 1,847,232    |
| Federal agency - MBS                     | 655,384        | 691,672      | 650,091           | 681,044      | 518,421        | 534,726      |
| CMOs - Federal agency                    | 4,388,817      | 4,477,264    | 4,239,205         | 4,326,907    | 3,383,652      | 3,453,901    |
| CMOs - Non-agency                        | 70,702         | 65,466       | 79,999            | 69,001       | 98,596         | 91,083       |
| State and municipal                      | 365,236        | 383,650      | 383,210           | 401,604      | 344,561        | 357,804      |
| Other debt securities                    | 231,795        | 229,908      | 106,051           | 99,074       | 48,826         | 44,121       |
| Total available-for-sale debt securities | 6,723,425      | 6,864,375    | 7,445,647         | 7,570,674    | 6,248,671      | 6,341,943    |
| Equity securities and mutual funds       | 336            | 1,506        | 352               | 1,227        | 2,088          | 6,112        |
| Total available-for-sale securities      | \$ 6,723,761   | \$ 6,865,881 | \$ 7,445,999      | \$ 7,571,901 | \$ 6,250,759   | \$ 6,348,055 |
| <b>Securities held-to-maturity (1):</b>  |                |              |                   |              |                |              |
| Federal agency - Debt                    | \$ 103,439     | \$ 105,441   | \$ 40,423         | \$ 41,203    | \$             | \$           |
| Federal agency - MBS                     | 200,763        | 206,184      | 75,231            | 76,863       |                |              |
| CMOs - Federal agency                    | 642,102        | 660,464      | 292,547           | 294,932      |                | \$           |
| State and municipal                      | 153,925        | 154,964      | 59,479            | 60,905       |                |              |
| Total held-to-maturity securities        | \$ 1,100,229   | \$ 1,127,053 | \$ 467,680        | \$ 473,903   | \$             | \$           |

(1) Securities held-to-maturity are presented in the consolidated balance sheets at amortized cost.

The duration of securities available-for-sale and held-to-maturity at June 30, 2012 was 3.0 years compared to 3.1 years at March 31, 2012 and 2.3 years at June 30, 2011. The duration of the \$6.87 billion available-for-sale portfolio was 2.4 years at June 30, 2012. Changes in the fair value of securities available-for-sale will impact other comprehensive income, and thus shareholders' equity, on an after-tax basis. Securities held-to-maturity are presented in the consolidated balance sheets at amortized cost. Changes in the fair value of securities held-to-maturity do not have an impact on other comprehensive income.

At June 30, 2012, the available-for-sale securities portfolio had a net unrealized gain of \$142.1 million, comprised of \$156.3 million of unrealized gains and \$14.2 million of unrealized losses. At December 31, 2011, the available-for-sale securities portfolio had a net unrealized gain of \$125.9 million, comprised of \$149.1 million of unrealized gains and \$23.2 million of unrealized losses. At June 30, 2011, the available-for-sale securities portfolio had a net unrealized gain of \$97.3 million, comprised of \$118.4 million of unrealized gains and \$21.1 million of unrealized losses.



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The following table provides the expected remaining maturities of debt securities included in the securities portfolio at June 30, 2012. The maturities of mortgage-backed securities are allocated according to the average life of expected cash flows. Average expected maturities will differ from contractual maturities because of the amortizing nature of the loan collateral and prepayment behavior of borrowers.

| (in thousands)   | One year or less | Over 1 year through 5 years | Over 5 years through 10 years | Over 10 years | Total        |
|--|------------------|-----------------------------|-------------------------------|---------------|--------------|
| <b>Securities available-for-sale:</b>                    |                  |                             |                               |               |              |
| U.S. Treasury  | \$ 5,003         | \$ 12,205                   | \$                            | \$            | \$ 17,208    |
| Federal agency - Debt                                    | 663,719          | 335,488                     |                               |               | 999,207      |
| Federal agency - MBS                                     | 11               | 455,069                     | 236,592                       |               | 691,672      |
| CMOs - Federal agency                                    | 309,857          | 4,012,348                   | 155,059                       |               | 4,477,264    |
| CMOs - Non-agency  | 12,442           | 20,992                      | 32,032                        |               | 65,466       |
| State and municipal                                      | 47,369           | 218,736                     | 67,047                        | 50,498        | 383,650      |
| Other  | 3,416            | 184,044                     | 42,448                        |               | 229,908      |
| Total debt securities available-for-sale                 | \$ 1,041,817     | \$ 5,238,882                | \$ 533,178                    | \$ 50,498     | \$ 6,864,375 |
| Amortized cost   | \$ 1,035,552     | \$ 5,130,739                | \$ 506,789                    | \$ 50,345     | \$ 6,723,425 |
| <b>Securities held-to-maturity:</b>                      |                  |                             |                               |               |              |
| Federal agency - Debt                                    | \$ 10,947        | \$                          | \$                            | \$ 92,492     | \$ 103,439   |
| Federal agency - MBS                                     |                  | 2,663                       | 198,100                       |               | 200,763      |
| CMOs - Federal agency                                    |                  | 92,378                      | 549,724                       |               | 642,102      |
| State and municipal                                      | 500              | 10,386                      | 96,733                        | 46,306        | 153,925      |
| Total debt securities held-to-maturity at amortized cost | \$ 11,447        | \$ 105,427                  | \$ 844,557                    | \$ 138,798    | \$ 1,100,229 |

*Impairment Assessment*

The Company performs a quarterly assessment of the debt and equity securities in its investment portfolio that have an unrealized loss to determine whether the decline in the fair value of these securities below their cost is other-than-temporary. Impairment is considered other-than-temporary when it becomes probable that an investor will be unable to recover the cost of an investment. The Company's impairment assessment takes into consideration factors such as the length of time and the extent to which the market value has been less than cost; the financial condition and near-term prospects of the issuer, including events specific to the issuer or industry; defaults or deferrals of scheduled interest, principal or dividend payments; external credit ratings and recent downgrades; and whether the Company intends to sell the security and whether it is more likely than not it will be required to sell the security prior to recovery of its amortized cost basis. If a decline in fair value is judged to be other than temporary, the cost basis of the individual security is written down to fair value which then becomes the new cost basis. The new cost basis is not adjusted for subsequent recoveries in fair value.

Through the impairment assessment process, the Company determined that certain non-agency CMOs were other-than-temporarily impaired at June 30, 2012. The Company recorded impairment losses in earnings on securities available-for-sale of \$0.2 million for the three and six months ended June 30, 2012. Impairment losses recognized in earnings on securities available-for-sale during the three and six months ended June 30, 2011 were \$0.3 million and \$0.5 million, respectively. The Company recognized \$4.0 million and \$3.8 million of non-credit-related other-than-temporary impairment in AOCI on securities available-for-sale at June 30, 2012 and 2011, respectively. There were no impairment losses recognized in earnings or AOCI for securities held-to-maturity during the three and six months ended June 30, 2012.

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Of the total securities available-for-sale in an unrealized loss position at June 30, 2012, approximately \$504.0 million of securities with unrealized losses of \$1.0 million were in a continuous unrealized loss position for less than 12 months and \$50.9 million of securities with unrealized losses of \$13.3 million were in a continuous loss position for more than 12 months. While the securities in a loss position at June 30, 2012 were comprised mostly of federal agency CMOs, a significant portion of the total gross unrealized loss relates to non-agency CMOs and collateralized debt obligation senior notes.

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At December 31, 2011, approximately \$1.28 billion of securities with unrealized losses of \$4.2 million were in a continuous unrealized loss position for less than 12 months and \$48.1 million of securities with unrealized losses of \$19.0 million were in a continuous loss position for more than 12 months. At June 30, 2011, approximately \$835.8 million of securities with unrealized losses of \$5.8 million were in a continuous unrealized loss position for less than 12 months and \$59.6 million of securities with unrealized losses of \$15.4 million were in a continuous unrealized loss position for more than 12 months.

See Note 4, *Securities*, of the Notes to Consolidated Financial Statements for further disclosures related to the securities portfolio.

***Loan and Lease Portfolio***

A comparative period-end loan and lease table is presented below:

**Loans and Leases**

| (in thousands)                                 | June 30,<br>2012 | December 31,<br>2011 | June 30,<br>2011 |
|--|------------------|----------------------|------------------|
| Commercial                                     | \$ 5,379,489     | \$ 4,846,594         | \$ 4,420,899     |
| Commercial real estate mortgages               | 2,424,333        | 2,110,749            | 1,930,269        |
| Residential mortgages                          | 3,822,630        | 3,763,218            | 3,710,765        |
| Real estate construction                       | 301,829          | 315,609              | 355,014          |
| Equity lines of credit                         | 741,270          | 741,081              | 735,899          |
| Installment                                    | 130,200          | 132,647              | 130,924          |
| Lease financing                                | 707,458          | 399,487              | 379,353          |
| Loans and leases, excluding covered loans      | 13,507,209       | 12,309,385           | 11,663,123       |
| Less: Allowance for loan and lease losses      | (269,534)        | (262,557)            | (265,933)        |
| Loans and leases, excluding covered loans, net | 13,237,675       | 12,046,828           | 11,397,190       |
| Covered loans                                  | 1,260,135        | 1,481,854            | 1,724,633        |
| Less: Allowance for loan losses                | (43,147)         | (64,565)             | (67,629)         |
| Covered loans, net                             | 1,216,988        | 1,417,289            | 1,657,004        |
| Total loans and leases                         | \$ 14,767,344    | \$ 13,791,239        | \$ 13,387,756    |
| Total loans and leases, net                    | \$ 14,454,663    | \$ 13,464,117        | \$ 13,054,194    |

Total loans and leases were \$14.77 billion, \$13.79 billion and \$13.39 billion at June 30, 2012, December 31, 2011 and June 30, 2011, respectively. Total loans, excluding covered loans, were \$13.51 billion, \$12.31 billion and \$11.66 billion at June 30, 2012, December 31, 2011 and June 30, 2011, respectively.

Total loans and leases, excluding covered loans, at June 30, 2012 increased 10 percent from December 31, 2011 and 16 percent from June 30, 2011. Commercial loans, including lease financing, were up 16 percent from year-end 2011 and 27 percent from the year-earlier quarter. The increases were due to organic loan growth and the acquisition of FAEF, which added \$318.3 million of lease financing loans at acquisition date.



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Commercial real estate mortgage loans increased by 15 percent from year-end 2011 and 26 percent from the year-earlier quarter. Residential mortgages grew by 2 percent from year-end 2011 and 3 percent from the year-earlier quarter. Real estate construction loans declined by 4 percent and 15 percent for the same periods, respectively.

### *Covered Loans*

Covered loans represent loans acquired from the FDIC that are subject to loss-sharing agreements and were \$1.26 billion at June 30, 2012, \$1.48 billion as of December 31, 2011 and \$1.72 billion as of June 30, 2011. Covered loans, net of allowance for loan losses, were \$1.22 billion as of June 30, 2012, \$1.42 billion as of December 31, 2011 and \$1.66 billion as of June 30, 2011.

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The following is a summary of the major categories of covered loans:

| (in thousands)                   | June 30,<br>2012 | December 31,<br>2011 | June 30,<br>2011 |
|----------------------------------|------------------|----------------------|------------------|
| Commercial                       | \$ 22,772        | \$ 30,911            | \$ 41,135        |
| Commercial real estate mortgages | 1,135,071        | 1,288,352            | 1,482,186        |
| Residential mortgages            | 5,766            | 14,931               | 19,494           |
| Real estate construction         | 90,196           | 140,992              | 173,263          |
| Equity lines of credit           | 5,265            | 5,167                | 5,791            |
| Installment                      | 1,065            | 1,501                | 2,764            |
| Covered loans                    | 1,260,135        | 1,481,854            | 1,724,633        |
| Less: Allowance for loan losses  | (43,147)         | (64,565)             | (67,629)         |
| Covered loans, net               | \$ 1,216,988     | \$ 1,417,289         | \$ 1,657,004     |

The Company evaluated the acquired loans from its FDIC-assisted acquisitions and concluded that all loans, with the exception of a small population of acquired loans, would be accounted for under ASC 310-30. Loans are accounted for under ASC 310-30 when there is evidence of credit deterioration since origination and for which it is probable, at acquisition, that the Company would be unable to collect all contractually required payments. Interest income is recognized on all acquired impaired loans through accretion of the difference between the carrying amount of the loans and their expected cash flows.

At acquisition date, the Company recorded an indemnification asset for its FDIC-assisted acquisitions. The FDIC indemnification asset represents the present value of the expected reimbursement from the FDIC related to expected losses on acquired loans, OREO and unfunded loan commitments. The FDIC indemnification asset from all FDIC-assisted acquisitions was \$170.7 million at June 30, 2012, \$204.3 million at December 31, 2011 and \$261.7 million as of June 30, 2011.

*Other*

To grow loans and diversify and manage concentration risk of the Company's loan portfolio, the Company purchases and sells participations in loans. Included in this portfolio are purchased participations in Shared National Credits (SNC). Purchased SNC commitments totaled \$2.78 billion, or 13 percent of total loan commitments, at June 30, 2012, \$2.24 billion or 12 percent at December 31, 2011 and \$1.93 billion or 11 percent at June 30, 2011. Outstanding loan balances on purchased SNCs were \$1.20 billion, or approximately 9 percent of total loans outstanding, excluding covered loans, at June 30, 2012, compared to \$941.7 million or 8 percent at December 31, 2011 and \$808.8 million or 7 percent at June 30, 2011.

Bank regulatory guidance on risk management practices for financial institutions with high or increasing concentrations of commercial real estate (CRE) loans on their balance sheets emphasizes the need for sound internal risk management practices for those institutions that have experienced rapid growth in CRE lending, have notable exposure to specific types of CRE, or are approaching or exceeding the supervisory criteria used to evaluate CRE concentration risk. The supervisory criteria are: total reported loans for construction, land development and other land represent 100 percent of the institution's total risk-based capital, and both total CRE loans represent 300 percent or more of the institution's total risk-based capital and the institution's CRE loan portfolio has increased 50 percent or more within the last 36 months. As of June 30, 2012, total loans for construction, land development and other land represented 16 percent of total risk-based capital; total CRE loans represented 134 percent of total risk-based capital and the total portfolio of loans for construction, land development, other land and CRE increased 17 percent over the last 36 months.

*Asset Quality*

*Credit Risk Management*

The Company has a comprehensive methodology to monitor credit quality and prudently manage credit concentration within each portfolio. The methodology includes establishing concentration limits to ensure that the loan portfolio is diversified. The limits are evaluated quarterly and are intended to mitigate the impact of any segment on the Company's capital and earnings. The limits cover major industry groups, geography, product type, loan size and customer relationship. Additional sub-limits are established for certain industries where the bank has higher exposure. The concentration limits are approved by the Bank's Credit Policy Committee and reviewed annually by the Audit & Risk Committee of the Board of Directors.

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The loan portfolios are monitored through delinquency tracking and a dynamic risk rating process that is designed to detect early signs of deterioration. In addition, once a loan has shown signs of deterioration, it is transferred to a Special Assets Department that consists of professionals who specialize in managing problem assets. An oversight group meets monthly to review the progress of problem loans and OREO. Also, the Company has established portfolio review requirements that include a periodic review and risk assessment by the Risk Management Division that reports to the Audit & Risk Committee of the Board of Directors.

Through the recent economic down-turn, the Company has taken and continues to take steps to address deterioration in credit quality in various segments of its loan portfolio. Deterioration has been centered in the land, acquisition and development and construction portfolios with lesser deterioration in its commercial loans portfolio. These steps have included modifying underwriting standards, implementation of loss mitigation actions including curtailment of certain commitments and lending to certain sectors, and proactively identifying, managing, and resolving problem loans.

*Geographic Concentrations and Economic Trends by Geographic Region*

Although the Company's lending activities are predominately in California, and to a lesser extent, New York and Nevada, the Company has various specialty lending businesses that lend to businesses located throughout the United States of America. Excluding covered loans, at June 30, 2012, California represented 81 percent of total loans outstanding and New York and Nevada represented 7 percent and 3 percent, respectively. The remaining 9 percent of total loans outstanding represented other states. Concentrations of credit risk arise when a number of clients are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic conditions. Although the Company has a diversified loan portfolio, a substantial portion of the loan portfolio and credit performance depends on the economic stability of Southern California. California has experienced significant declines in real estate values and adverse effects of the recession. California's unemployment rate in June 2012 was 10.7 percent. The Company's loan portfolio has been affected by the economy, but the impact is lessened by the Company having most of its loans in large metropolitan California cities such as Los Angeles, San Francisco and San Diego rather than in the outlying suburban communities that have seen higher declines in real estate values. Within the Company's Commercial loan portfolio, the five California counties with the largest exposures are Los Angeles (65 percent), Orange (7 percent), San Diego (6 percent), Ventura (3 percent) and San Francisco (3 percent). Within the Commercial Real Estate Mortgage loan portfolio, the five California counties with the largest exposures are Los Angeles (37 percent), San Diego (11 percent), Orange (11 percent), Ventura (5 percent) and Riverside (4 percent). For the Real Estate Construction loan portfolio, the concentration in California is predominately in Los Angeles (25 percent), Ventura (10 percent), Santa Barbara (10 percent), San Diego (6 percent) and Contra Costa (5 percent).

Generally, loan portfolios related to borrowers or properties located within Nevada have fared worse than California and New York. The Nevada economy continues to struggle and recovery is anticipated to be protracted as it is dependent on economic improvement at the national level such that Nevada tourism increases to a level that supports new jobs and real estate development. In June 2012, the Nevada unemployment rate was 11.6 percent. The consensus outlook for 2012 is that the Nevada economy will remain challenged in part due to its troubled real estate and tourism sectors. The Company's construction and land portfolios in Nevada, which had been affected by significant stress in prior years, now represent 0.4 percent of total loans, excluding covered loans. The Company has very few residential mortgage loans in Nevada. The New York loan portfolio primarily relates to private banking clients in the Entertainment and Legal industries which continue to perform well.

Within the Company's covered loan portfolio at June 30, 2012, the five states with the largest concentration were California (39 percent), Texas (12 percent), Nevada (8 percent), Arizona (4 percent) and Ohio (4 percent). The remaining 33 percent of total covered loans outstanding represented other states.

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### *Allowance for Loan and Lease Losses and Reserve for Off-Balance Sheet Credit Commitments*

A consequence of lending activities is that losses may be experienced. The amount of such losses will vary from time to time depending upon the risk characteristics of the loan portfolio as affected by economic conditions, changing interest rates, and the financial performance of borrowers. The allowance for loan and lease losses and the reserve for off-balance sheet credit commitments which provide for the risk of losses inherent in the credit extension process, are increased by the provision for credit losses charged to operating expense. The allowance for loan and lease losses is decreased by the amount of charge-offs, net of recoveries. There is no exact method of predicting specific losses or amounts that ultimately may be charged off on particular segments of the loan portfolio.

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The Company has an internal credit risk analysis and review staff that issues reports to the Audit & Risk Committee of the Board of Directors and continually reviews loan quality. This analysis includes a detailed review of the classification and categorization of problem loans, potential problem loans and loans to be charged off, an assessment of the overall quality and collectibility of the portfolio, consideration of the credit loss experience, trends in problem loans and concentration of credit risk, as well as current economic conditions, particularly in California and Nevada. Management then evaluates the allowance, determines its appropriate level and the need for additional provisions, and presents its analysis to the Audit & Risk Committee which ultimately reviews and approves management's recommendation.

The provision is the expense recognized in the consolidated statements of income to adjust the allowance and reserve to the level deemed appropriate by management, as determined through application of the Company's allowance methodology procedures. See "Critical Accounting Policies - Allowance for Loan and Lease Losses and Reserve for Off-Balance Sheet Credit Commitments" in the Company's 2011 Annual Report on Form 10-K. The process used for determining the adequacy of the reserve for off-balance sheet credit commitments is consistent with the process for the allowance for loan and lease losses.

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The following table summarizes the activity in the allowance for loan and lease losses and the reserve for off-balance sheet credit commitments, excluding covered loans, for the three and six months ended June 30, 2012 and 2011. Activity is provided by loan type which is consistent with the Company's methodology for determining the allowance for loan and lease losses:

**Changes in Allowance for Loan and Lease Losses**

| (in thousands)  | For the three months ended<br>June 30, |               | For the six months ended<br>June 30, |               |
|---|--|---------------|--------------------------------------|---------------|
|   | 2012                                   | 2011          | 2012                                 | 2011          |
| Loans and leases outstanding, excluding covered loans   | \$ 13,507,209                          | \$ 11,663,123 | \$ 13,507,209                        | \$ 11,663,123 |
| Average loans and leases outstanding, excluding covered loans                                     | \$ 13,125,867                          | \$ 11,515,989 | \$ 12,779,080                        | \$ 11,386,657 |
| <b>Allowance for loan and lease losses (1)</b>  |  |               |                                      |               |
| Balance, beginning of period  | \$ 266,077                             | \$ 263,356    | \$ 262,557                           | \$ 257,007    |
| Loans charged-off:  |  |               |                                      |               |
| Commercial  | (1,302)                                | (3,446)       | (10,219)                             | (6,684)       |
| Commercial real estate mortgages  | (181)                                  | (98)          | (873)                                | (2,897)       |
| Residential mortgages   | (749)                                  | (375)         | (1,303)                              | (1,022)       |
| Real estate construction  | (7,858)                                | (1,897)       | (9,459)                              | (2,463)       |
| Equity lines of credit  | (846)                                  | (128)         | (1,035)                              | (921)         |
| Installment   | (617)                                  | (131)         | (826)                                | (455)         |
| Total loans charged-off   | (11,553)                               | (6,075)       | (23,715)                             | (14,442)      |
| Recoveries of loans previously charged-off:   |  |               |                                      |               |
| Commercial  | 9,394                                  | 6,062         | 23,594                               | 7,363         |
| Commercial real estate mortgages  | 1,294                                  | 1,367         | 1,320                                | 10,378        |
| Residential mortgages   | 206                                    | 122           | 266                                  | 154           |
| Real estate construction  | 3,019                                  | 2,474         | 4,724                                | 6,866         |
| Equity lines of credit  | 38                                     | 8             | 73                                   | 44            |
| Installment   | 343                                    | 237           | 969                                  | 359           |
| Total recoveries  | 14,294                                 | 10,270        | 30,946                               | 25,164        |
| Net recoveries  | 2,741                                  | 4,195         | 7,231                                | 10,722        |
| Provision for credit losses   | 1,000                                  |               | 1,000                                |               |
| Transfers to reserve for off-balance sheet credit commitments                                     | (284)                                  | (1,618)       | (1,254)                              | (1,796)       |
| Balance, end of period  | \$ 269,534                             | \$ 265,933    | \$ 269,534                           | \$ 265,933    |
| Net recoveries to average loans and leases, excluding covered loans (annualized)                  | 0.08%                                  | 0.15%         | 0.11%                                | 0.19%         |
| Allowance for loan and lease losses to total period-end loans and leases, excluding covered loans | 2.00%                                  | 2.28%         | 2.00%                                | 2.28%         |
| <b>Reserve for off-balance sheet credit commitments</b>   |  |               |                                      |               |
| Balance, beginning of period  | \$ 24,067                              | \$ 21,707     | \$ 23,097                            | \$ 21,529     |
| Transfers from allowance  | 284                                    | 1,618         | 1,254                                | 1,796         |
| Balance, end of period  | \$ 24,351                              | \$ 23,325     | \$ 24,351                            | \$ 23,325     |

(1) The allowance for loan and lease losses in this table excludes amounts related to covered loans.

For the quarter-ended June 30, 2012, net loan recoveries on non-covered loans were \$2.7 million, and were comprised of gross charge-offs of \$11.6 million and gross recoveries of \$14.3 million. The charge-offs were primarily driven by two real estate construction loans, while recoveries were primarily driven by one commercial loan and large recoveries recognized on a small group of real estate construction loans. For the six months ending June 30, 2012, net loan recoveries on non-covered loans were \$7.2 million, and were comprised of gross charge-offs of \$23.7 million and gross recoveries of \$30.9 million. The majority of the charge-offs and recoveries for the year-to-date period relate to a small group of commercial and real estate construction loans. While the Company has recognized significant recoveries and charge-offs in its commercial and real estate construction loan portfolio throughout 2012 and 2011, the activity is primarily driven by a small group of individual credits. This activity is not necessarily of a recurring nature and not indicative of a trend for future recoveries and charge-offs.



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Based on an evaluation of individual credits, previous loan and lease loss experience, management's evaluation of the current loan portfolio, and current economic conditions, management has allocated the allowance for loan and lease losses on non-covered loans for June 30, 2012, December 31, 2011 and June 30, 2011 as shown in the table below:

| (in thousands)                   | Allowance amount |                   |               | Percentage of total allowance |                   |               |
|----------------------------------|------------------|-------------------|---------------|-------------------------------|-------------------|---------------|
|                                  | June 30, 2012    | December 31, 2011 | June 30, 2011 | June 30, 2012                 | December 31, 2011 | June 30, 2011 |
| Commercial and lease financing   | \$ 100,392       | \$ 82,965         | \$ 85,717     | 37%                           | 32%               | 32%           |
| Commercial real estate mortgages | 50,059           | 45,967            | 49,060        | 18                            | 17                | 18            |
| Residential mortgages            | 7,704            | 14,029            | 12,873        | 3                             | 5                 | 5             |
| Real estate construction         | 15,793           | 23,347            | 29,455        | 6                             | 9                 | 11            |
| Equity lines of credit           | 5,020            | 8,024             | 6,668         | 2                             | 3                 | 3             |
| Installment                      | 1,460            | 1,959             | 1,951         | 1                             | 1                 | 1             |
| Unallocated                      | 89,106           | 86,266            | 80,209        | 33                            | 33                | 30            |
| Total                            | \$ 269,534       | \$ 262,557        | \$ 265,933    | 100%                          | 100%              | 100%          |

The Company has a qualitative factor matrix to determine the amount of unallocated reserves needed for judgmental factors that are not attributable to or reflected in quantitative models. Examples of these factors include industry concentration, size of loans, general business and economic environment, internal systems and procedures, credit quality trends, changes in underwriting standards, risk appetite, loan growth and acquisitions. The qualitative factor matrix is divided into three segments: Commercial Real Estate ( CRE ), Commercial and Industrial ( C&I ) and Consumer. For each segment, the matrix evaluates the qualitative factors that could cause the quantitative models to vary from historic loss values. Each factor is assigned a risk level and a risk weight in points which is aggregated to determine the level of qualitative reserves. The factors are updated and supported quarterly to reflect changing conditions. At June 30, 2012, the Company had total qualitative reserves of \$89.1 million, of which \$24.9 million, \$40.9 million and \$23.3 million were assigned to the CRE, C&I and Consumer segments, respectively. Currently, the primary drivers of the qualitative reserves are uncertainty in the macroeconomic environment in California and Nevada, industry concentration and loan size.

The following table summarizes the activity in the allowance for loan losses on covered loans for the three and six months ended June 30, 2012 and 2011:

| (in thousands)                              | For the three months ended |               |    | For the six months ended |               |    |
|---|----------------------------|---------------|----|--------------------------|---------------|----|
|   | 2012                       | June 30, 2011 |    | 2012                     | June 30, 2011 |    |
| Balance, beginning of period                | \$ 61,471                  | \$ 82,016     | \$ | 64,565                   | \$ 67,389     | \$ |
| Provision for losses                        | 13,293                     | 1,716         |    | 20,759                   | 20,832        |    |
| Reduction in allowance due to loan removals | (31,617)                   | (16,103)      |    | (42,177)                 | (20,592)      |    |
| Balance, end of period                      | \$ 43,147                  | \$ 67,629     | \$ | 43,147                   | \$ 67,629     | \$ |

The allowance for loan losses on covered loans was \$43.1 million as of June 30, 2012, compared to \$64.6 million at December 31, 2011 and \$67.6 million at June 30, 2011. The Company recorded provision expense of \$13.3 million and \$20.8 million on covered loans for the three and six months ended June 30, 2012, respectively, and \$1.7 million and \$20.8 million for the three and six months ended June 30, 2011, respectively. The Company updates its cash flow projections for covered loans accounted for under ASC 310-30 on a quarterly basis, and may recognize provision expense and an allowance for loan losses as a result of that analysis. The loss on covered loans is the result of changes in expected

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cash flows, both amount and timing, due to loan payments and the Company's revised loss forecasts. The revisions of the loss forecasts were based on the results of management's review of the credit quality of the outstanding covered loans and the analysis of the loan performance data since the acquisition of covered loans. The allowance for loan losses on covered loans is reduced for any loan removals. A loan is removed when it has been fully paid-off, fully charged off, sold or transferred to OREO.

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Loans, other than those included in large groups of smaller-balance homogeneous loans, are considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement, including scheduled interest payments. The assessment for impairment occurs when and while such loans are on nonaccrual, or when the loan has been restructured. When a loan with unique risk characteristics has been identified as being impaired, the amount of impairment will be measured by the Company using discounted cash flows, except when it is determined that the primary (remaining) source of repayment for the loan is the operation or liquidation of the underlying collateral. In these cases, the current fair value of the collateral, reduced by costs to sell, will be used in place of discounted cash flows. As a final alternative, the observable market price of the debt may be used to assess impairment. In general, nonperforming loans under \$500,000 are not individually evaluated for impairment. Instead, these loans are measured using historical loss factors which approximate the discounted cash flows method.

If the measurement of the impaired loan is less than the recorded investment in the loan (including accrued interest, net deferred loan fees or costs and unamortized premium or discount), an impairment allowance is recognized by creating or adjusting the existing allocation of the allowance for loan and lease losses. Interest payments received on impaired loans are generally applied as follows: (1) to principal if the loan is on nonaccrual principal recapture status, (2) to interest income if the loan is on cash basis nonaccrual and (3) to interest income if the impaired loan has been returned to accrual status.

The following table presents information on impaired loans as of June 30, 2012, December 31, 2011 and June 30, 2011:

| (in thousands)                                  | June 30, 2012    |                   | December 31, 2011 |                   | June 30, 2011    |                   |
|---|------------------|-------------------|-------------------|-------------------|------------------|-------------------|
|   | Loans and Leases | Related Allowance | Loans and Leases  | Related Allowance | Loans and Leases | Related Allowance |
| Impaired loans, excluding covered loans (1)(2): |                  |                   |                   |                   |                  |                   |
| Impaired loans with an allowance                | \$ 43,428        | \$ 7,550          | \$ 49,079         | \$ 13,262         | \$ 36,442        | \$ 11,068         |
| Impaired loans with no related allowance        | 130,354          |                   | 99,655            |                   | 84,292           |                   |
| Total impaired loans, excluding covered loans   | \$ 173,782       |                   | \$ 148,734        |                   | \$ 120,734       |                   |
| Total impaired loans by loan type:              |                  |                   |                   |                   |                  |                   |
| Commercial                                      | \$ 43,144        | \$ 2,850          | \$ 25,780         | \$ 7,135          | \$ 18,474        | \$ 7,605          |
| Commercial real estate mortgages                | 45,491           | 2,282             | 30,678            | 1,551             | 23,769           | 1,150             |
| Residential mortgages                           | 13,634           | 398               | 9,146             | 108               | 12,536           | 56                |
| Real estate construction                        | 66,529           | 1,866             | 75,811            | 4,377             | 60,630           | 1,853             |
| Equity lines of credit                          | 4,434            | 154               | 6,633             | 91                | 4,522            | 404               |
| Installment                                     | 550              |                   | 658               |                   | 41               |                   |
| Lease financing                                 |                  |                   | 28                |                   | 762              |                   |
| Total impaired loans, excluding covered loans   | \$ 173,782       | \$ 7,550          | \$ 148,734        | \$ 13,262         | \$ 120,734       | \$ 11,068         |
| Impaired covered loans                          | \$ 422           | \$                | \$ 422            | \$                | \$ 1,408         | \$                |

(1) Impaired loans exclude \$8.8 million, \$10.2 million and \$13.4 million of nonaccrual loans under \$500,000 that are not individually evaluated for impairment at June 30, 2012, December 31, 2011 and June 30, 2011, respectively.

(2) Impaired loans include \$72.8 million, \$46.6 million and \$1.2 million of troubled debt restructured loans on accrual status at June 30, 2012, December 31, 2011 and June 30, 2011, respectively.

The recorded investment in impaired loans, excluding covered loans, was \$173.8 million at June 30, 2012, \$148.7 million at December 31, 2011 and \$120.7 million at June 30, 2011. Impaired covered loans were \$0.4 million at June 30, 2012, \$0.4 million at December 31, 2011 and \$1.4 million at June 30, 2011, and are included in the Company's population of acquired covered loans that are accounted for outside the scope of ASC 310-30.

*Nonaccrual, Past Due and Restructured Loans*

Total nonperforming assets (nonaccrual loans and OREO), excluding covered assets, were \$133.3 million, or 0.98 percent of total loans and OREO, excluding covered assets, at June 30, 2012, compared with \$142.8 million, or 1.16 percent, at December 31, 2011, and \$180.4 million, or 1.54 percent, at June 30, 2011. Total nonperforming covered assets (nonaccrual covered loans and covered OREO) were \$83.3 million at June 30, 2012, \$99.0 million at December 31, 2011 and \$116.3 million at June 30, 2011.

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Troubled debt restructured loans were \$113.7 million, before specific reserves of \$2.6 million, at June 30, 2012. Troubled debt restructured loans were \$89.4 million, before specific reserves of \$1.7 million, at December 31, 2011. At June 30, 2011, troubled debt restructured loans were \$18.3 million, before specific reserves of \$1.3 million. Troubled debt restructured loans included \$72.8 million, \$46.6 million and \$1.2 million of restructured loans on accrual status at June 30, 2012, December 31, 2011 and June 30, 2011. There were no commitments to lend additional funds on restructured loans at June 30, 2012.

The following table presents information on nonaccrual loans and OREO as of June 30, 2012, December 31, 2011 and June 30, 2011:

| (in thousands)  | June 30,<br>2012 | December 31,<br>2011 | June 30,<br>2011 |
|---|------------------|----------------------|------------------|
| <b>Nonperforming assets, excluding covered assets</b>             |                  |                      |                  |
| Nonaccrual loans, excluding covered loans                         |                  |                      |                  |
| Commercial  | \$ 18,936        | \$ 19,888            | \$ 23,575        |
| Commercial real estate mortgages                                  | 28,780           | 21,948               | 26,676           |
| Residential mortgages   | 14,064           | 9,771                | 14,211           |
| Real estate construction  | 29,676           | 50,876               | 60,543           |
| Equity lines of credit  | 6,505            | 8,669                | 6,668            |
| Installment   | 575              | 874                  | 365              |
| Lease financing   | 120              |                      | 762              |
| Total nonaccrual loans, excluding covered loans                   | 98,656           | 112,026              | 132,800          |
| OREO, excluding covered OREO                                      | 34,667           | 30,790               | 47,634           |
| Total nonperforming assets, excluding covered assets              | \$ 133,323       | \$ 142,816           | \$ 180,434       |
| <b>Nonperforming covered assets</b>                               |                  |                      |                  |
| Nonaccrual loans  | \$ 422           | \$ 422               | \$ 1,408         |
| OREO  | 82,834           | 98,550               | 114,907          |
| Total nonperforming covered assets                                | \$ 83,256        | \$ 98,972            | \$ 116,315       |
| <b>Ratios (excluding covered assets):</b>                         |                  |                      |                  |
| Nonaccrual loans as a percentage of total loans                   | 0.73%            | 0.91%                | 1.14%            |
| Nonperforming assets as a percentage of total loans and OREO      | 0.98             | 1.16                 | 1.54             |
| Allowance for loan and lease losses to nonaccrual loans           | 273.21           | 234.37               | 200.25           |
| Allowance for loan and lease losses to total nonperforming assets | 202.17           | 183.84               | 147.39           |
| Allowance for loan and lease losses to total loans and leases     | 2.00             | 2.13                 | 2.28             |

Company policy requires that a loan be placed on nonaccrual status if either principal or interest payments are 90 days past due, unless the loan is both well secured and in process of collection, or if full collection of interest or principal becomes uncertain, regardless of the time period involved. Covered loans accounted for under ASC 310-30 are generally considered accruing and performing loans as the loans accrete interest income over the estimated life of the loan when cash flows are reasonably estimable. Accordingly, acquired impaired covered loans that are contractually past due are still considered to be accruing and performing loans. If the timing and amount of future cash flows is not reasonably estimable, the loans may be classified as nonaccrual loans and interest income is not recognized until the timing and amount of future cash flows can be reasonably estimated.



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Loans are considered past due following the date when either interest or principal is contractually due and unpaid. A summary of past due loans, excluding loans on nonaccrual status, is provided below:

| (in thousands)                                   | June 30,<br>2012 | December 31,<br>2011 | June 30,<br>2011 |
|--|------------------|----------------------|------------------|
| <b>Past due loans, excluding covered loans</b>   |                  |                      |                  |
| 30-89 days past due                              | \$ 53,724        | \$ 17,978            | \$ 35,920        |
| 90 days or more past due on accrual status:      |                  |                      |                  |
| Commercial                                       |                  |                      | 351              |
| Commercial real estate mortgages                 |                  |                      | 586              |
| Residential mortgages                            | 1,244            | 379                  | 1,282            |
| Real estate construction                         |                  |                      | 4,995            |
| Equity lines of credit                           | 322              | 74                   |                  |
| Lease financing                                  | 499              |                      |                  |
| Total 90 days or more past due on accrual status | \$ 2,065         | \$ 453               | \$ 7,214         |
| <b>Past due covered loans</b>                    |                  |                      |                  |
| 30-89 days past due                              | \$ 17,337        | \$ 49,111            | \$ 47,318        |
| 90 days or more past due on accrual status       | 190,005          | 330,169              | 368,379          |

Nonaccrual loans, excluding covered loans, were \$98.7 million at June 30, 2012, down from \$112.0 million at December 31, 2011 and \$132.8 million at June 30, 2011. Net loan recoveries in the second quarter of 2012 were \$2.7 million, or 0.08 percent of average loans and leases, excluding covered loans, on an annualized basis, compared with net loan recoveries of \$4.5 million, or 0.15 percent, for the first quarter of 2012, and net loan recoveries of \$4.2 million, or 0.15 percent, for the second quarter of 2011. In accordance with the Company's allowance for loan and lease losses methodology and in response to growth in the Company's loan portfolio and stable credit quality, the Company recorded provision for loan and lease losses of \$1.0 million for the three months ending June 30, 2012. The Company recorded no provision in the first quarter of 2012 and the second quarter of 2011.

The allowance for loan and lease losses, excluding covered loans, was \$269.5 million as of June 30, 2012, compared with \$262.6 million as of December 31, 2011 and \$265.9 million as of June 30, 2011. The ratio of the allowance for loan and lease losses as a percentage of total loans and leases, excluding covered loans, was 2.00 percent at June 30, 2012 compared to 2.13 percent at December 31, 2011 and 2.28 percent at June 30, 2011. The allowance for loan and lease losses as a percentage of nonperforming assets, excluding covered assets, was 202.2 percent, 183.8 percent, and 147.4 percent at June 30, 2012, December 31, 2011 and June 30, 2011, respectively. The Company believes that its allowance for loan and lease losses continues to be adequate.

All nonaccrual loans greater than \$500,000 are considered impaired and are individually analyzed. The Company does not maintain a reserve for impaired loans where the carrying value of the loan is less than the fair value of the collateral, reduced by costs to sell. Where the carrying value of the impaired loan is greater than the fair value of the collateral, less costs to sell, the Company specifically establishes an allowance for loan and lease losses to cover the deficiency. This analysis ensures that the non-accruing loans have been adequately reserved.

At June 30, 2012, there were no acquired impaired covered loans accounted for under ASC 310-30 that were on nonaccrual basis. Of the population of covered loans that are accounted for outside the scope of ASC 310-30, the Company had \$0.4 million of acquired covered loans that were on nonaccrual status at June 30, 2012, compared to \$0.4 million and \$1.4 million at December 31, 2011 and June 30, 2011, respectively.





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The table below summarizes the total activity in non-covered and covered nonaccrual loans for the three and six months ended June 30, 2012 and 2011:

**Changes in Nonaccrual Loans**

| (in thousands)                                       | For the three months ended<br>June 30, |            |    | For the six months ended<br>June 30, |            |    |
|--|--|------------|----|--------------------------------------|------------|----|
|  | 2012                                   | 2011       |    | 2012                                 | 2011       |    |
| Balance, beginning of the period                     | \$ 113,229                             | \$ 159,735 | \$ | \$ 112,448                           | \$ 193,480 | \$ |
| Loans placed on nonaccrual                           | 17,608                                 | 10,924     |    | 37,340                               | 29,619     |    |
| Charge-offs  | (9,790)                                | (4,444)    |    | (20,916)                             | (10,139)   |    |
| Loans returned to accrual status                     | (237)                                  | (12,115)   |    | (443)                                | (17,322)   |    |
| Repayments (including interest applied to principal) | (14,099)                               | (16,232)   |    | (19,702)                             | (49,816)   |    |
| Transfers to OREO                                    | (7,633)                                | (3,660)    |    | (9,649)                              | (11,614)   |    |
| Balance, end of the period                           | \$ 99,078                              | \$ 134,208 | \$ | \$ 99,078                            | \$ 134,208 | \$ |

In addition to loans disclosed above as past due or nonaccrual, management has also identified \$39.6 million of loans to 18 borrowers as of July 26, 2012, where the ability to comply with the present loan payment terms in the future is questionable. However, the inability of the borrowers to comply with repayment terms was not sufficiently probable to place the loan on nonaccrual status at June 30, 2012, and the identification of these loans is not necessarily indicative of whether the loans will be placed on nonaccrual status. This amount was determined based on analysis of information known to management about the borrowers' financial condition and current economic conditions. In the 2011 Form 10-K, the Company reported that management had identified \$35.7 million of loans to 19 borrowers where the ability to comply with the loan payment terms in the future was questionable. Management's classification of credits as nonaccrual, restructured or problems does not necessarily indicate that the principal is uncollectible in whole or part.

***Other Real Estate Owned***

The following tables provide a summary of OREO activity for the three and six months ended June 30, 2012 and 2011:

| (in thousands)               | For the three months ended<br>June 30, 2012 |                 |            | For the three months ended<br>June 30, 2011 |                 |            |
|------------------------------|---|-----------------|------------|---|-----------------|------------|
|                              | Non-Covered<br>OREO                         | Covered<br>OREO | Total      | Non-Covered<br>OREO                         | Covered<br>OREO | Total      |
| Balance, beginning of period | \$ 29,074                                   | \$ 78,456       | \$ 107,530 | \$ 56,342                                   | \$ 121,822      | \$ 178,164 |
| Additions                    | 10,476                                      | 22,960          | 33,436     | 3,967                                       | 33,549          | 37,516     |
| Sales                        | (1,540)                                     | (14,332)        | (15,872)   | (11,083)                                    | (24,836)        | (35,919)   |
| Valuation adjustments        | (3,343)                                     | (4,250)         | (7,593)    | (1,592)                                     | (15,628)        | (17,220)   |
| Balance, end of period       | \$ 34,667                                   | \$ 82,834       | \$ 117,501 | \$ 47,634                                   | \$ 114,907      | \$ 162,541 |

For the six months ended  
June 30, 2012

For the six months ended  
June 30, 2011

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| (in thousands)               | Non-Covered<br>OREO |         | Covered<br>OREO |          | Total      | Non-Covered<br>OREO |          | Covered<br>OREO |          | Total      |
|------------------------------|---------------------|---------|-----------------|----------|------------|---------------------|----------|-----------------|----------|------------|
| Balance, beginning of period | \$                  | 30,790  | \$              | 98,550   | \$ 129,340 | \$                  | 57,317   | \$              | 120,866  | \$ 178,183 |
| Additions                    |                     | 12,693  |                 | 29,035   | 41,728     |                     | 10,528   |                 | 61,126   | 71,654     |
| Sales                        |                     | (4,417) |                 | (32,693) | (37,110)   |                     | (17,147) |                 | (43,153) | (60,300)   |
| Valuation adjustments        |                     | (4,399) |                 | (12,058) | (16,457)   |                     | (3,064)  |                 | (23,932) | (26,996)   |
| Balance, end of period       | \$                  | 34,667  | \$              | 82,834   | \$ 117,501 | \$                  | 47,634   | \$              | 114,907  | \$ 162,541 |

OREO was \$117.5 million at June 30, 2012, \$129.3 million at December 31 2011 and \$162.5 million at June 30, 2011, respectively. The OREO balance at June 30, 2012 includes covered OREO of \$82.8 million compared with \$98.6 million at December 31, 2011 and \$114.9 million at June 30, 2011. Covered OREO represents OREO from the FDIC-assisted acquisitions that is subject to loss-sharing agreements. The balance of OREO at June 30, 2012, December 31, 2011 and June 30, 2011 is net of valuation allowances of \$38.8 million, \$37.4 million and \$32.8 million, respectively.

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The Company recognized \$2.8 million in total net gain on the sale of OREO in the second quarter of 2012, compared with \$2.2 million in the first quarter of 2012 and \$8.4 million in the year-earlier quarter. Net gain on the sale of OREO in the second quarter of 2012 included \$1.5 million of net gain related to the sale of covered OREO, compared to \$2.1 million in the first quarter of 2012 and \$9.1 million in the year-earlier quarter.

Covered OREO expenses and valuation write-downs are recorded in the noninterest expense section of the consolidated statements of income and gains or losses on sale of covered OREO are recognized in the noninterest income section. Under the loss sharing agreements, 80 percent of eligible covered OREO expenses, valuation write-downs, and losses on sales are reimbursable to the Company from the FDIC and 80 percent of covered gains on sales are payable to the FDIC. The portion of these expenses that is reimbursable or income that is payable is recorded in FDIC loss sharing income (expense), net in the noninterest income section of the consolidated statements of income.

***Other Assets***

The following table presents information on other assets:

| (in thousands)                             | June 30,<br>2012 | December 31,<br>2011 | June 30,<br>2011 |
|--|------------------|----------------------|------------------|
| Accrued interest receivable                | \$ 64,904        | \$ 67,257            | \$ 61,219        |
| Deferred compensation fund assets          | 58,279           | 53,648               | 57,928           |
| Stock in government agencies               | 99,716           | 107,423              | 114,874          |
| Private equity and alternative investments | 40,238           | 39,919               | 38,303           |
| Bank-owned life insurance                  | 81,710           | 80,337               | 80,441           |
| Mark-to-market on derivatives              | 66,659           | 62,230               | 44,488           |
| Income tax receivable                      | 17,659           | 40,300               | 80,594           |
| Prepaid FDIC assessment                    | 29,103           | 36,975               | 44,900           |
| FDIC receivable                            | 12,517           | 19,763               | 69,386           |
| Other                                      | 97,483           | 69,689               | 87,976           |
| Total other assets                         | \$ 568,268       | \$ 577,541           | \$ 680,109       |

***Deposits***

Deposits totaled \$21.11 billion, \$20.39 billion and \$19.27 billion at June 30, 2012, December 31, 2011 and June 30, 2011, respectively. Average deposits totaled \$20.95 billion for the second quarter of 2012, an increase of 2 percent from \$20.50 billion for the fourth quarter of 2011 and an increase of 12 percent from \$18.78 billion for the second quarter of 2011. Core deposits, which include noninterest-bearing deposits and interest-bearing deposits excluding time deposits of \$100,000 and over, provide a stable source of low cost funding. Average core deposits were \$20.22 billion, \$19.78 billion and \$17.95 billion for the quarters ended June 30, 2012, December 31, 2011 and June 30, 2011, respectively, and represented 97 percent, 96 percent and 96 percent of total deposits for the same periods. Average noninterest-bearing deposits in the second quarter of 2012 increased 10 percent and 33 percent compared with the fourth quarter of 2011 and year-earlier quarter, respectively.

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Treasury Services deposit balances, which consists primarily of title, escrow, community association and property management deposits, averaged \$2.14 billion in the second quarter of 2012, compared with \$1.83 billion in the fourth quarter of 2011 and \$1.76 billion for the second quarter of 2011. The increases were due primarily to the addition of new escrow and property management clients, as well as continued growth in deposit balances by existing clients.

### ***Borrowed Funds***

Total borrowed funds were \$1.03 billion, \$747.8 million and \$851.6 million at June 30, 2012, December 31, 2011 and June 30, 2011, respectively. Total average borrowed funds were \$800.8 million, \$702.4 million and \$865.3 million for the quarters ended June 30, 2012, December 31, 2011 and June 30, 2011, respectively.

Short-term borrowings consist of funds with remaining maturities of one year or less. Short-term borrowings were \$322.1 million as of June 30, 2012 compared to \$50.0 million as of December 31, 2011 and \$149.8 million as of June 30, 2011. Short-term borrowings at June 30, 2012 consist primarily of the current portion of senior notes that mature in February 2013.

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Long-term debt consists of borrowings with remaining maturities greater than one year and is primarily comprised of senior notes, subordinated debt, junior subordinated debt and nonrecourse debt. Long-term debt was \$712.3 million, \$697.8 million and \$701.8 million as of June 30, 2012, December 31, 2011 and June 30, 2011, respectively. The Company's long-term borrowings have maturity dates ranging from July 2013 to November 2034.

On April 30, 2012, the Company assumed \$320.9 million in borrowings in its acquisition of FAEF. Subsequent to the acquisition date, the Company paid off a significant portion of the outstanding balance and as of June 30, 2012, FAEF borrowings were comprised of \$82.8 million of nonrecourse debt. FAEF assigns the future rentals of certain lease financing loans to financial institutions on a nonrecourse basis at fixed interest rates. In return for future minimum lease rentals assigned, FAEF receives a discounted cash payment. Proceeds from discounting are reflected as nonrecourse debt and classified as short-term borrowings or long-term debt based on its maturities.

On June 20, 2012, the Bank issued \$150.0 million in subordinated notes that bear a fixed rate of interest of 5.375 percent. The notes mature on July 15, 2022. The proceeds will be used for general corporate purposes, including to pay off and reduce short-term wholesale deposits and other borrowings.

***Off-Balance Sheet***

In the normal course of business, the Company is a party to financial instruments with off-balance sheet risk. These financial instruments include commitments to extend credit and letters of credit; and to invest in affordable housing funds, private equity and other alternative investments. These instruments involve elements of credit, foreign exchange, and interest rate risk, to varying degrees, in excess of the amount reflected in the consolidated balance sheets.

Exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and letters of credit is represented by the contractual notional amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments, and will evaluate each client's creditworthiness on a case-by-case basis.

Commitments to extend credit are agreements to lend to a client as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since a portion of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company had off-balance sheet credit commitments totaling \$6.36 billion at June 30, 2012, \$5.67 billion at December 31, 2011 and \$5.33 billion at June 30, 2011.

Standby letters of credit are commitments issued by the Company to guarantee the obligations of its customer to beneficiaries. Commercial letters of credit are issued on behalf of customers to ensure payment in connection with trade transactions. The Company had \$761.2 million in letters of credit at June 30, 2012, of which \$748.3 million relate to standby letters of credit and \$12.9 million relate to commercial letters of credit. The Company had \$723.5 million outstanding in letters of credit at December 31, 2011, of which \$708.9 million relate to standby letters of credit and \$14.7 million relate to commercial letters of credit. At June 30, 2011, the Company had \$607.6 million outstanding in letters of credit of which \$582.4 million relate to standby letters of credit and \$25.2 million relate to commercial letters of credit.

As of June 30, 2012, the Company had private equity fund and alternative investment fund commitments of \$68.9 million, of which \$58.9 million was funded. As of December 31, 2011 and June 30, 2011, the Company had private equity and alternative investment fund commitments of \$68.9 million and \$65.9 million, of which \$57.9 million and \$54.4 million was funded, respectively.

In connection with the liquidation of an investment acquired in a previous bank merger, the Company has an outstanding long-term indemnity. The maximum liability under the indemnity is \$23.0 million, but the Company does not expect to make any payments of more than nominal amounts under the terms of this indemnity.

Table of Contents***Fair Value Measurements***

Management employs market standard valuation techniques in determining the fair value of assets and liabilities. Inputs used in valuation techniques are based on assumptions that market participants would use in pricing an asset or liability. The Company utilizes quoted market prices to measure fair value to the extent available (Level 1). If market prices are not available, fair value measurements are based on models that use primarily market-based assumptions including interest rate yield curves, anticipated prepayment rates, default rates and foreign currency rates (Level 2). In certain circumstances, market observable inputs for model-based valuation techniques may not be available and the Company is required to make judgments about assumptions that market participants would use in estimating the fair value of a financial instrument (Level 3). Refer to Note 3, *Fair Value Measurements*, to the Consolidated Financial Statements for additional information on fair value measurements.

At June 30, 2012, \$7.00 billion, or approximately 28 percent, of the Company's total assets were recorded at fair value on a recurring basis. The majority of these financial assets were valued using Level 1 or Level 2 inputs. Less than one percent of total assets is measured using Level 3 inputs. At June 30, 2012, \$61.8 million of the Company's total liabilities were recorded at fair value on a recurring basis using Level 1 or Level 2 inputs.

At June 30, 2012, \$83.7 million, or approximately 0.3 percent, of the Company's total assets, were recorded at fair value on a nonrecurring basis. These assets were measured using Level 2 and Level 3 inputs. No liabilities were measured at fair value on a nonrecurring basis at June 30, 2012.

***Capital***

The ratio of period-end equity to period-end assets was 9.09 percent, 9.06 percent and 9.25 percent as of June 30, 2012, December 31, 2011 and June 30, 2011, respectively.

The following table presents the regulatory standards for well capitalized institutions and the capital ratios for the Corporation and the Bank at June 30, 2012, December 31, 2011 and June 30, 2011:

|   | Regulatory<br>Well-Capitalized<br>Standards | June 30,<br>2012 | December 31,<br>2011 | June 30,<br>2011 |
|---|---|------------------|----------------------|------------------|
| <b>City National Corporation</b>                            |   |                  |                      |                  |
| Tier 1 leverage   |   | 6.74%            | 6.77%                | 7.09%            |
| Tier 1 risk-based capital                                   | 6.00%                                       | 9.58             | 10.26                | 10.66            |
| Total risk-based capital                                    | 10.00                                       | 12.91            | 12.83                | 13.34            |
| Tangible equity to tangible assets (1)                      |   | 6.88             | 7.01                 | 7.08             |
| Tier 1 common shareholders' equity to risk-based assets (2) |   | 9.55             | 10.22                | 10.45            |
| <b>City National Bank</b>                                   |   |                  |                      |                  |
| Tier 1 leverage   | 5.00%                                       | 7.91%            | 8.07%                | 8.55%            |

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|                           |       |       |       |       |
|---------------------------|-------|-------|-------|-------|
| Tier 1 risk-based capital | 6.00  | 11.27 | 12.23 | 12.87 |
| Total risk-based capital  | 10.00 | 14.53 | 14.68 | 15.41 |

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(1) Tangible equity to tangible assets is a non-GAAP financial measure that represents total equity less identifiable intangible assets and goodwill divided by total assets less identifiable assets and goodwill. Management reviews tangible equity to tangible assets in evaluating the Company's capital levels and has included this ratio in response to market participants' interest in tangible equity as a measure of capital. See reconciliation of the GAAP financial measure to this non-GAAP financial measure below.

(2) Tier 1 common shareholders' equity to risk-based assets is calculated by dividing (a) Tier 1 capital less non-common components including qualifying noncontrolling interest in subsidiaries and qualifying trust preferred securities by (b) risk-weighted assets. Tier 1 capital and risk-weighted assets are calculated in accordance with applicable bank regulatory guidelines. This ratio is a non-GAAP measure that is used by investors, analysts and bank regulatory agencies to assess the capital position of financial services companies. Management reviews this measure in evaluating the Company's capital levels and has included this measure in response to market participants' interest in the Tier 1 common shareholders' equity to risk-based assets ratio. See reconciliation of the GAAP financial measure to this non-GAAP financial measure below.



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| (in thousands)  | June 30,<br>2012 | December 31,<br>2011 | June 30,<br>2011 |
|---|------------------|----------------------|------------------|
| Total equity  | \$ 2,255,365     | \$ 2,144,849         | \$ 2,084,010     |
| Less: Goodwill and other intangible assets                      | (589,114)        | (522,753)            | (526,207)        |
| Tangible equity (A)   | \$ 1,666,251     | \$ 1,622,096         | \$ 1,557,803     |
| Total assets  | \$ 24,801,973    | \$ 23,666,291        | \$ 22,526,089    |
| Less: Goodwill and other intangible assets                      | (589,114)        | (522,753)            | (526,207)        |
| Tangible assets (B)   | \$ 24,212,859    | \$ 23,143,538        | \$ 21,999,882    |
| Tangible equity to tangible assets (A)/(B)                      | 6.88%            | 7.01%                | 7.08%            |
| Tier 1 capital  | 1,602,398        | 1,570,101            | 1,523,269        |
| Less: Noncontrolling interest                                   |                  |                      | (25,089)         |
| Less: Trust preferred securities                                | (5,155)          | (5,155)              | (5,155)          |
| Tier 1 common shareholders' equity (C)                          | \$ 1,597,243     | \$ 1,564,946         | \$ 1,493,025     |
| Risk-weighted assets (D)  | \$ 16,722,999    | \$ 15,305,328        | \$ 14,285,572    |
| Tier 1 common shareholders' equity to risk-based assets (C)/(D) | 9.55%            | 10.22%               | 10.45%           |

In December 2010, the Basel Committee on Bank Supervision (BCBS) published the final version of the Capital Accord commonly referred to as Basel III. A key goal of the Basel III agreement is to strengthen the capital resources of banking organizations during normal and challenging business environments. The standards established in the Capital Accord will be implemented by the governing regulatory agencies of the participating nations. These standards must also be integrated with the safety and soundness standards required under the Dodd-Frank Act. In June 2012, United States banking regulators issued proposed standards combining Basel III and Dodd-Frank Act requirements. The proposed requirements will be phased in over several years, and will replace the previous regulatory model established under the Basel I Accord. Important elements of the standards are as follows:

- Increase minimum capital requirements,
- Raise the quality of capital so banks are better able to absorb losses,
- Implement a leverage ratio concept for U.S. bank holding companies,
- Establish a specific capital conservation buffer, and
- Provide a more uniform supervisory standard for U.S. financial institution regulatory agencies

Although these new rules have not yet been finalized and implemented by the federal banking agencies, the Company has estimated its capital ratios using the proposed standards and the pro forma ratios exceed the requirements of the fully implemented capital rules.

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

#### **ASSET/LIABILITY MANAGEMENT**

Market risk results from the variability of future cash flows and earnings due to changes in the financial markets. These changes may also impact the fair values of loans, securities and borrowings. The values of financial instruments may fluctuate because of interest rate changes, foreign currency exchange rate changes or other market changes. The Company's asset/liability management process entails the evaluation, measurement and management of market risk and liquidity risk. The principal objective of asset/liability management is to optimize net interest income subject to margin volatility and liquidity constraints over the long term. Margin volatility results when the rate reset (or repricing) characteristics of assets are materially different from those of the Company's liabilities. The Board of Directors approves asset/liability policies and annually reviews and approves the limits within which the risks must be managed. The Asset/Liability Management Committee (ALCO), which is comprised of senior management and key risk management individuals, sets risk management guidelines within the broader limits approved by the Board, monitors the risks and periodically reports results to the Board.

A quantitative and qualitative discussion about market risk is included on pages 66 to 72 of the Corporation's Form 10-K for the year ended December 31, 2011.

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***Liquidity Risk***

Liquidity risk results from the mismatching of asset and liability cash flows. Funds for this purpose can be obtained in cash markets, by borrowing, or by selling certain assets. The objective of liquidity management is to manage cash flow and liquidity reserves so that they are adequate to fund the Company's operations and meet obligations and other commitments on a timely basis and at a reasonable cost. The Company achieves this objective through the selection of asset and liability maturity mixes that it believes best meet its needs. The Company's liquidity position is enhanced by its ability to raise additional funds as needed in the wholesale markets. Liquidity risk management is an important element in the Company's ALCO process, and is managed within limits approved by the Board of Directors and guidelines set by management. Attention is also paid to potential outflows resulting from disruptions in the financial markets or to unexpected credit events. These factors are incorporated into the Company's contingency funding analysis, and provide the basis for the identification of primary and secondary liquidity reserves.

In recent years, the Company's core deposit base has provided the majority of the Company's funding requirements. This relatively stable and low-cost source of funds, along with shareholders' equity, provided 92 percent of funding for average total assets in the second quarter and first six months of 2012, respectively, and 91 percent for the year-earlier periods. Strong core deposits are indicative of the strength of the Company's franchise in its chosen markets and reflect the confidence that clients have in the Company. The Company places a very high priority in maintaining this confidence through conservative credit and capital management practices and by maintaining significant on-balance sheet liquidity reserves.

Funding obtained through short-term wholesale or market sources averaged \$3.5 million and \$84.9 million for the three and six months ended June 30, 2012, respectively and \$11.2 million and \$6.0 million for the year-earlier periods. The balance of short-term funding from market sources was \$110.0 million at June 30, 2012. The Company's liquidity position was also supported through longer-term borrowings (including the current portion of long-term debt) which averaged \$797.3 million and \$747.0 million for the three and six months ended June 30, 2012, respectively, compared with \$854.1 million and \$856.0 million for the year-earlier periods. Market sources of funds comprise a modest portion of total Bank funding and are managed within concentration and maturity guidelines reviewed by management and implemented by the Company's treasury department.

Liquidity is further provided by assets such as federal funds sold, balances held at the Federal Reserve Bank, and trading securities, which may be immediately converted to cash at minimal cost. The aggregate of these assets averaged \$402.3 million and \$289.6 million for the second quarter and six months of 2012, respectively, compared with \$641.5 million and \$672.1 million in the year-earlier period. In addition, the Company has committed and unutilized secured borrowing capacity of \$4.26 billion as of June 30, 2012 from the Federal Home Loan Bank of San Francisco, of which the Bank is a member. The Company's investment portfolio also provides a substantial liquidity reserve. The portfolio of securities available-for-sale averaged \$6.65 billion and \$6.90 billion for the quarter and six months ended June 30, 2012, respectively. The portfolio of securities available-for-sale averaged \$6.16 billion and \$5.89 billion for the quarter and six months ended June 30, 2011, respectively. The unpledged portion of securities available-for-sale and held-to-maturity at fair value totaled \$6.94 billion at June 30, 2012. These securities could be used as collateral for borrowing or a portion could be sold.

***Interest Rate Risk***

*Net Interest Simulation:* As part of its overall interest rate risk management process, the Company performs stress tests on net interest income projections based on a variety of factors, including interest rate levels, changes in the relationship between the prime rate and short-term interest rates, and the shape of the yield curve. The Company uses a simulation model to estimate the severity of this risk and to develop mitigation

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strategies, including interest-rate hedges. The magnitude of the change is determined from historical volatility analysis. The assumptions used in the model are updated periodically and reviewed and approved by ALCO. In addition, the Board of Directors has adopted limits within which interest rate exposure must be contained. Within these broader limits, ALCO sets management guidelines to further contain interest rate risk exposure.

The Company is naturally asset-sensitive due to its large portfolio of rate-sensitive commercial loans that are funded in part by noninterest bearing and rate-stable core deposits. As a result, if there are no significant changes in the mix of assets and liabilities, the net interest margin increases when interest rates increase and decreases when interest rates decrease. The Company uses on and off-balance sheet hedging vehicles to manage risk. The Company uses a simulation model to estimate the impact of changes in interest rates on net interest income. Interest rate scenarios include stable rates and a 400 basis point parallel shift in the yield curve occurring gradually over a two-year period.

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The model is used to project net interest income assuming no changes in loans or deposit mix as it stood at June 30, 2012, as well as a dynamic simulation that includes changes to balance sheet mix in response to changes in interest rates. In the dynamic simulation, loan and deposit balances are modeled based on experience in previous vigorous economic recovery cycles. Loans, excluding covered loans, increase 10 percent per year compared to the base case. Similarly, deposits decline 5 percent per year. Loan yields and deposit rates change over the simulation horizon based on current spreads and adjustment factors that are statistically derived using historical rate and balance sheet data.

As of June 30, 2012, the Federal funds target rate was at a range of zero percent to 0.25 percent. Further declines in interest rates are not expected to significantly reduce earning asset yields or liability costs, nor have a meaningful effect on net interest margin. At June 30, 2012, a gradual 400 basis point parallel increase in the yield curve over the next 24 months assuming a static balance sheet would result in an increase in projected net interest income of approximately 7.6 percent in year one and a 26.9 percent increase in year two. This compares to an increase in projected net interest income of 3.9 percent in year one and a 16.1 percent increase in year two at June 30, 2011. Interest rate sensitivity has increased due to changes in the mix of the balance sheet, primarily significant growth in floating rate loans and non-rate sensitive deposits. The dynamic simulation incorporates balance sheet changes resulting from a gradual 400 basis point increase in rates. In combination, these rate and balance sheet effects result in an increase in projected net interest income of approximately 8.7 percent in year one and 29.0 percent increase in year two. The Company's interest rate risk exposure remains within Board limits and ALCO guidelines.

The Company's loan portfolio includes floating rate loans which are tied to short-term market index rates, adjustable rate loans for which the initial rate is fixed for a period from one year to as much as ten years, and fixed-rate loans whose interest rate does not change through the life of the transaction. The following table shows the composition of the Company's loan portfolio, including covered loans, by major loan category as of June 30, 2012. Each loan category is further divided into Floating, Adjustable and Fixed rate components. Floating rate loans are generally tied to either the Prime rate or to a LIBOR based index.

| (in millions)                    | Prime    | Floating Rate<br>LIBOR | Total    | Adjustable | Fixed    | Total<br>Loans |
|----------------------------------|----------|------------------------|----------|------------|----------|----------------|
| Commercial                       | \$ 2,169 | \$ 2,733               | \$ 4,902 | \$ 63      | \$ 1,122 | \$ 6,087       |
| Commercial real estate mortgages | 302      | 896                    | 1,198    | 72         | 1,154    | 2,424          |
| Residential mortgages            |          |                        |          | 2,322      | 1,501    | 3,823          |
| Real estate construction         | 139      | 129                    | 268      |            | 34       | 302            |
| Equity lines of credit           | 741      |                        | 741      |            |          | 741            |
| Installment                      | 74       |                        | 74       |            | 56       | 130            |
| Covered loans                    | 91       | 132                    | 223      | 756        | 281      | 1,260          |
| Total loans and leases           | \$ 3,516 | \$ 3,890               | \$ 7,406 | \$ 3,213   | \$ 4,148 | \$ 14,767      |
| Percentage of portfolio          | 24%      | 26%                    | 50%      | 22%        | 28%      | 100%           |

Certain floating rate loans have a floor rate which is absolute and below which the loan rate will not fall even though market rates may be unusually low. At June 30, 2012, \$7.41 billion (50 percent) of the Company's loan portfolio was floating rate, of which \$5.30 billion (72 percent) was not impacted by rate floors. This is because either the loan contract does not specify a minimum or floor rate, or because the contractual loan rate is above the minimum rate specified in the loan contract. Of the loans which were at their contractual minimum rate, \$1.41 billion (19 percent) were within 0.75 percent of the contractual loan rate absent the effects of the floor. Thus, the rate on these loans will be relatively responsive to increases in the underlying Prime or LIBOR index, and all will adjust upwards should the underlying index increase by more than 0.75 percent. Only \$88.0 million of floating rate loans have floors that are more than 2.00 percent above the contractual rate formula. Thus, the yield on the Company's floating rate loan portfolio is expected to be highly responsive to changes in market rates. The following table shows the balance of loans in the Floating Rate portfolio stratified by spread between the current loan rate and the floor rate as of June 30, 2012:



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| (in millions)                  | Loans with No Floor and Current Rate Greater than Floor |         | Interest Rate Increase Needed for Loans Currently at Floor Rate to Become Floating |         |    |     | Total |    |    |       |
|--------------------------------|---|---------|--|---------|----|-----|-------|----|----|-------|
|                                |   | < 0.75% | 0.76% - 2.00%  | > 2.00% |    |     |       |    |    |       |
| Prime                          | \$  | 1,993   | \$   | 987     | \$ | 504 | \$    | 32 | \$ | 3,516 |
| LIBOR                          |   | 3,303   |  | 421     |    | 110 |       | 56 |    | 3,890 |
| Total floating rate loans      | \$  | 5,296   | \$   | 1,408   | \$ | 614 | \$    | 88 | \$ | 7,406 |
| % of total floating rate loans |   | 72%     |  | 19%     |    | 8%  |       | 1% |    | 100%  |

**Economic Value of Equity:** The economic value of equity (EVE) model is used to evaluate the vulnerability of the market value of shareholders equity to changes in interest rates. The EVE model calculates the expected cash flow of all of the Company's assets and liabilities under sharply higher and lower interest rate scenarios. The present value of these cash flows is calculated by discounting them using the interest rates for that scenario. The difference between the present value of assets and the present value of liabilities in each scenario is the EVE. The assumptions about the timing of cash flows, level of interest rates and shape of the yield curve are the same as those used in the net interest income simulation. They are updated periodically and are reviewed by ALCO at least annually.

As of June 30, 2012, an instantaneous 200 basis point increase in interest rates results in a 0.8 percent decline in EVE. This compares to a 2.4 percent decline a year-earlier. The decrease is due to changes in the mix of the balance sheet resulting from the historically low interest rate environment. Measurement of a 200 basis point decrease in rates as of June 30, 2012 and June 30, 2011 is not meaningful due to the current low rate environment.

## Interest-Rate Risk Management

The following table presents the notional amount and fair value of the Company's interest rate swap agreements according to the specific asset or liability hedged:

| (in millions)             | June 30, 2012   |            |                  | December 31, 2011 |            |                  | June 30, 2011   |            |                  |
|---------------------------|-----------------|------------|------------------|-------------------|------------|------------------|-----------------|------------|------------------|
|                           | Notional Amount | Fair Value | Duration (Years) | Notional Amount   | Fair Value | Duration (Years) | Notional Amount | Fair Value | Duration (Years) |
| <b>Fair Value Hedge</b>   |                 |            |                  |                   |            |                  |                 |            |                  |
| <b>Interest Rate Swap</b> |                 |            |                  |                   |            |                  |                 |            |                  |
| Long-term debt            | \$ 205.5        | \$ 6.2     | 0.5              | \$ 207.4          | \$ 9.8     | 1.0              | \$ 355.2        | \$ 14.5    | 0.9              |

(1) Net fair value is the estimated net gain (loss) to settle derivative contracts. The net fair value is the sum of the mark-to-market asset net of cash collateral received, mark-to-market liability (if applicable), and net interest receivable or payable.

Interest-rate swaps may be used to reduce cash flow variability and to moderate changes in the fair value of long-term financial instruments. Net interest income or expense associated with interest-rate swaps (the difference between the fixed and floating rates paid or received) is included in net interest income in the reporting periods in which they are earned. All derivatives are recorded on the consolidated balance sheets at their fair value. The treatment of changes in the fair value of derivatives depends on the character of the transaction.

At June 30, 2012, the Company had \$205.5 million notional amount of interest-rate swap hedge transactions, all of which were designated as fair value hedges of long-term debt. There were no cash flow hedges outstanding at June 30, 2012. The positive fair value of the fair value hedges of \$6.2 million is recorded in other assets. It consists of a positive mark-to-market of \$5.1 million and net interest receivable of \$1.1 million. The balance of debt reported in the consolidated balance sheet has been increased by a \$5.1 million mark-to-market adjustment associated with interest-rate hedge transactions.

The hedged long-term debt consists of City National Corporation senior notes with a face value of \$205.5 million due on February 15, 2013.

The Company has not entered into any hedge transactions involving any other interest-rate derivative instruments, such as interest-rate floors, caps, and interest-rate futures contracts for its own portfolio in 2012. Under existing policy, the Company could use such financial instruments in the future if deemed appropriate.



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*Other Derivatives*

The Company also offers various derivative products to clients and enters into derivative transactions in due course. These derivative contracts are offset by paired trades with unrelated bank counterparties. These transactions are not linked to specific Company assets or liabilities in the consolidated balance sheets or to forecasted transactions in a hedge relationship and, therefore, do not qualify for hedge accounting. The contracts are marked-to-market each reporting period with changes in fair value recorded as part of Other noninterest income in the consolidated statements of income. Fair values are determined from verifiable first-party sources that have considerable experience with the derivative markets. The Company provides client data to the first-party source for purposes of calculating the credit valuation component of the fair value measurement of client derivative contracts. At June 30, 2012 and 2011, the Company had entered into derivative contracts with clients (and offsetting derivative contracts with counterparties) having a notional balance of \$1.93 billion and \$1.19 billion, respectively.

*Counterparty Risk and Collateral*

Interest-rate swap agreements involve the exchange of fixed and variable-rate interest payments based upon a notional principal amount and maturity date. The Company's interest-rate swaps had \$3.1 million, \$5.3 million and \$6.1 million of credit risk exposure at June 30, 2012, December 31, 2011 and June 30, 2011, respectively. The credit exposure represents the cost to replace, on a present value basis and at current market rates, all contracts outstanding by trading counterparty having an aggregate positive market value, net of margin collateral received. The Company's swap agreements require the deposit of cash or marketable debt securities as collateral for this risk if it exceeds certain market value thresholds. These requirements apply individually to the Corporation and to the Bank. Collateral in the form of securities valued at \$3.0 million had been received from swap counterparties at June 30, 2012. At June 30, 2011, collateral valued at \$9.7 million comprised of securities valued at \$7.9 million and cash of \$1.8 million, had been received from swap counterparties. Additionally, the Company delivered collateral valued at \$42.8 million on swap agreements at June 30, 2012.

*Market Risk Foreign Currency Exchange*

The Company enters into foreign-exchange contracts with its clients and counterparty banks primarily for the purpose of offsetting or hedging clients' transaction and economic exposures arising out of commercial transactions. The Company's policies also permit taking proprietary currency positions within certain approved limits. The Company actively manages its foreign exchange exposures within prescribed risk limits and controls. At June 30, 2012, the Company's outstanding foreign exchange contracts, both proprietary and for customer accounts, totaled \$270.4 million. The mark-to-market on foreign exchange contracts included in other assets and other liabilities totaled \$3.7 million and \$3.3 million at June 30, 2012, respectively.

**ITEM 4. CONTROL AND PROCEDURES**

**DISCLOSURE CONTROLS AND PROCEDURES**

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Under the supervision and with the participation of the Company's management, including its Chief Executive Officer and Chief Financial Officer, the Company has evaluated the effectiveness of its disclosure controls and procedures (as defined in Rule 13a - 15(e) under the Securities Exchange Act of 1934 (the Exchange Act)). Based upon this evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures were effective.

### **INTERNAL CONTROL OVER FINANCIAL REPORTING**

There was no change in the Company's internal control over financial reporting that occurred during the Company's last fiscal quarter that has materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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**PART II OTHER INFORMATION**

**ITEM 1A. RISK FACTORS**

Refer to Item 1A of Part I of the Company's Annual Report on Form 10-K for the year ended December 31, 2011 for a discussion of risk factors relating to the Company's business. There has been no material change in the Corporation's risk factors as previously disclosed in the Company's Form 10-K, with the exception of an update to our risk factor on cyber security as described below.

In the ordinary course of business, the Company relies on electronic communications and information systems to conduct our businesses and to store sensitive data, including financial information regarding our customers. The Company employs an in-depth defense approach that leverages people, processes and technology to manage and maintain cyber security controls. The Company has an experienced team of Information Security professionals, the latest automated tools, and Board-approved policies, to secure our digital environment. The Company employs a variety of preventative and detective tools to monitor, block, and alert on any suspicious activity, as well as to report on any suspected advanced persistent threats. The Company has not experienced any significant compromises due to cyber security attacks. There have been no security breaches of its systems, no virus outbreaks, no compromise of data, and no material financial losses related to cyber attacks. Although rogue viruses on occasion do penetrate the external automated tools, they have been caught timely by internal filters. The historical impact of such attacks on the Company's operations, expenses and risks has been very low, with no incidents experienced in recent years that pose any significant risks to the integrity of confidential company or client information. Although to date we have not experienced material financial losses related to these risks, there can be no assurance that the Company will not suffer such losses in the future. Any such losses can adversely affect our financial condition or results of operations, and could expose the Company to reputation risk, the loss of client business, as well as additional regulatory scrutiny, possible litigation, and related financial liability. These risks also include possible business interruption. Cyber security risks may also occur with the Company's third party technology service providers, and may interfere with their ability to fulfill their contractual obligations to the Company, with attendant potential for financial loss or liability that could adversely affect the Company's financial condition or results of operations. Risks and exposures related to cyber security attacks are expected to remain high for the foreseeable future due to the rapidly evolving nature and sophistication of these threats, as well as due to the expanding use of Internet banking, mobile banking and other technology-based products and services by the Company and our clients.

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

(c) Purchase of Equity Securities by the Issuer and Affiliated Purchaser.

The information required by subsection (c) of this item regarding purchases by the Company during the quarter ended June 30, 2012 of equity securities that are registered by the Company pursuant to Section 12 of the Exchange Act is incorporated by reference from that portion of Part I, Item 1 of the report under Note 9.

**ITEM 6. EXHIBITS**

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| No.     |   |
|---------|---|
| 31.1    | Chief Executive Officer certification pursuant to section 302 of the Sarbanes-Oxley Act of 2002.                        |
| 31.2    | Chief Financial Officer certification pursuant to section 302 of the Sarbanes-Oxley Act of 2002.                        |
| 32.1    | Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002. |
| 101.INS | XBRL Instance Document  |
| 101.SCH | XBRL Taxonomy Extension Schema Document   |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document   |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document   |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document  |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document  |

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## **SIGNATURES**

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

**CITY NATIONAL CORPORATION**  
(Registrant)

/s/ Christopher J. Carey

**CHRISTOPHER J. CAREY**  
Executive Vice President and  
Chief Financial Officer  
(Authorized Officer and  
Principal Financial Officer)

**DATE:** August 8, 2012