CVB FINANCIAL CORP
Form 10-Q
May 10, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2012

or

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

For the transition period from to

Commission File Number: 0-10140

CVB FINANCIAL CORP.

(Exact name of registrant as specified in its charter)

California **(State or other jurisdiction of** **incorporation or organization)**	**95-3629339** **(I.R.S. Employer** **Identification No.)**
701 North Haven Ave, Suite 350, Ontario, California **(Address of Principal Executive Offices)**	**91764** **(Zip Code)**
(Registrant s telephone number, including area code)	**(909) 980-4030**

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

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

Large accelerated filer	x	Accelerated filer	¨
Non-accelerated filer	¨	Smaller reporting company	¨

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

Number of shares of common stock of the registrant: 104,725,224 outstanding as of April 30, 2012.

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CVB FINANCIAL CORP.

2012 QUARTERLY REPORT ON FORM 10-Q

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GENERAL

Forward Looking Statements

Certain statements in this Report on Form 10-Q, including, but not limited to, statements under the heading Management Discussion and Analysis of Financial Condition and Results of Operations constitute forward-looking statements under the Private Securities Litigation Reform Act of 1995, including but not limited to, statements about anticipated future operating and financial performance, financial position and liquidity, business prospects, strategic alternatives, business strategies, regulatory and competitive outlook, capital and financing needs and availability, acquisition and divestiture opportunities, investment and expenditure plans, plans and objectives of management for future operations and other similar forecasts and statements of expectations of assumptions underlying any of the foregoing. Words such as will likely result, aims , anticipates , believes , could , estimates , expects , hopes , intends , may , plans , projects , seeks , should , wil words and similar expressions are intended to identify these forward looking statements, which involve risks and uncertainties. Our actual results may differ significantly from the results discussed in such forward-looking statements. Factors that might cause such a difference include, but are not limited to, local, regional, national and international economic conditions and events and the impact they may have on us and our customers; ability to attract deposits and other sources of liquidity; oversupply of property inventory and continued deterioration in values of California real estate, both residential and commercial; a prolonged slowdown or decline in construction activity; changes in the financial performance and/or condition of our borrowers; changes in the level of non-performing assets and charge-offs; the cost or effect of acquisitions we may make; the effect of changes in laws and regulations (including laws, regulations and judicial decisions concerning financial reform, taxes, banking, securities, employment, executive compensation, insurance, and information security) with which we and our subsidiaries must comply; changes in estimates of future reserve requirements based upon the periodic review thereof under relevant regulatory and accounting requirements; inflation, interest rate, securities market and monetary fluctuations; cyber-security threats including loss of system functionality or theft or loss of data; political instability; acts of war or terrorism, or natural disasters, such as earthquakes, or the effects of pandemic flu; the timely development and acceptance of new banking products and services and perceived overall value of these products and services by users; changes in consumer spending, borrowing and savings habits; technological changes; the ability to increase market share, retain customers and control expenses; changes in the competitive environment among financial and bank holding companies and other financial service providers; continued volatility in the credit and equity markets and its effect on the general economy; the effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board and other accounting standard setters; changes in our organization, management, compensation and benefit plans, and our ability to retain or expand our management team; the costs and effects of legal and regulatory developments including the resolution of legal proceedings or regulatory or other governmental inquiries, including, but not limited to, the current investigation by the Securities and Exchange Commission and the related class-action lawsuits filed against us, and the results of regulatory examinations or reviews. The Company cautions that the foregoing factors are not exclusive. For additional information concerning these factors and other factors which may cause actual results to differ from the results discussed in our forward-looking statements, see the periodic filings the Company makes with the Securities and Exchange Commission, and, in particular, the information set forth in Item 1A herein and in Item 1A. Risk Factors contained in the Company s Annual Report on Form 10-K for the year ended December 31, 2011. The Company does not undertake, and specifically disclaims, any obligation to update any forward-looking statements to reflect the occurrence of events or circumstances after the date of such statements except as required by law.

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PART I FINANCIAL INFORMATION (UNAUDITED)

ITEM 1. FINANCIAL STATEMENTS

CVB FINANCIAL CORP. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except share data)

(Unaudited)

	March 31, 2012	December 31, 2011
ASSETS		
Cash and due from banks	$ 94,523	$ 35,407
Interest-earning balances due from Federal Reserve	181,795	309,936
Total cash and cash equivalents	276,318	345,343
Interest-earning balances due from depository institutions	60,000	60,000
Investment securities available-for-sale, at fair value (with amortized cost of $2,301,303 at March 31, 2012 and $2,130,029 at December 31, 2011)	2,372,729	2,201,526
Investment securities held-to-maturity	2,280	2,383
Investment in stock of Federal Home Loan Bank (FHLB)	69,222	72,689
Non-covered loans held-for-sale	630	348
Covered loans held-for-sale	3,771	5,664
Loans and lease finance receivables, excluding covered loans	3,186,013	3,219,727
Allowance for credit losses	(91,922)	(93,964)
Net non-covered loans and lease finance receivables	3,094,091	3,125,763
Covered loans and lease finance receivables, net	241,943	256,869
Premises and equipment, net	35,624	36,280
Bank owned life insurance	116,878	116,132
Accrued interest receivable	23,375	23,512
Intangibles	4,731	5,548
Goodwill	55,097	55,097
FDIC loss sharing asset	55,193	59,453
Non-covered other real estate owned	11,427	13,820
Covered other real estate owned	6,401	9,782
Income taxes	36,794	48,033
Other assets	39,579	44,673
TOTAL ASSETS	$ 6,506,083	$ 6,482,915
LIABILITIES AND STOCKHOLDERS EQUITY		
Liabilities:		
Deposits:		
Noninterest-bearing	$ 2,120,382	$ 2,027,876
Interest-bearing	2,559,725	2,576,672

Total deposits	4,680,107	4,604,548
Customer repurchase agreements	477,568	509,370
Borrowings	448,730	448,662
Accrued interest payable	3,417	3,526
Deferred compensation	9,092	8,735
Junior subordinated debentures	108,250	115,055
Other liabilities	48,912	78,205
TOTAL LIABILITIES	5,776,076	5,768,101
COMMITMENTS AND CONTINGENCIES		
Stockholders Equity:		
Preferred stock, authorized, 20,000,000 shares without par; none issued or outstanding		
Common stock, authorized, 225,000,000 shares without par; issued and outstanding 104,707,012 at March 31, 2012 and 104,482,271 at December 31, 2011	481,843	479,973
Retained earnings	206,737	193,372
Accumulated other comprehensive income, net of tax	41,427	41,469
Total stockholders equity	730,007	714,814
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 6,506,083	$ 6,482,915

See accompanying notes to the consolidated financial statements.

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CVB FINANCIAL CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF EARNINGS AND COMPREHENSIVE INCOME

(Dollars in thousands, except per share amounts)

(Unaudited)

	For the Three Months Ended March 31, 2012	For the Three Months Ended March 31, 2011
Interest income:		
Loans held-for-sale	$ 4	$ 20
Loans and leases, including fees	46,028	49,344
Accelerated accretion on acquired loans	4,692	1,951
Loans, including fees	50,724	51,315
Investment securities:		
Taxable	9,170	8,839
Tax-advantaged	5,796	5,919
Total investment income	14,966	14,758
Dividends from FHLB	90	65
Federal funds sold and interest-bearing deposits with other institutions	285	374
Total interest income	66,065	66,512
Interest expense:		
Deposits	1,653	2,788
Borrowings	4,971	5,796
Junior subordinated debentures	839	819
Total interest expense	7,463	9,403
Net interest income before provision for credit losses	58,602	57,109
Provision for credit losses		7,068
Net interest income after provision for credit losses	58,602	50,041
Noninterest income:		
Service charges on deposit accounts	4,124	3,723
Trust and investment services	2,185	2,152
Bankcard services	919	708
BOLI Income	750	707
Increase (decrease) in FDIC loss sharing asset, net	(2,944)	1,415
Other	222	1,273
Total noninterest income	5,256	9,978

Noninterest expense:		
Salaries and employee benefits	16,721	17,660
Occupancy and equipment	3,948	4,321
Professional services	1,991	3,610
Software licenses and maintenance	909	960
Promotion	1,251	1,326
Amortization of Intangibles	816	901
Provision for unfunded commitments		732
OREO expense	730	1,105
Other	3,846	5,690
Total noninterest expense	30,212	36,305
Earnings before income taxes	33,646	23,714
Income taxes	11,378	7,114
Net earnings	$ 22,268	$ 16,600
Other comprehensive income:		
Unrealized (loss) gain on securities arising during the period	$ (73)	$ 4,291
Less: Reclassification adjustment for net gain on securities included in net income		
Other comprehensive income, before tax	(73)	4,291
Income tax related to items of other comprehensive income	31	(1,736)
Other comprehensive income, net of tax	$ (42)	$ 2,555
Comprehensive income	$ 22,226	$ 19,155
Basic earnings per common share	$ 0.21	$ 0.16
Diluted earnings per common share	$ 0.21	$ 0.16
Cash dividends per common share	$ 0.085	$ 0.085

See accompanying notes to consolidated financial statements.

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CVB FINANCIAL CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

Three Months Ended March 31, 2012 and 2011

(unaudited)

	Common Shares Outstanding	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income/(Loss)	Total
	(Dollars and shares in thousands)				
Balance January 1, 2011	106,076	$ 490,226	$ 147,444	$ 6,185	$ 643,855
Exercise of stock options	2	19			19
Tax benefit from exercise of stock options		2			2
Stock-based compensation expense		590			590
Cash dividends declared					
Common ($0.085 per share)			(9,017)		(9,017)
Net earnings			16,600		16,600
Other comprehensive income				2,555	2,555
Balance March 31, 2011	106,078	$ 490,837	$ 155,027	$ 8,740	$ 654,604
Balance January 1, 2012	104,482	$ 479,973	$ 193,372	$ 41,469	$ 714,814
Exercise of stock options	225	1,355			1,355
Tax benefit from exercise of stock options		110			110
Stock-based compensation expense		405			405
Cash dividends declared					
Common ($0.085 per share)			(8,903)		(8,903)
Net earnings			22,268		22,268
Other comprehensive income				(42)	(42)
Balance March 31, 2012	104,707	$ 481,843	$ 206,737	$ 41,427	$ 730,007

See accompanying notes to the consolidated financial statements.

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CVB FINANCIAL CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

(unaudited)

	For the Three Months Ended March 31, 2012	For the Three Months Ended March 31, 2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Interest and dividends received	$ 66,789	$ 67,948
Service charges and other fees received	8,030	8,446
Interest paid	(7,504)	(9,695)
Cash paid to vendors and employees	(34,081)	(33,942)
Income taxes paid		(27,000)
Proceeds from FDIC shared-loss agreements	1,316	21,734
Net cash provided by operating activities	34,550	27,491
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from redemption of FHLB Stock	3,467	3,434
Proceeds from repayment of investment securities	129,203	86,684
Proceeds from maturity of investment securities	36,397	25,055
Purchases of investment securities	(360,846)	(280,623)
Net decrease in loans and lease finance receivables	52,869	136,380
Proceeds from sales of premises and equipment	25	147
Proceeds from sales of other real estate owned	6,507	1,789
Purchase of premises and equipment	(711)	(309)
Other, net		(1)
Net cash used in investing activities	(133,089)	(27,444)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in transaction deposits	115,807	95,328
Net decrease in time deposits	(40,248)	(128,464)
Net decrease in other borrowings		1,049
Net (decrease)/ increase in customer repurchase agreements	(31,802)	35,821
Repayment of FCB Statutory Trust II	(6,805)	
Cash dividends on common stock	(8,903)	(9,017)
Proceeds from exercise of stock options	1,355	19
Tax benefit related to exercise of stock options	110	2
Net cash provided by (used in) financing activities	29,514	(5,262)
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(69,025)	(5,215)
CASH AND CASH EQUIVALENTS, beginning of period	345,343	404,275
CASH AND CASH EQUIVALENTS, end of period	$ 276,318	$ 399,060

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CVB FINANCIAL CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)

(Dollars in thousands)

(unaudited)

CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Three Months Ended March 31, 2012	2011
RECONCILIATION OF NET EARNINGS TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Net earnings	$ 22,268	$ 16,600
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Amortization of capitalized prepayment penalty on borrowings	68	
(Gain)/loss on sale of premises and equipment		(7)
(Gain)/loss on sale of other real estate owned	(151)	(74)
Increase from bank owned life insurance	(750)	(707)
Net amortization of premiums on investment securities	5,448	3,212
Accretion of SJB Discount	(4,692)	(1,951)
Provisions for credit losses		7,068
Provisions for losses on other real estate owned	226	820
Change in FDIC Loss Sharing Asset	2,944	(1,415)
Stock-based compensation	405	590
Depreciation and amortization	2,158	2,560
Proceeds from FDIC shared-loss agreements	1,316	21,734
Change in accrued interest receivable	137	384
Change in accrued interest payable	(109)	(359)
Change in other assets and liabilities	5,282	(20,964)
Total adjustments	12,282	10,891
NET CASH PROVIDED BY OPERATING ACTIVITIES	$ 34,550	$ 27,491
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING ACTIVITIES		
Securities purchased and not settled	$ 2,014	$ 55,791
Transfer from loans to Other Real Estate Owned	$ 808	$ 3,669

See accompanying notes to the consolidated financial statements.

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CVB FINANCIAL CORP. AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the three months ended March 31, 2012, and 2011

(unaudited)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying condensed consolidated unaudited financial statements and notes thereto have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission (SEC) for Form 10-Q and conform to practices within the banking industry and include all of the information and disclosures required by accounting principles generally accepted in the United States of America (GAAP) for interim financial reporting. The results of operations for the three months ended March 31, 2012 are not necessarily indicative of the results for the full year. These unaudited financial statements should be read in conjunction with the financial statements, accounting policies and financial notes thereto included in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2011 filed with the Securities and Exchange Commission. In the opinion of management, the accompanying condensed consolidated unaudited financial statements reflect all adjustments (consisting only of normal recurring adjustments), which are necessary for a fair presentation of financial results for the interim periods presented. A summary of the significant accounting policies consistently applied in the preparation of the accompanying consolidated financial statements follows.

Principles of Consolidation The consolidated financial statements include the accounts of CVB Financial Corp. and its wholly owned subsidiaries (the Company): Citizens Business Bank (the Bank) after elimination of all intercompany transactions and balances. The Company also has three inactive subsidiaries; CVB Ventures, Inc.; Chino Valley Bancorp; and ONB Bancorp. The Company is also the common stockholder of CVB Statutory Trust I, CVB Statutory Trust II, and CVB Statutory Trust III. CVB Statutory Trusts I and II were created in December 2003 and CVB Statutory Trust III was created in January 2006 to issue trust preferred securities in order to raise capital for the Company. The Company acquired FCB Trust II through the acquisition of First Coastal Bancshares (FCB). The FCB Trust II was redeemed on January 7, 2012. In accordance with ASC 810 Consolidation (previously Financial Accounting Standards Board (FASB) Interpretation No. 46R Consolidation of Variable Interest Entities), these trusts do not meet the criteria for consolidation.

Nature of Operations The Company s primary operations are related to traditional banking activities, including the acceptance of deposits and the lending and investing of money through the operations of the Bank. The Bank also provides automobile and equipment leasing to customers through its Citizens Financial Services Group and trust and investment-related services to customers through its CitizensTrust Division. The Bank s customers consist primarily of small to mid-sized businesses and individuals located in San Bernardino County, Riverside County, Orange County, Los Angeles County, Madera County, Fresno County, Tulare County, Kern County and San Joaquin County. The Bank operates 42 Business Financial Centers, five Commercial Banking Centers, and two trust office locations with its headquarters located in the city of Ontario.

The Company s operating business units have been divided into two main segments: (i) Business Financial and Commercial Banking Centers (Centers) and (ii) Treasury. The Business Financial and Commercial Banking Centers lines of business generally consist of loans, deposits, and fee generating products and services that the Bank offers to its clients and prospects. The other segment is Treasury, which manages the investment portfolio of the Company. The Company s remaining centralized functions and eliminations of inter-segment amounts have been aggregated and included in Other.

The internal reporting of the Company considers all business units. Funds are allocated to each business unit based on its need to fund assets (use of funds) or its need to invest funds (source of funds). Net income is determined based on the actual net income of the business unit plus the allocated income or expense based on the sources and uses of funds for each business unit. Non-interest income and non-interest expense are those items directly attributable to a business unit.

Cash and cash equivalents Cash on hand, cash items in the process of collection, and amounts due from correspondent banks, the Federal Reserve Bank and interest-bearing balances due from depository institutions, with initial terms of ninety days or less, are included in Cash and cash equivalents.

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

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

Loans Held-for-Sale Loans held-for-sale include mortgage loans originated for resale and other non-covered or covered loans transferred from our held-for-investment portfolio when a decision is made to sell a loan(s) and are reported at the lower of cost or fair value. Occasionally, we may transfer other loans from our held-for-investment loan portfolio to loans held-for-sale when a decision is made to sell a loan(s). Normally a formal marketing strategy or plan for sale is developed at the time the decision to sell the loan(s) is made. Cost generally approximates fair value at any reporting date, as the mortgage loans were recently originated. The transfer of the loan to held-for-sale is done at the lower of cost or fair value and if a reduction in value is required at time of the transfer, a charge-off is recorded against the allowance for credit losses (ALLL). Any subsequent decline in value or any subsequent gain on sale of the loan is recorded to current earnings and reported as part of other non-interest income. Gains or losses on the sale of loans that are held for sale are recognized at the time of sale and determined by the difference between net sale proceeds and the net book value of the loans. We do not currently retain servicing on any mortgage loans sold.

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

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

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

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

Loans are reported as a Troubled Debt Restructuring (TDR) if the Company for economic or legal reasons related to the debtor s financial difficulties grants a concession to the debtor that it would not otherwise consider. Examples of such concessions may include deferral of principal or accrued interest, extending the payment due dates or loan maturity date(s), or providing a lower interest rate than would be normally available for new debt with similar risk. Where collateral is offered by a borrower and it is significant in proportion to the nature of the concession requested, to the extent that it substantially reduces the Company s risk of loss we may provide a concession. In such cases, these modifications are not considered a TDR as, in substance, no concession was made as a result of the significant additional collateral obtained.

When determining whether or not a loan modification is a TDR under ASC 310-40, the Company evaluates loan modification requests from borrowers experiencing financial difficulties on a case-by-case basis. Any such modifications granted are unique to the borrower s circumstances, and are not easily categorized by type, key features, or other terms, but are evaluated individually based on all relevant facts and circumstances pertaining to the modification request and the borrower s/guarantor s financial condition at the time of the request. The evaluation of whether or not the borrower is experiencing financial difficulties will include, among other relevant factors considered by the Company, a review of significant factors such as (i) whether the borrower is in default on any of its debt, (ii) whether the borrower is experiencing payment delinquency, (iii) whether the borrower s current cash flows have diminished below what is necessary to service existing debt obligations, (iv) whether the borrower forecasts its cash flows will be insufficient to service the debt in future periods or in accordance with the contractual terms of the existing agreement through maturity, (v) whether the borrower is unable to refinance the subject debt from other financing sources with similar terms, and (vi) whether the borrower is in jeopardy as a going-concern and/or is the borrower considering bankruptcy. In any case, the debtor is presumed to be experiencing financial difficulties if the Company determines it is probable the debtor will default on the original loan if the modification is not granted.

The types of loans subject to modification vary greatly, but during the subject period are concentrated in commercial and industrial loans, dairy and agricultural loans, and term loans to commercial real estate investors. Some examples of key features include payment deferrals and delays, interest rate reductions, and extensions or renewals where the contract rate may or may not be below the market rate of interest for debt with similar characteristics as those of the modified debt. The typical length of the modified terms often ranges from three (3) to twelve (12) months; however, all actual modified terms will depend on the facts, circumstances and attributes of the specific borrower requesting a modification. In general, after a careful evaluation of all relevant facts and circumstances taken together, including the nature of any concession, certain modification requests will result in troubled debt restructurings while certain other modifications will not, pursuant to the criteria and judgments as discussed throughout this report. In many cases, modification requests for delays or deferrals of principal were evaluated and determined to be exempt from TDR reporting because they constituted insignificant delays under ASC 310-40-15.

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

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

2. The delay is insignificant relative to any of the following:

    - The frequency of payments due;

    - The debt s original contractual maturity; or

The debt s original expected duration.

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

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

The Company s policy is to record a specific valuation allowance, which is included in the allowance for credit losses, or charge-off that portion of an impaired loan that represents the impairment or shortfall amount as determined utilizing one of the three methods described in ASC 310-10-35-22. Impairment on non-collateral dependent restructured loans are measured by comparing the present value of expected future cash flows on the restructured loans discounted at the interest rate of the original loan agreement to the loan s carrying value. The impairment amount, if any, is generally charged-off and recorded against the allowance for credit losses at the time impairment is measurable and a probable loss is determined. As a result, most of the TDRs have no specific allowance allocated because, consistent with the Company s stated practice, any impairment is typically charged-off in the period in which it is identified. Impairment on collateral dependent restructured loans are measured by determining the amount the impaired loan exceeds the fair value of the collateral less estimated selling costs. The fair value is generally determined by an appraisal of the collateral performed by a Company-approved third-party independent appraiser. The majority of impaired loans that are collateral dependent are charged-off down to their estimated fair value of the collateral (less selling costs) at each reporting date based on current appraised value.

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

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

The Company measures impairment based on the present value of expected future cash flows discounted at the loan s effective interest rate, except that as a practical expedient, the Company may measure impairment based on a loan s observable market price, or the fair value of the collateral if the loan is a collateral-dependent loan. Impaired single-family mortgage loans that have been modified in accordance with the various government modification programs are also measured based on the present value of the expected cash flows discounted at the loan s pre-modification interest rate. The Company recognizes the change in present value attributable to the passage of time as interest income on such performing single-family mortgage loans and the amount of interest income recognized has been insignificant. During 2011, eleven such single-family mortgage loans have been returned to accrual status after demonstrating sustained repayment performance.

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

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