CVB FINANCIAL CORP
Form 10-Q
May 10, 2013
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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 March 31, 2013

or

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

For the transition period from _________ to _________

Commission File Number: 0-10140

CVB FINANCIAL CORP.

(Exact name of registrant as specified in its charter)

California	**95-3629339**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
701 North Haven Ave, Suite 350, Ontario, California	**91764**
(Address of Principal Executive Offices)	**(Zip Code)**

(909) 980-4030

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes 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: 104,953,607 outstanding as of April 30, 2013.

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PART I FINANCIAL INFORMATION (UNAUDITED)

GENERAL

Forward Looking Statements

Certain statements in this Report on Form 10-Q, including, but not limited to, statements under the heading Management Discussion and Analysis of Financial Condition and Results of Operations constitute forward-looking statements under the Private Securities Litigation Reform Act of 1995, including but not limited to, statements about anticipated future operating and financial performance, financial position and liquidity, business prospects, strategic alternatives, business strategies, regulatory 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; supply of property inventory and renewed fluctuation or deterioration in values of real estate in California or other jurisdictions where we lend, whether involving residential or commercial property; a prolonged slowdown or decline in construction activity; changes in the financial performance and/or condition of our borrowers; changes in the level of nonperforming 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 the applicability or costs of deposit insurance; changes in estimates of future reserve requirements and minimum capital requirements based upon the periodic review thereof under relevant legal, regulatory and accounting requirements; inflation, interest rate, securities market and monetary fluctuations; internal and external fraud and cyber-security threats including theft or loss of bank or customer funds, 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; the effects of technological change and product innovation; the ability to retain or increase market share, retain or grow customers and control expenses; changes in the risk or competitive environment among financial and bank 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 national or international accounting standard setters; changes in our organization, management, compensation and benefit plans, and our ability to retain or expand our management team; the costs and effects of legal and regulatory 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, 2012. The Company does not undertake, and specifically disclaims, any obligation to update any forward-looking statements to reflect occurrences or unanticipated events or circumstances after the date of such statements except as required by law.

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ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

CVB FINANCIAL CORP. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except share data)

(Unaudited)

	March 31, 2013	December 31, 2012
ASSETS		
Cash and due from banks	$ 79,669	$ 87,274
Interest-earning balances due from Federal Reserve	55,609	11,157
Total cash and cash equivalents	135,278	98,431
Interest-earning balances due from depository institutions	70,000	70,000
Investment securities available-for-sale, at fair value (with amortized cost of $2,329,892 at March 31, 2013, and $2,374,816 at December 31, 2012)	2,390,673	2,449,387
Investment securities held-to-maturity	1,975	2,050
Investment in stock of Federal Home Loan Bank (FHLB)	50,981	56,651
Loans and lease finance receivables, excluding covered loans	3,189,514	3,252,313
Allowance for loan losses	(92,218)	(92,441)
Net loans and lease finance receivables	3,097,296	3,159,872
Covered loans and lease finance receivables, net	178,694	195,215
Premises and equipment, net	34,886	35,080
Bank owned life insurance	120,476	119,744
Accrued interest receivable	22,985	22,355
Intangibles	2,950	3,389
Goodwill	55,097	55,097
FDIC loss sharing asset	14,230	18,489
Non-covered other real estate owned	13,341	14,832
Covered other real estate owned	857	1,067
Income taxes	35,077	16,978
Other assets	40,971	44,727
TOTAL ASSETS	$ 6,265,767	$ 6,363,364
LIABILITIES AND STOCKHOLDERS EQUITY		
Liabilities:		
Deposits:		
Noninterest-bearing	$ 2,366,719	$ 2,420,993
Interest-bearing	2,319,442	2,352,994
Total deposits	4,686,161	4,773,987
Customer repurchase agreements	500,115	473,244
FHLB advances	199,002	198,934
Other borrowings		26,000
Accrued interest payable	1,306	1,493
Deferred compensation	9,259	8,781
Junior subordinated debentures	46,393	67,012
Other liabilities	55,319	50,943

TOTAL LIABILITIES	5,497,555	5,600,394
COMMITMENTS AND CONTINGENCIES		
Stockholders Equity:		
Common stock, authorized, 225,000,000 shares without par; issued and outstanding 104,903,107 at March 31, 2013, and 104,889,586 at December 31, 2012.	485,246	484,709
Retained earnings	247,713	235,010
Accumulated other comprehensive income, net of tax	35,253	43,251
Total stockholders equity	768,212	762,970
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 6,265,767	$ 6,363,364

See accompanying notes to the condensed consolidated financial statements.

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CVB FINANCIAL CORP. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS AND COMPREHENSIVE INCOME

(Dollars in thousands, except per share amounts)

(Unaudited)

	For the Three Months Ended March 31,	
	2013	2012
Interest income:		
Loans and leases, including fees	41,654	46,032
Accretion on acquired loans	4,393	4,692
Loans, including fees	46,047	50,724
Investment securities:		
Taxable	6,747	9,170
Tax-advantaged	5,541	5,796
Total investment income	12,288	14,966
Dividends from FHLB stock	343	90
Federal funds sold	14	185
Interest-earning deposits with other institutions	121	100
Total interest income	58,813	66,065
Interest expense:		
Deposits	1,241	1,653
Borrowings	2,700	4,971
Junior subordinated debentures	283	839
Total interest expense	4,224	7,463
Net interest income before provision for credit losses	54,589	58,602
Provision for credit losses		
Net interest income after provision for credit losses	54,589	58,602
Noninterest income:		
Service charges on deposit accounts	3,826	4,124
Trust and investment services	2,005	2,185
Bankcard services	839	919
BOLI income	743	750
Gain on sale of securities, net	2,094	
Decrease in FDIC loss sharing asset, net	(4,023)	(2,944)
Other	1,261	222
Total noninterest income	6,745	5,256
Noninterest expense:		
Salaries and employee benefits	17,300	16,721
Occupancy and equipment	3,682	3,948
Professional services	1,596	1,991
Software licenses and maintenance	1,152	909
Promotion	1,258	1,251

Amortization of intangibles		438		816
OREO expense		330		730
Other		5,042		3,846
Total noninterest expense		30,798		30,212
Earnings before income taxes		30,536		33,646
Income taxes		8,921		11,378
Net earnings	$	21,615	$	22,268
Other comprehensive income (loss):				
Unrealized loss on securities arising during the period	$	(11,696)	$	(73)
Less: Reclassification adjustment for net gain on securities included in net income		(2,094)		
Other comprehensive loss, before tax		(13,790)		(73)
Income tax benefit related to items of other comprehensive loss		5,792		31
Other comprehensive loss, net of tax		(7,998)		(42)
Comprehensive income	$	13,617	$	22,226
Basic earnings per common share	$	0.21	$	0.21
Diluted earnings per common share	$	0.21	$	0.21
Cash dividends declared per common share	$	0.085	$	0.085

See accompanying notes to the condensed consolidated financial statements.

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CVB FINANCIAL CORP. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

Three Months Ended March 31, 2013 and 2012

(Dollars and shares in thousands)

(Unaudited)

	Common Shares Outstanding	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income/(Loss)	Total
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
Shares issued pursuant to stock-based compensation plan		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
Balance January 1, 2013	104,890	484,709	235,010	43,251	762,970
Repurchase of common stock	(2)	(24)			(24)
Exercise of stock options	10	95			95
Tax benefit from exercise of stock options		5			5
Shares issued pursuant to stock-based compensation plan	5	461			461
Cash dividends declared Common ($0.085 per share)			(8,912)		(8,912)
Net earnings			21,615		21,615
Other comprehensive income				(7,998)	(7,998)
Balance March 31, 2013	104,903	$ 485,246	$ 247,713	$ 35,253	$ 768,212

See accompanying notes to the condensed consolidated financial statements.

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CVB FINANCIAL CORP. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

(Unaudited)

	For the Three Months Ended March 31,	
	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES		
Interest and dividends received	$ 59,834	$ 66,789
Service charges and other fees received	8,905	8,030
Interest paid	(4,343)	(7,504)
Cash paid to vendors and employees	(34,057)	(34,081)
Income taxes paid	(22,200)	
Proceeds from FDIC loss share agreement	187	1,316
Net cash provided by operating activities	8,326	34,550
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from redemption of FHLB stock	5,670	3,467
Proceeds from sale of investment securities	99,155	
Proceeds from repayment of investment securities	136,939	129,203
Proceeds from maturity of investment securities	6,533	36,397
Purchases of investment securities	(197,690)	(360,846)
Net decrease in loan and lease finance receivables	83,023	52,869
Proceeds from sales of premises and equipment	5	25
Purchase of premises and equipment	(1,059)	(711)
Proceeds from sales of other real estate owned	3,443	6,507
Net cash provided by/(used in) investing activities	136,019	(133,089)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net (decrease)/increase in transaction deposits	(85,560)	115,807
Net decrease in time deposits	(2,266)	(40,248)
Repayment of junior subordinated debentures	(20,619)	(6,805)
Net decrease in other borrowings	(26,000)	
Net increase/(decrease) in customer repurchase agreements	26,871	(31,802)
Cash dividends on common stock		(8,903)
Repurchase of common stock	(24)	
Proceeds from exercise of stock options	95	1,355
Tax benefit related to exercise of stock options	5	110
Net cash (used in)/provided by financing activities	(107,498)	29,514
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS	36,847	(69,025)
CASH AND CASH EQUIVALENTS, beginning of period	98,431	345,343
CASH AND CASH EQUIVALENTS, end of period	$ 135,278	$ 276,318

See accompanying notes to the condensed consolidated financial statements.

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CVB FINANCIAL CORP. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)

(Dollars in thousands)

(Unaudited)

	For the Three Months Ended March 31, 2013	2012
RECONCILIATION OF NET EARNINGS TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Net earnings	$ 21,615	$ 22,268
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Gain on sale of investment securities	(2,094)	
Loss on sale of premises and equipment, net	6	
Gain on sale of other real estate owned	(512)	(151)
Amortization of capitalized prepayment penalty on borrowings	68	68
Increase in bank owned life insurance	(732)	(750)
Net amortization of premiums and discounts on investment securities	6,786	5,448
Accretion of SJB discount	(4,393)	(4,692)
Provision for credit losses		
Valuation adjustment on other real estate owned	73	226
Change in FDIC loss share asset	4,023	2,944
Proceeds from FDIC loss share agreement	187	1,316
Stock-based compensation	461	405
Depreciation, amortization, net	831	2,158
Change in accrued interest receivable	(630)	137
Change in accrued interest payable	(187)	(109)
Change in other assets and liabilities	(17,176)	5,282
Total adjustments	(13,289)	12,282
Net cash provided by operating activities	$ 8,326	$ 34,550
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING ACTIVITIES		
Securities purchased and not settled	$ 4,630	$ 2,014
Transfer of loans to other real estate owned	$ 1,303	$ 808

See accompanying notes to the condensed consolidated financial statements.

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CVB FINANCIAL CORP. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the Three Months Ended March 31, 2013, and 2012

(Unaudited)

1. BUSINESS

The condensed consolidated financial statements include the accounts of CVB Financial Corp. and its wholly owned subsidiaries (the Company) Citizens Business Bank (the Bank) after elimination of all intercompany transactions and balances. The Company also has three inactive subsidiaries; CVB Ventures, Inc.; Chino Valley Bancorp; and ONB Bancorp. The Company is also the common stockholder of CVB Statutory Trust II, and CVB Statutory Trust III. CVB Statutory Trust II was 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. 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.

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, California. The Bank operates 40 Business Financial Centers, five Commercial Banking Centers, and three trust office locations, with its headquarters located in the city of Ontario, California.

2. BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated 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, 2013 are not necessarily indicative of the results for the full year. These unaudited financial statements should be read in conjunction with the financial statements, accounting policies and financial notes thereto included in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2012 filed with the Securities and Exchange Commission. In the opinion of management, the accompanying unaudited condensed consolidated 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 unaudited condensed consolidated financial statements follows.

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

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

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

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

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

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

When determining whether or not a loan modification is a TDR under ASC 310-40, the Company evaluates loan modification requests from borrowers experiencing financial difficulties on a case-by-case basis. Any such modifications granted are unique to the borrower s circumstances. Because of the Company s focus on the commercial lending sector, each business customer has unique attributes, which in turn means that modifications of loans to those customers are not easily categorized by type, key features, or other terms, but are evaluated individually based on all relevant facts and circumstances pertaining to the modification request and the borrower s/guarantor s financial condition at the time of the request. The evaluation of whether or not a borrower is experiencing financial difficulties will include, among other relevant factors considered by the Company, a review of (i) whether the borrower is in default on any of its debt, (ii) whether the borrower is experiencing payment delinquency, (iii) whether the global cash

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flows of the borrower and the owner guarantor(s) of the borrower have diminished below what is necessary to service existing debt obligations, (iv) whether the borrowers forecasted cash flows will be insufficient to service the debt in future periods or in accordance with the contractual terms of the existing agreement with the Company (or agreements with other lenders) through maturity, (v) whether the borrower is unable to refinance the subject debt from other financing sources with similar terms, and (vi) whether the borrower is in jeopardy as a going-concern and/or considering bankruptcy. In any case, the debtor is presumed to be experiencing financial difficulties if the Company determines it is probable the debtor will default on the original loan if the modification is not granted.

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

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

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

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

    - The frequency of payments due;

    - The debt s original contractual maturity; or

    - The debt s original expected duration.

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

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

The Company s policy is to record a specific valuation allowance, which is included in the allowance for credit losses, or to charge off that portion of an impaired loan that represents the impairment or shortfall amount as determined utilizing one of the three methods described in ASC 310-10-35-22. Impairment on non-collateral dependent restructured loans is measured by comparing the present value of expected future cash flows on the restructured loans discounted at the interest rate of the original loan agreement to the loan s carrying value. The impairment amount, if any, is generally charged off and recorded against the allowance for 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 is measured by determining the amount by which the impaired loan exceeds the fair value of the collateral less estimated selling costs. The fair value is generally determined by one or more appraisals of the collateral, performed by a Company approved third-party independent appraiser. The majority of impaired loans that are collateral dependent are charged off down to their estimated fair value of the collateral (less selling costs) at each reporting date based on current appraised value.

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

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

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

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 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.

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

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

A provision for credit losses on the covered portfolio will be recorded if there is deterioration in the expected cash flows on covered loans as a result of deteriorated credit quality, compared to those previously estimated without regard to the reimbursement from the FDIC under the FDIC loss sharing agreement. The portion of the loss on covered loans reimbursable from the FDIC is recorded in noninterest income as an increase in the FDIC loss sharing asset. Decreases in expected cash flows on the acquired impaired loans as of the measurement date compared to previously estimated are recognized by recording a provision for credit losses on acquired impaired loans. Loans accounted for as part of a pool are measured based on the expected cash flows of the entire pool.

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

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

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

Intangible assets with definite useful lives are amortized over their estimated useful lives to their estimated residual values. Goodwill is the only intangible asset with an indefinite life on our balance sheet. Based on the Company s annual impairment test, there was zero recorded impairment as of March 31, 2013.

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

At March 31, 2013, goodwill was $55.1 million. As of March 31, 2013, intangible assets that continue to be subject to amortization include core deposit premiums of $3.0 million (net of $29.0 million of accumulated amortization). Amortization expense for such intangible assets was $438,000 for the three months ended March 31, 2013. Estimated amortization expense for the remainder of 2013 is expected to be $689,000. Estimated amortization expense for the succeeding years is $475,000 for 2014, $437,000 for 2015, $395,000 for 2016, $366,000 for 2017, and $589,000 for the period from 2018 to 2019. The weighted average remaining life of intangible assets is approximately 2.1 years.

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

Earnings per Common Share The Company calculates earnings per common share (EPS) using the two-class method. The two-class method requires the Company to present EPS as if all of the earnings for the period are distributed to common shareholders and any participating securities. All outstanding unvested share-based payment awards that contain rights to non-forfeitable dividends are considered participating securities. The Company grants restricted shares under the 2008 Equity Incentive

Plan that qualify as participating securities. Restricted shares issued under this plan are entitled to dividends at the same rate as common stock. A reconciliation of the numerator and the denominator used in the computation of basic and diluted earnings per common share is included in Note 7 of these condensed consolidated financial statements.

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

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

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

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

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

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

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

Other Contingencies In the ordinary course of business, the Company becomes involved in litigation. Based upon the Company s internal records and discussions with legal counsel, the Company records reserves as appropriate, for estimates of the probable outcome of all cases brought against the Company. Except as discussed in Part II Other Information, Item 1. Legal Proceedings, at March 31, 2013, the Company does not have any litigation reserves, and is not aware of any material pending legal action or complaints asserted against the Company.

Recent Accounting Pronouncements In January 2013, the FASB issued Accounting Standards Update (ASU) 2013-01, Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities (Topic 210) , which amends the scope of FASB ASU 2011-11, Disclosures about Offsetting Assets and Liabilities , to clarify that the disclosure requirements of ASU 2011-11 are limited to derivatives, including bifurcated embedded derivatives, repurchase and reverse repurchase agreements, and securities borrowing and lending transactions that are either offset in the statement of financial position or subject to an enforceable master netting arrangement or similar agreement. The ASU responds to implementation issues raised by stakeholders about the scope of ASU 2011-11. Consistent with the effective date of ASU 2011-11, an entity is required to apply the amendments retrospectively for annual periods beginning on or after January 1, 2013 (and interim periods within those annual periods). The adoption of this new guidance does not have a material impact on the Company s consolidated financial statements.

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

Our interest rate swap derivatives are subject to a master netting arrangement with one counterparty bank. None of our derivative assets and liabilities are offset in the balance sheet.

In February 2013, the FASB issued ASU 2013-02, *Other Comprehensive Income (Topic 220), Reporting of Amounts Reclassified out of Other Comprehensive Income*. The provisions in the ASU supersede and replace the presentation requirements for reclassifications out of accumulated other comprehensive income (AOCI) in ASUs 2011-05 and 2011-12. ASU 2013-02 requires entities to disclose additional information about reclassification adjustments, including (1) changes in AOCI balances by component and (2) significant items reclassified out of AOCI. The new disclosure requirements are effective for fiscal years, and interim periods within those years, beginning after December 15, 2012. The Company s adoption of this new guidance does not have a material effect on its consolidated financial statements.

4. FEDERALLY ASSISTED ACQUISITION OF SAN JOAQUIN BANK

On October 16, 2009, the Bank acquired SJB and entered into a loss sharing agreement with the FDIC that is more fully discussed in the Significant Accounting Policies (Note3) included herein.

Loans acquired from the SJB acquisition have performed better than originally expected. At March 31, 2013, the remaining discount associated with the SJB loans approximated $20.9 million. Based on the Company s regular re-forecast of expected cash flows from these loans, approximately $13.2 million of the related discount is expected to accrete into interest income over the remaining average lives of the respective pools and individual loans, which approximates 4.9 years and 0.9 year, respectively. Due to the decrease in estimated losses to be incurred in the remaining portfolio, the expected reimbursement from the FDIC under the loss sharing agreement decreased. The FDIC loss sharing asset of $14.2 million at March 31, 2013 will continue to be reduced by reimbursements of loss claims submitted to the FDIC with the remaining balance amortized on the same basis as the discount on the related loans, not to exceed its remaining contract life of approximately 1.5 years.

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5. INVESTMENT SECURITIES

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

	March 31, 2013				
	Amortized Cost	Gross Unrealized Holding Gain	Gross Unrealized Holding Loss	Fair Value	Total Percent
	(Dollars in thousands)				
Investment securities available-for-sale:					
Government agency	$ 391,336	$ 845	$ (1,543)	$ 390,638	16.34%
Residential mortgage-backed securities	874,913	21,139	(3,415)	892,637	37.34%
CMO s / REMIC s - residential	470,694	7,439	(556)	477,577	19.98%
Municipal bonds	587,949	37,264	(414)	624,799	26.13%
Other securities	5,000	22		5,022	0.21%
Total investment securities	$ 2,329,892	$ 66,709	$ (5,928)	$ 2,390,673	100.00%

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

Approximately 74% of the available-for-sale portfolio at March 31, 2013 represents securities issued by the U.S government or U.S. government-sponsored agencies and enterprises, with the implied guarantee of payment of principal and interest. The remaining CMO/REMICs are backed by agency-pooled collateral or whole loan collateral. All non-agency available-for-sale CMO/REMIC issues held are rated investment grade or better by either Standard & Poor s or Moody s, as of March 31, 2013 and December 31, 2012. The Company had $1.1 million and $1.2 million in CMO/REMIC s backed by whole loans issued by private-label companies (non-government sponsored) as of March 31, 2013, and December 31, 2012, respectively.

During the first quarter of 2013, we identified 13 securities with a par value of $94.2 million that were experiencing accelerated prepayment speeds that were causing a deterioration in yield. We elected to sell these securities and recognized a net pre-tax gain on sale of $2.1 million. There were no gains or losses recognized during the first quarter of 2012.

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	March 31, 2013					
	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Gross Unrealized Holding Losses	Fair Value	Gross Unrealized Holding Losses	Fair Value	Gross Unrealized Holding Losses
	(Dollars in thousands)					
Held-to-maturity:						
CMO	$	$	$	$	$	$
Available-for-sale:						
Government agency	$ 182,843	$ 1,543	$	$	$ 182,843	$ 1,543
Residential mortgage-backed securities	173,748	3,415			173,748	3,415
CMO / REMICs - residential	45,399	539	5,460	17	50,859	556
Municipal bonds	26,788	343	2,207	71	28,995	414
Other securities						
Total	$ 428,778	$ 5,840	$ 7,667	$ 88	$ 436,445	$ 5,928

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

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

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

CMO Held-to-Maturity We have one investment security classified as held-to-maturity. This security was issued by Countrywide Financial and is collateralized by Alt-A mortgages. The mortgages are primarily fixed-rate, 30-year loans, originated in early 2006 with average FICO scores of 715 and an average LTV of 71% at origination. The security was a senior security in the securitization, was rated triple AAA at origination and was supported by subordinate securities. This security is classified as held-to-maturity as we have both the intent and ability to hold this debt security to maturity. We acquired this security in February 2008 at a price of 98.25%. The significant decline in the fair value of the security first appeared in August 2008 at the time the financial crisis in the markets occurred and the market for securities collateralized by Alt-A mortgages diminished.

As of March 31, 2013, the unrealized loss on this security was zero and the current fair value on the security was 72% of the current par value. This Alt-A bond, with a book value of $2.0 million as of March 31, 2013, has had $1.9 million in net impairment losses to date. These losses have been recorded as a reduction to noninterest income. The security is rated non-investment grade. We evaluated the security for an other-than-temporary decline in fair value as of March 31, 2013. The key assumptions include default rates, loss severities and prepayment rates. There were no changes in credit related other-than temporary impairment recognized in earnings for the three months ended March 31, 2013, and 2012.

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Government Agency & Government-Sponsored Enterprise The government agency bonds are backed by the full faith and credit of Agencies of the U.S. Government. As of March 31, 2013, approximately $162.1 million in U.S. government agency bonds are callable. These securities are bullet securities, that is, they have a defined maturity date on which the principal is paid. The contractual term of these investments provides that the Company will receive the face value of the bond at maturity which will equal the amortized cost of the bond. Interest is received throughout the life of the security.

Mortgage-Backed Securities and CMO/REMICs Almost all of the available-for-sale mortgage-backed and CMO/REMICs securities are issued by the government-sponsored enterprises such as Ginnie Mae, Fannie Mae and Freddie Mac. These securities are collateralized or backed by the underlying residential mortgages. All mortgage-backed securities are considered to be rated investment grade with a weighted average life of approximately 4.2 years. Of the total MBS/CMO, 99.92% have the implied guarantee of U.S. government-sponsored agencies and enterprises. The remaining 0.08% are issued by banks. Accordingly, it is expected the securities would not be settled at a price less than the amortized cost of the bonds.

Municipal Bonds The majority of our municipal bonds are insured by the largest bond insurance companies with maturities of approximately 9.3 years. The Company diversifies its holdings by owning selections of securities from different issuers and by holding securities from geographically diversified municipal issuers, thus reducing the Company s exposure to any single adverse event. Because we believe the decline in fair value is attributable to the changes in interest rates and not credit quality and because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized costs, which may be at maturity, management does not consider these investments to be other than temporarily impaired at March 31, 2013.

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

At March 31, 2013 and December 31, 2012, investment securities having a carrying value of approximately $2.30 billion and $2.24 billion, respectively, were pledged to secure public deposits, short and long-term borrowings, and for other purposes as required or permitted by law.

The amortized cost and fair value of debt securities at March 31, 2013, by contractual maturity, are shown below. Although mortgage-backed securities and CMO/REMICs have contractual maturities through 2041, expected maturities will differ from contractual maturities because borrowers may have the right to prepay such obligations without penalty. Mortgage-backed securities and CMO/REMICs are included in maturity categories based upon estimated prepayment speeds.

	March 31, 2013		
	Amortized Cost	**Fair Value**	**Weighted-Average Yield**
		(Dollars in thousands)	
Available-for-Sale:			
Due in one year or less	$ 226,351	$ 228,686	1.83%
Due after one year through five years	1,566,483	1,613,119	2.36%
Due after five years through ten years	492,241	501,892	2.54%
Due after ten years	44,817	46,976	3.45%
Total	$ 2,329,892	$ 2,390,673	2.36%

The investment in FHLB stock is periodically evaluated for impairment based on, among other things, the capital adequacy of the FHLB and its overall financial condition. No impairment losses have been recorded through March 31, 2013.

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6. LOAN AND LEASE FINANCE RECEIVABLES AND ALLOWANCE FOR CREDIT LOSSES

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

	March 31, 2013		
	Non-Covered Loans	Covered Loans	Total
	(Dollars in thousands)		
Commercial and industrial	$ 532,941	$ 25,314	$ 558,255
Real estate:			
Construction	55,703	1,061	56,764
Commercial real estate	1,996,198	160,069	2,156,267
SFR mortgage	162,022	1,321	163,343
Consumer	44,116	5,967	50,083
Municipal lease finance receivables	109,727		109,727
Auto and equipment leases, net of unearned discount	12,422		12,422
Dairy and livestock	278,502		278,502
Agribusiness	5,370	5,870	11,240
Gross loans	3,197,001	199,602	3,396,603
Less:			
Purchase accounting discount		(20,908)	(20,908)
Deferred loan fees, net	(7,487)		(7,487)
Gross loans, net of deferred loan fees and discount	3,189,514	178,694	3,368,208
Less: Allowance for credit losses	(92,218)		(92,218)
Net loans	$ 3,097,296	$ 178,694	$ 3,275,990

	December 31, 2012		
	Non-Covered Loans	Covered Loans	Total
	(Dollars in thousands)		
Commercial and industrial	$ 547,422	$ 26,149	$ 573,571
Real estate:			
Construction	59,721	1,579	61,300
Commercial real estate	1,990,107	179,428	2,169,535
SFR mortgage	159,288	1,415	160,703
Consumer	47,557	6,337	53,894
Municipal lease finance receivables	105,767		105,767
Auto and equipment leases, net of unearned discount	12,716		12,716
Dairy and livestock	327,579		327,579
Agribusiness	9,081	5,651	14,732
Gross loans	3,259,238	220,559	3,479,797
Less:			
Purchase accounting discount		(25,344)	(25,344)
Deferred loan fees, net	(6,925)		(6,925)
Gross loans, net of deferred loan fees and discount	3,252,313	195,215	3,447,528
Less: Allowance for credit losses	(92,441)		(92,441)

Net loans	$ 3,159,872	$ 195,215	$ 3,355,087

As of March 31, 2013, 63.48% of the total gross loan portfolio consisted of commercial real estate loans and 1.67% of the total gross loan portfolio consisted of construction loans, respectively. Substantially all of the Company s real estate loans and construction loans are secured by real properties located in California. At March 31, 2013, the Company held approximately $1.56 billion of fixed rate loans.

At March 31, 2013 and December 31, 2012, loans totaling $2.31 billion and $2.32 billion, respectively, were pledged to secure borrowings from the FHLB and the Federal Reserve Bank.

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Credit Quality Indicators

Central to our credit risk management is our loan risk rating system. The originating credit officer assigns borrowers an initial risk rating, which is reviewed and possibly changed by Credit Management, which is based primarily on a thorough analysis of each borrower s financial capacity in conjunction with industry and economic trends. Approvals are made based upon the amount of inherent credit risk specific to the transaction and are reviewed for appropriateness by senior line and credit management personnel. Credits are monitored by line and credit management personnel for deterioration in a borrower s financial condition, which would impact the ability of the borrower to perform under the contract. Risk ratings are adjusted as necessary.

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

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

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

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

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

Doubtful Loans classified doubtful have all the weaknesses inherent in those classified substandard with the added provision that the weaknesses make collection or the liquidation, on the basis of currently existing facts, conditions and values, highly

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questionable and improbable. The possibility of loss is extremely high, but because of certain important and reasonable specific pending factors which may work to the advantage and strengthening of the assets, their classifications as losses are deferred until their more exact status may be determined.

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

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

Credit Quality Indicators

	March 31, 2013					
	Pass	Watch List	Special Mention	Substandard	Doubtful & Loss	Total
	(Dollars in thousands)					
Commercial & industrial	$ 338,974	$ 119,560	$ 48,081	$ 24,931	$ 1,395	$ 532,941
Construction - speculative	3,756		13,599	18,272		35,627
Construction - non-speculative	6,540	4,317		9,219		20,076
Commercial real estate - owner occupied	374,300	142,436	88,461	85,950		691,147
Commercial real estate - non-owner occupied	926,150	215,660	94,016	69,225		1,305,051
Residential real estate (SFR 1-4)	131,708	11,158	4,273	14,883		162,022
Dairy and livestock	48,015	64,557	80,048	81,822	4,060	278,502
Agribusiness	3,630	1,050	690			5,370
Municipal lease finance receivables	65,673	21,249	14,535	8,270		109,727
Consumer	37,625	3,206	1,914	1,367	4	44,116
Auto and equipment leases	8,527	2,983	776	136		12,422
Total non-covered loans	1,944,898	586,176	346,393	314,075	5,459	3,197,001
Covered loans	47,139	69,482	22,465	60,516		199,602
Total gross loans	$ 1,992,037	$ 655,658	$ 368,858	$ 374,591	$ 5,459	$ 3,396,603

	December 31, 2012					
	Pass	Watch List	Special Mention	Substandard	Doubtful & Loss	Total
	(Dollars in thousands)					
Commercial & industrial	$ 347,275	$ 131,186	$ 44,466	$ 22,901	$ 1,594	$ 547,422
Construction - speculative	1,417		15,163	21,314		37,894
Construction - non-speculative	9,841	2,767		9,219		21,827
Commercial real estate - owner occupied	382,111	159,653	78,087	84,116		703,967
Commercial real estate - non-owner occupied	888,777	214,901	105,121	77,341		1,286,140
Residential real estate (SFR 1-4)	129,730	10,215	3,107	16,236		159,288
Dairy and livestock	67,144	108,087	74,510	77,721	117	327,579
Agribusiness	4,969	3,306	806			9,081
Municipal lease finance receivables	72,432	20,237	11,124	1,974		105,767
Consumer	40,650	3,538	1,976	1,339	54	47,557
Auto and equipment leases	8,671	3,225	738	82		12,716
Total non-covered loans	1,953,017	657,115	335,098	312,243	1,765	3,259,238
Covered loans	52,637	72,803	31,689	63,354	76	220,559

Total gross loans	$ 2,005,654	$ 729,918	$ 366,787	$ 375,597	$ 1,841	$ 3,479,797

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Allowance for Credit Losses

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

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

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

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

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

The methodology is consistently applied across all the portfolio segments taking into account the applicable historical loss rates and the qualitative factors applicable to each pool of loans. Periodically, we assess various attributes utilized in adjusting our historical loss factors to reflect current economic conditions. Our dairy and livestock borrowers continue to experience a difficult operating environment. Milk prices are up, but high feed costs continue to put pressure on profit margins. As part of our qualitative analysis during the current period, we adjusted the attributes used in the allowance for credit losses to account for challenges evident in the current economic environment of the dairy and livestock industry.

Management believes that the ALLL was appropriate at March 31, 2013. No assurance can be given that economic conditions which adversely affect our service areas or other circumstances will not be reflected in increased provisions for credit losses in the future.

The following table presents the balance and activity in the allowance for credit losses; and the recorded investment in held-for-investment loans by portfolio segment and based upon our impairment method as of March 31, 2013, and 2012:

Allowance for Credit Losses and Recorded Investment in Financing Receivables

	As of and For the Three Months Ended March 31, 2013								
	Commercial and Industrial	Construction	Real Estate	Municipal Lease Finance Receivables	Dairy, Livestock / Agribusiness	Consumer, Auto & Other	Covered Loans (1)	Unallocated	Total
	(Dollars in thousands)								
Allowance for loan losses:									
Beginning balance, January 1, 2013	$ 11,652	$ 2,291	$ 50,905	$ 1,588	$ 18,696	$ 1,170	$	$ 6,139	$ 92,441
Charge-offs	(357)		(142)			(47)			(546)
Recoveries	99	126	71		14	13			323
Provision / reallocation of ALLL	919	(293)	(503)	1,044	(2,139)	(3)		975	
Ending balance, March 31, 2013	$ 12,313	$ 2,124	$ 50,331	$ 2,632	$ 16,571	$ 1,133	$	$ 7,114	$ 92,218
Individually evaluated for impairment	$ 1,055	$	$ 429	$	$ 2,560	$ 27	$	$	$ 4,071
Collectively evaluated for impairment	$ 11,258	$ 2,124	$ 49,902	$ 2,632	$ 14,011	$ 1,106	$	$ 7,114	$ 88,147
Loans and financing receivables (2):									
Ending balance, March 31, 2013	$ 532,941	$ 55,703	$ 2,158,220	$ 109,727	$ 283,872	$ 56,538	$ 178,694	$	$ 3,375,695
Individually evaluated for impairment	$ 4,579	$ 27,491	$ 55,098	$	$ 25,327	$ 226	$	$	$ 112,721
Collectively evaluated for impairment	$ 528,362	$ 28,212	$ 2,103,122	$ 109,727	$ 258,545	$ 56,312	$	$	$ 3,084,280
Acquired loans with deteriorated credit quality, net of discount	$	$	$	$	$	$	$ 178,694	$	$ 178,694

	As of and For the Three Months Ended March 31, 2012								
	Commercial and Industrial	Construction	Real Estate	Municipal Lease Finance Receivables	Dairy, Livestock / Agribusiness	Consumer, Auto & Other	Covered Loans (1)	Unallocated	Total
	(Dollars in thousands)								
Allowance for loan losses:									
Beginning balance, January 1, 2012	$ 10,654	$ 4,947	$ 51,873	$ 2,403	$ 17,278	$ 1,590	$	$ 5,219	$ 93,964
Charge-offs	(560)		(530)		(1,150)	(85)	(31)		(2,356)
Recoveries	62	27	221			4			314
Provision / reallocation of ALLL	1,751	(651)	371	(383)	(48)	(20)	31	(1,051)	

Ending balance, March 31, 2012	$ 11,907	$ 4,323	$ 51,935	$ 2,020	$ 16,080	$ 1,489	$	$ 4,168	$ 91,922
Individually evaluated for impairment	$ 421	$	$ 787	$	$ 221	$ 81	$	$	$ 1,510
Collectively evaluated for impairment	$ 11,486	$ 4,323	$ 51,148	$ 2,020	$ 15,859	$ 1,408	$	$ 4,168	$ 90,412
Loans and financing receivables (2):									
Ending balance, March 31, 2012	$ 497,625	$ 67,382	$ 2,153,345	$ 114,724	$ 290,578	$ 67,862	$ 241,943	$	$ 3,433,459
Individually evaluated for impairment	$ 7,820	$ 29,354	$ 51,153	$	$ 8,470	$ 389		$	$ 97,186
Collectively evaluated for impairment	$ 489,805	$ 38,028	$ 2,102,192	$ 114,724	$ 282,108	$ 67,473		$	$ 3,094,330
Acquired loans with deteriorated credit quality, net of discount	$	$	$	$	$	$	$ 241,943	$	$ 241,943

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

Past Due and Nonperforming Loans

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

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

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

The accrual of interest on loans is discontinued when the loan becomes 90 or more days past due based on the contractual term of the loan, or when the full collection of principal and interest is in doubt. 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. Nonaccrual loans may be restored to accrual status when principal and interest become current and full payment of principal and interest is expected.

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

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

Non-Covered Past Due and Nonaccrual Loans

	March 31, 2013						
	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due and Accruing	Total Past Due and Accruing	Nonaccrual	Current	Total Loans and Financing Receivables
	(Dollars in thousands)						
Commercial and industrial	$ 1,893	$ 133	$	$ 2,026	$ 3,387	$ 527,528	$ 532,941
Construction - speculative					10,620	25,007	35,627
Construction - non-speculative						20,076	20,076
Commercial real estate - owner occupied	945			945	1,658	688,544	691,147
Commercial real estate - non-owner occupied	875			875	18,306	1,285,870	1,305,051
Residential real estate (SFR 1-4)	824			824	11,561	149,637	162,022
Dairy and livestock					9,371	269,131	278,502
Agribusiness						5,370	5,370
Municipal lease finance receivables						109,727	109,727
Consumer	63			63	161	43,892	44,116
Auto and equipment leases					65	12,357	12,422
Total non-covered gross loans	$ 4,600	$ 133	$	$ 4,733	$ 55,129	$ 3,137,139	$ 3,197,001

	December 31, 2012						
	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due and Accruing	Total Past Due and Accruing	Nonaccrual	Current	Total Loans and Financing Receivables
	(Dollars in thousands)						
Commercial and industrial	$ 233	$ 457	$	$ 690	$ 3,136	$ 543,596	$ 547,422
Construction - speculative					10,663	27,231	37,894
Construction - non-speculative						21,827	21,827
Commercial real estate - owner occupied					5,415	698,552	703,967
Commercial real estate - non-owner occupied					15,624	1,270,516	1,286,140
Residential real estate (SFR 1-4)	107			107	13,102	146,079	159,288
Dairy and livestock					9,842	317,737	327,579
Agribusiness						9,081	9,081
Municipal lease finance receivables						105,767	105,767
Consumer	74	8		82	215	47,260	47,557
Auto and equipment leases	8			8		12,708	12,716
Total non-covered gross loans	$ 422	$ 465	$	$ 887	$ 57,997	$ 3,200,354	$ 3,259,238

Non-Covered Impaired Loans

At March 31, 2013, the Company had non-covered impaired loans of $112.7 million. Of this amount, there was $10.6 million in nonaccrual commercial construction loans, $11.5 million of nonaccrual single family mortgage loans, $20.0 million of nonaccrual commercial real estate loans, $3.4 million of nonaccrual commercial and industrial loans, $9.4 million of nonaccrual dairy and livestock loans and $226,000 of other loans. These non-covered impaired loans included $87.2 million of loans whose terms were modified in a troubled debt restructure, of which $29.6 million are classified as nonaccrual. The remaining balance of $57.6 million consists of 44 loans performing according to the restructured terms. The impaired loans had a specific allowance of $4.1 million at March 31, 2013. At December 31, 2012, the Company had classified as impaired, non-covered loans with a balance of $108.4 million with a related allowance of $2.3 million.

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

Non-Covered Impaired Loans

	March 31, 2013				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
	(Dollars in thousands)				
With no related allowance recorded:					
Commercial and industrial	$ 2,873	$ 3,617	$	$ 2,899	$ 18
Construction - speculative	18,272	18,607		18,272	77
Construction - non-speculative	9,219	9,219		9,219	141
Commercial real estate - owner occupied	13,616	14,827		13,630	122
Commercial real estate - non-owner occupied	27,877	38,306		28,092	202
Residential real estate (SFR 1-4)	10,184	12,821		10,319	16
Dairy and livestock	20,843	21,874		19,170	98
Municipal lease finance receivables					
Consumer	141	196		141	
Auto and equipment leases					
Total	103,025	119,467		101,742	674
With a related allowance recorded:					
Commercial and industrial	1,706	1,871	1,055	1,723	
Construction - speculative					
Construction - non-speculative					
Commercial real estate - owner occupied	12	14	1	16	
Commercial real estate - non-owner occupied					
Residential real estate (SFR 1-4)	3,409	4,040	428	3,415	
Dairy and livestock	4,484	4,944	2,560	4,603	
Municipal lease finance receivables					
Consumer	20	22	7	21	
Auto and equipment leases	65	65	20	22	
Total	9,696	10,956	4,071	9,800	
Total non-covered impaired loans	$ 112,721	$ 130,423	$ 4,071	$ 111,542	$ 674

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

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

Impaired construction speculative loans increased in the second quarter of 2012 due to a participating interest in the Company s only Shared National Credit loan that was transferred to nonaccrual status. The outstanding balance was $10.6 million as of March 31, 2013.

The allowance for off-balance sheet credit exposure relates to commitments to extend credit, letters of credit and undisbursed funds on lines of credit. The Company evaluates credit risk associated with the off-balance sheet commitments at the same time it evaluates credit risk associated with the loan and lease portfolio. The Company recorded zero provision for unfunded commitments for the three months ended March 31, 2013 and 2012. At March 31, 2013 and December 31, 2012, the balance in this reserve was $8.6 million and was included in other liabilities.

Troubled Debt Restructurings (TDR)

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

As of March 31, 2013, we had loans of $87.2 million classified as troubled debt restructured, of which $29.6 million are nonperforming and $57.6 million are performing. TDRs on accrual status are comprised of loans that were accruing at the time of

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restructuring or have demonstrated repayment performance in compliance with the restructured terms for a sustained period and for which the Company anticipates full repayment of both principal and interest. At March 31, 2013, performing TDRs were comprised of 14 commercial real estate loans of $21.5 million, two construction loans of $16.9 million, 13 dairy and livestock loans of $16.0 million, seven single-family residential loans of $2.0 million, and eight commercial and industrial loans of $1.2 million.

The majority of TDRs have no specific allowance allocated as any impairment amount is normally charged off at the time a probable loss is determined. We have allocated $1.8 million and $1.4 million specific allowance to TDRs as of March 31, 2013 and December 31, 2012.

The following are the loans modified as troubled debt restructuring during the three months ended March 31, 2013, and 2012:

Modifications

	For the Three Months Ended March 31, 2013			
	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Outstanding Recorded Investment at March 31, 2013
		(Dollars in thousands)		
Commercial and industrial	2	$ 204	$ 204	$ 193
Construction - speculative				
Construction - non-speculative				
Commercial real estate - owner occupied	1	168	168	168
Commercial real estate - non-owner occupied				
Residential real estate (SFR 1-4)				
Dairy and livestock	8	9,973	9,973	9,855
Municipal lease finance receivables				
Total non-covered loans	11	10,345	10,345	10,216
Covered loans				
Total gross loans	11	$ 10,345	$ 10,345	$ 10,216

	For the Three Months Ended March 31, 2012			
	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Outstanding Recorded Investment at March 31, 2012
		(Dollars in thousands)		
Commercial and industrial	2	$ 2,534	$ 2,534	$ 2,532
Construction - speculative				
Construction - non-speculative				
Commercial real estate - owner occupied	1	307	307	304
Commercial real estate - non-owner occupied	1	513	513	513
Residential real estate (SFR 1-4)				
Dairy and livestock				
Municipal lease finance receivables				
Total non-covered loans	4	3,354	3,354	3,349
Covered loans				
Total gross loans	4	$ 3,354	$ 3,354	$ 3,349

As of March 31, 2013, there were no loans that were previously modified as a troubled debt restructuring within the previous 12 months that subsequently defaulted during the three months ended March 31, 2013.

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7. EARNINGS PER SHARE

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

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

	For the Three Months Ended March 31,	
	2013	2012
	(In thousands, except per share amounts)	
Earnings per common share:		
Net earnings	$ 21,615	$ 22,268
Less: Net earnings allocated to restricted stock	69	72
Net earnings allocated to common shareholders (numerator)	$ 21,546	$ 22,196
Weighted average shares outstanding (denominator)	104,564	104,303
Earnings per common share	$ 0.21	$ 0.21
Diluted earnings per common share:		
Net income allocated to common shareholders (numerator)	$ 21,546	$ 22,196
Weighted average shares outstanding	104,564	104,303
Incremental shares from assumed exercise of outstanding options	246	197
Diluted weighted average shares outstanding (denominator)	104,810	104,500
Diluted earnings per common share	$ 0.21	$ 0.21

8. FAIR VALUE INFORMATION

Fair Value Hierarchy

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

The following disclosure provides the fair value information for financial assets and liabilities as of March 31, 2013. The fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value into three broad levels (Level 1, Level 2, and Level 3).

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

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

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

There were no transfers in and out of Level 1 and Level 2 measurement during the three months ended March 31, 2013 and 2012.

Determination of Fair Value

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Assets and Liabilities Measured at Fair Value on a Recurring Basis

	Carrying Value at March 31, 2013	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		(Dollars in thousands)		
Description of assets				
Investment securities - AFS:				
Government agency	$ 390,638	$	$ 390,638	$
Residential mortgage-backed securities	892,637		892,637	
CMO s / REMIC s - residential	477,577		477,577	
Municipal bonds	624,799		624,799	
Other securities	5,022		5,022	
Total investment securities - AFS	2,390,673		2,390,673	
Interest rate swaps	21,358		21,358	
Total assets	$ 2,412,031	$	$ 2,412,031	$
Description of liability				
Interest rate swaps	$ 21,358	$	$ 21,358	$
Total liabilities	$ 21,358	$	$ 21,358	$

	Carrying Value at December 31, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		(Dollars in thousands)		
Description of assets				
Investment securities - AFS:				
Government agency	$ 359,300	$	$ 359,300	$
Residential mortgage-backed securities	887,598		887,598	
CMO s / REMIC s - residential	571,960		571,960	
Municipal bonds	625,429		625,429	
Other securities	5,100		5,100	
Total investment securities - AFS	2,449,387		2,449,387	
Interest rate swaps	23,966		23,966	
Total assets	$ 2,473,353	$	$ 2,473,353	$

Description of liability								
Interest rate swaps	$	23,966	$		$	23,966	$	
Total liabilities	$	23,966	$		$	23,966	$	

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Assets and Liabilities Measured at Fair Value on a Non-Recurring Basis

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

	Carrying Value at March 31, 2013	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Losses for the Three Months Ended March 31, 2013
			(Dollars in thousands)		
Description of assets					
Impaired loans-non-covered	$ 4,169	$	$	$ 4,169	$ (2,164)
OREO-non-covered	828			828	(73)
OREO-covered					
Total assets	$ 4,997	$	$	$ 4,997	$ (2,237)

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

Fair Value of Financial Instruments

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

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	March 31, 2013				
	Carrying Amount	Estimated Fair Value Level 1	Level 2	Level 3	Total
	(Dollars in thousands)				
Assets					
Total cash and cash equivalents	$ 135,278	$ 135,278	$	$	$ 135,278
Interest-earning balances due from depository institutions	70,000		70,000		70,000
FHLB stock	50,981		50,981		50,981
Investment securities available-for-sale	2,390,673		2,390,673		2,390,673
Investment securities held-to-maturity	1,975			2,425	2,425
Total loans, net of allowance for credit losses	3,275,990			3,394,235	3,394,235
Accrued interest receivable	22,985		22,985		22,985
Swaps	21,358		21,358		21,358
Liabilities					
Deposits:					
Noninterest-bearing	$ 2,366,719	$ 2,366,719	$	$	$ 2,366,719
Interest-bearing	2,319,442		2,320,514		2,320,514
Borrowings	699,117		727,065		727,065
Junior subordinated debentures	46,393		46,649		46,649
Accrued interest payable	1,306		1,306		1,306
Swaps	21,358		21,358		21,358

	December 31, 2012				
	Carrying Amount	Estimated Fair Value Level 1	Level 2	Level 3	Total
	(Dollars in thousands)				
Assets					
Total cash and cash equivalents	$ 98,431	$ 98,431	$	$	$ 98,431
Interest-earning balances due from depository institutions	70,000		70,000		70,000
FHLB stock	56,651		56,651		56,651
Investment securities available-for-sale	2,449,387		2,449,387		2,449,387
Investment securities held-to-maturity	2,050			2,515	2,515
Total loans, net of allowance for credit losses	3,355,087			3,503,332	3,503,332
Accrued interest receivable	22,355		22,355		22,355
Swaps	23,966		23,966		23,966
Liabilities					
Deposits:					
Noninterest-bearing	$ 2,420,993	$ 2,420,993	$	$	$ 2,420,993
Interest-bearing	2,352,994		2,354,126		2,354,126
Borrowings	698,178		727,512		727,512
Junior subordinated debentures	67,012		67,415		67,415
Accrued interest payable	1,493		1,493		1,493
Swaps	23,966		23,966		23,966

The fair value estimates presented herein are based on pertinent information available to management as of March 31, 2013 and December 31, 2012. Although management is not aware of any factors that would significantly affect the estimated fair value amounts, such amounts have not been comprehensively revalued for purposes of these financial statements since that date, and therefore, current estimates of fair value may differ significantly from the amounts presented above.

9. BUSINESS SEGMENTS

The Company has identified two principal reportable segments: Business Financial and Commercial Banking Centers (Centers) and the Treasury Department. The Company s subsidiary bank has 40 Business Financial Centers and five Commercial Banking Centers organized in geographic regions, which are the focal points for customer sales and services. The Company utilizes an internal reporting system to measure the performance of various operating segments within the Bank which is the basis for

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

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

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

	For the Three Months Ended March 31, 2013				
	Centers	Treasury	Other	Eliminations	Total
			(Dollars in thousands)		
Interest income, including loan fees	$ 35,435	$ 12,788	$ 10,590	$	$ 58,813
Credit for funds provided (1)	6,312		2,559	(8,871)	
Total interest income	41,747	12,788	13,149	(8,871)	58,813
Interest expense	1,499	2,417	308		4,224
Charge for funds used (1)	1,073	10,514	(2,716)	(8,871)	
Total interest expense	2,572	12,931	(2,408)	(8,871)	4,224
Net interest income	39,175	(143)	15,557		54,589
Provision for credit losses					
Net interest income after provision for credit losses	39,175	(143)	15,557		54,589
Noninterest income	5,106	2,094	(455)		6,745
Noninterest expense	11,577	184	19,037		30,798
Segment pre-tax profit (loss)	$ 32,704	$ 1,767	$ (3,935)	$	$ 30,536
Segment assets as of March 31, 2013	$ 4,985,725	$ 2,622,402	$ 788,016	$ (2,130,376)	$ 6,265,767

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

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	For the Three Months Ended March 31, 2012				
	Centers	Treasury	Other	Eliminations	Total
	(Dollars in thousands)				
Interest income, including loan fees	$ 37,671	$ 15,363	$ 13,031	$	$ 66,065
Credit for funds provided (1)	6,347		2,600	(8,947)	
Total interest income	44,018	15,363	15,631	(8,947)	66,065
Interest expense	2,051	4,548	864		7,463
Charge for funds used (1)	1,097	10,028	(2,178)	(8,947)	
Total interest expense	3,148	14,576	(1,314)	(8,947)	7,463
Net interest income	40,870	787	16,945		58,602
Provision for credit losses					
Net interest income after provision for credit losses	40,870	787	16,945		58,602
Noninterest income	5,983		(727)		5,256
Noninterest expense	11,898	195	18,119		30,212
Debt termination					
Segment pre-tax profit (loss)	$ 34,955	$ 592	$ (1,901)	$	$ 33,646
Segment assets as of December 31, 2012	$ 4,838,109	$ 2,749,505	$ 922,575	$ (2,004,106)	$ 6,506,083

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

10. DERIVATIVE FINANCIAL INSTRUMENTS

The Bank is exposed to certain risks relating to its ongoing business operations and utilizes interest rate swap agreements (swaps) as part of its asset/liability management strategy to help manage its interest rate risk position. As of March 31, 2013, the Bank entered into 88 interest-rate swap agreements with customers and 88 with a counterparty bank. The swap agreements are not designated as hedging instruments. The purpose of entering into offsetting derivatives not designated as a hedging instrument is to provide the Bank a variable-rate loan receivable and provide the customer the financial effects of a fixed-rate loan without creating volatility in the Bank s earnings.

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

We believe our risk of loss associated with our counterparty borrowers related to interest rate swaps is mitigated as the loans with swaps are underwritten to take into account potential additional exposure.

Balance Sheet Classification of Derivative Financial Instruments

As of March 31, 2013, and December 31, 2012, the total notional amount of the Company s swaps was $238.2 million, and $240.1 million, respectively. The location of the asset and liability, and their respective fair values are summarized in the table below:

	March 31, 2013	
	Asset Derivatives	Liability Derivatives

	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
		(Dollars in thousands)		
Derivatives not designated as hedging instruments:				
Interest rate swaps	Other assets	$ 21,358	Other liabilities	$ 21,358
Total derivatives		$ 21,358		$ 21,358

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

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

The following table summarizes the effect of derivative financial instruments on the consolidated statements of earnings for the three months ended March 31, 2013, and 2012:

Derivatives Not Designated as Hedging Instruments	Location of Gain Recognized in Income on Derivative Instruments	Amount of Gain Recognized in Income on Derivative Instruments For the Three Months Ended March 31, 2013	2012
		(Dollars in thousands)	
Interest rate swaps	Other income	$	$ 503
Total		$	$ 503

11. OTHER COMPREHENSIVE INCOME/(LOSS)

The table below provides a summary of the changes in accumulated other comprehensive income (OCI) for the three months ended March 31, 2013.

	For the Three Months Ended March 31, 2013		
	Before-Tax	Tax Effect	After-Tax
	(Dollars in thousands)		
Investment securities available-for-sale:			
Net change in fair value recorded in accumulated OCI	$ (11,696)	$ (4,913)	$ (6,783)
Net realized gains reclassified into earnings(1)	(2,094)	(879)	(1,215)
Net change	$ (13,790)	$ (5,792)	$ (7,998)

(1) Net realized gains are included in noninterest income in the unaudited condensed consolidated statements of earnings and comprehensive income for the three months ended March 31, 2013.

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ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
The following discussion provides information about the results of operations, financial condition, liquidity, and capital resources of CVB Financial Corp. and its wholly owned subsidiaries. This information is intended to facilitate the understanding and assessment of significant changes and trends related to our financial condition and the results of our operations. This discussion and analysis should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2012, and the unaudited condensed consolidated financial statements and accompanying notes presented elsewhere in this report.

CRITICAL ACCOUNTING POLICIES

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

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

- Allowance for Credit Losses
- Troubled Debt Restructurings
- Investment Securities
- Goodwill Impairment
- Acquired Loans
- Covered Loans
- Covered Other Real Estate Owned
- FDIC Loss Sharing Asset
- Non-Covered Other Real Estate Owned
- Fair Value of Financial Instruments

Income Taxes

Share-based compensation

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

OVERVIEW

For the three months ended March 31, 2013, we reported net income of $21.6 million, compared with $22.3 million for the same period of 2012, a decrease of $653,000, or 2.93%. Diluted earnings per share were $0.21 per share for the three months ended March 31, 2013, compared to $0.21 per share for the same period in 2012. Net income for the first quarter of 2013 included a net pre-tax gain of $2.1 million on the sale of investment securities, and a $1.0 million accrual for potential interest and penalties associated with prior years federal and state income tax returns.

Net income for the three months ended March 31, 2013 produced a return on average equity of 11.32% and a return on average assets of 1.38%, compared to a return on average equity of 12.27% and a return on average assets of 1.37% for the same period of 2012.

Net interest income, before the provision for credit losses of $54.6 million for the three months ended March 31, 2013 decreased $4.0 million, or 6.85%, compared to the same period in 2012. Excluding the impact of the yield adjustment on covered loans, our tax equivalent (TE) net interest margin was 3.54% for the three months ended March 31, 2013, compared with 3.60% for the three months ended December 31, 2012 and 3.69% for the three months ended March 31, 2012. Total cost of funds decreased to 0.31% for the first quarter of 2013, from 0.32% for the fourth quarter of 2012, and from 0.52% for the three months ended March 31, 2012.

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Noninterest income was $6.7 million for the three months ended March 31, 2013, compared with $5.7 million for the three months ended December 31, 2012 and $5.3 million for the three months ended March 31, 2012. Noninterest income for the three months ended March 31, 2013 increased primarily due to a $2.1 million net pre-tax gain on the sale of investment. The net gain on sale of securities was somewhat offset by a $4.0 million net decrease in the FDIC loss sharing asset for the three months ended March 31, 2013, compared to a $2.6 million net decrease for the three months ended December 31, 2012 and a $2.9 million net decrease in the three months ended March 31, 2012.

Our efficiency ratio was 50.21% for the three months ended March 31, 2013, compared to 47.22% for the three months ended December 31, 2012, and 47.31% for the three months ended March 31, 2012. As a percentage of average assets, noninterest expense was 1.97% for the first quarter of 2013, compared to 1.85% for the same period in 2012.

Noninterest expense for the three months ended March 31, 2013 was $30.8 million, an increase of $1.8 million over the three months ended December 31, 2012 and an increase of $586,000 over the three months ended March 31, 2012. The quarter-over-quarter increase was due to the release of $1.0 million in reserves for unfunded commitments during the three months ended December 31, 2012, and a $1.0 million accrual for potential interest and penalties associated with previous years federal and state income tax returns.

The Company reported total assets of $6.27 billion at March 31, 2013. This represented a decrease of $97.6 million, or 1.53%, from total assets of $6.36 billion at December 31, 2012. Earning assets totaled $5.94 billion at March 31, 2013, a decrease of $99.3 million, or 1.65%, when compared with total earning assets of $6.04 billion at December 31, 2012. The decrease in earning assets was primarily due to a $79.3 million decrease in loans and a $58.8 million decrease in investment securities.

Investment securities totaled $2.39 billion at March 31, 2013, down from $2.45 billion at December 31, 2012. During the first quarter of 2013, we identified 13 securities with a par value of $94.2 million that were experiencing accelerated prepayment speeds that were causing an ongoing deterioration in yield. We elected to sell these securities and recognized a net gain on sale of $2.1 million. As of March 31, 2013, we had a pre-tax unrealized gain of $60.8 million on our overall securities portfolio. $36.9 million of this unrealized gain is attributed to our municipal securities portfolio, and $23.9 million is attributed to the remainder of the portfolio, which is predominantly mortgage-backed securities (MBS). For the three months ended March 31, 2013, we purchased $159.2 million in MBS with an average yield of 1.81% and $8.2 million in municipal securities with an average tax-equivalent yield of 3.16%.

Total loans and leases, net of deferred fees and discount, of $3.37 billion at March 31, 2013, decreased by $79.3 million, or 2.30%, from $3.48 billion at December 31, 2012. Quarter-over-quarter, non-covered loans decreased by $62.8 million, while covered loans declined by $16.5 million. $49.1 million of the $62.8 million decrease in non-covered loans was attributed to our Dairy and Livestock lending sector. The majority of the decline in dairy loans was due to seasonality. Non-covered commercial real estate loans totaled $2.0 billion at March 31, 2013, an increase of $6.1 million when compared with December 31, 2012. Non-covered commercial and industrial loans of $532.9 million at March 31, 2013 decreased $14.5 million when compared with December 31, 2012. The market remains very competitive for new loan originations for both commercial real estate and commercial and industrial loans. We continue to focus our sales effort on these two key areas but continue to seek lending opportunities that meet our credit quality guidelines.

Noninterest bearing deposits were $2.37 billion at March 31, 2013, a decrease of $54.3 million, or 2.24%, compared to $2.42 billion at December 31, 2012. At March 31, 2013, noninterest bearing deposits were 50.50% of total deposits, compared to 50.71% at December 31, 2012 and 45.31% at March 30, 2012. Our average cost of total deposits for the three months ended March 31, 2013 was 11 basis points, compared to 14 basis points for the same period in 2012.

Our capital ratios are well-above regulatory standards. As of March 31, 2013, our Tier 1 leverage capital ratio totaled 11.54%, our Tier 1 risk-based capital ratio totaled 18.36% and our total risk-based capital ratio totaled 19.63%.

Total equity increased $5.2 million, or 0.69%, to $768.2 million at March 31, 2013, compared with total equity of $763.0 million at December 31, 2012.

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ANALYSIS OF THE RESULTS OF OPERATIONS

Financial Performance

	For the Three Months Ended March 31, 2013	2012
	(Dollars in thousands, except per share amounts)	
Net earnings	$ 21,615	$ 22,268
Earnings per common share:		
Basic	$ 0.21	$ 0.21
Diluted	$ 0.21	$ 0.21
Return on average assets	1.38%	1.37%
Return on average shareholders equity	11.32%	12.27%

Income and Expense Related to Covered Assets

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

	For the Three Months Ended March 31, 2013	2012
	(Dollars in thousands)	
Interest income		
Interest income-accretion	$ 4,393	$ 4,692
Other income		
Decrease in FDIC loss share asset	(4,023)	(2,944)
Net gains on sale of OREO	376	136
Expenses		
Legal and professional	(131)	(518)
OREO write-down		(159)
OREO expenses	(58)	(111)
Other expenses (appraisals, and etc.)	(275)	(61)
Net income before income taxes related to covered assets	$ 282	$ 1,035

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

The discount accretion of $4.4 million for the three months ended March 31, 2013, recognized as part of interest income from covered loans, decreased $299,000, compared to $4.7 million for the same period in 2012. The discount accretion was reduced by the changes in the FDIC loss sharing asset, a net decrease of $4.0 million for the three months ended March 31, 2013, compared to a net decrease of $2.9 million for the same period in 2012.

Our credit loss experience on loans acquired from the SJB acquisition continued to improve during the first quarter of 2013. At March 31, 2013, the remaining discount associated with the SJB loans approximated $20.9 million. Based on the current forecast of expected cash flows, approximately $13.2 million of the discount is expected to accrete into interest income over the remaining lives of the respective pools and individual loans, which approximates 4.9 years and 0.9 year, respectively. The FDIC loss sharing asset totaled $14.2 million at March 31, 2013. The loss sharing asset will continue to be reduced by loss claims submitted to the FDIC with the remaining balance amortized on the same basis as the discount, not to exceed its remaining contract life of approximately 1.5 years.

The Company also recognized net gain on sales of covered assets of $376,000 for the three months ended March 31, 2013, compared to $136,000 for the same period in 2012.

Noninterest expense related to covered assets includes OREO expense, legal and professional expenses and other covered asset expenses totaled $464,000 for the three months ended March 31, 2013, compared to $849,000 for the same period in 2012. Covered loans decreased $87.8 million to $199.6 million at March 31, 2013 from $287.4 million at March 31, 2012.

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Net Interest Income

The principal component of our earnings is net interest income, which is the difference between the interest and fees earned on loans and investments (earning assets) and the interest paid on deposits and borrowed funds (interest-bearing liabilities). Net interest margin is the taxable-equivalent of net interest income as a percentage of average earning assets for the period. The level of interest rates and the volume and mix of earning assets and interest-bearing liabilities impact net interest income and net interest margin. The net interest spread is the yield on average earning assets minus the cost of average interest-bearing liabilities. Our net interest income, interest spread, and net interest margin are sensitive to general business and economic conditions. These conditions include short-term and long-term interest rates, inflation, monetary supply, and the strength of the international, national and state economies, in general, and more specifically the local economies in which we conduct business. Our ability to manage net interest income during changing interest rate environments will have a significant impact on our overall performance. As of March 31, 2013, our balance sheet is slightly asset-sensitive over a one-year horizon assuming no balance sheet growth; meaning interest-earning assets will generally reprice faster than interest-bearing liabilities. Therefore, our net interest margin is likely to modestly increase in sustained periods of rising interest rates and decrease modestly in sustained periods of declining interest rates. We manage net interest income through affecting changes in the mix of earning assets as well as the mix of interest-bearing liabilities, changes in the level of interest-bearing liabilities in proportion to earning assets, and in the growth of earning assets.

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

	Interest-Earning Assets and Interest-Bearing Liabilities For the Three Months Ended March 31,					
	2013			2012		
	Average Balance	Interest	Yield/ Rate	Average Balance	Interest	Yield/ Rate
	(Dollars in thousands)					
INTEREST-EARNING ASSETS						
Investment securities (1)						
Taxable	$ 1,792,429	$ 6,747	1.52%	$ 1,644,928	$ 9,170	2.26%
Tax-advantaged	625,850	5,541	4.85%	648,684	5,796	4.94%
Investment in FHLB stock	56,336	343	2.47%	72,194	90	0.50%
Federal funds sold & interest-earning deposits with other institutions	92,205	135	0.59%	284,346	285	0.40%
Loans HFS	75	1	5.41%	7,445	4	0.22%
Loans (2)	3,401,825	41,653	4.97%	3,476,480	46,028	5.32%
Yield adjustment to interest income from discount accretion	(24,075)	4,393		(50,155)	4,692	
Total earning assets	5,944,645	58,813	4.15%	6,083,922	66,065	4.53%
Total non earning assets	391,964			475,452		
Total assets	$ 6,336,609			$ 6,559,374		
INTEREST-BEARING LIABILITIES						
Savings deposits (3)	$ 1,633,789	882	0.22%	$ 1,753,479	1,157	0.27%
Time deposits	711,942	359	0.20%	813,957	496	0.25%
Total interest-bearing deposits	2,345,731	1,241	0.21%	2,567,436	1,653	0.26%
FHLB advances and other borrowings	806,613	2,983	1.50%	1,096,517	5,810	2.10%
Interest-bearing liabilities	3,152,344	4,224	0.54%	3,663,953	7,463	0.81%
Noninterest-bearing deposits	2,322,640			2,079,571		
Other liabilities	87,143			86,137		

Stockholders equity	774,482		729,713	
Total liabilities and stockholders equity	$ 6,336,609		$ 6,559,374	
Net interest income		$ 54,589		$ 58,602
Net interest income excluding discount		$ 50,196		$ 53,910
Net interest spread tax equivalent		3.61%		3.72%
Net interest spread tax equivalent excluding discount		3.29%		3.35%
Net interest margin		3.83%		3.89%
Net interest margin tax equivalent		3.86%		4.04%
Net interest margin tax equivalent excluding discount		3.54%		3.69%
Net interest margin excluding loan fees		3.77%		3.87%
Net interest margin excluding loan fees tax equivalent		3.80%		4.01%

(1) Non tax-equivalent (TE) rate was 2.30%, and 2.64% for the three months ended March 31, 2013, and 2012, respectively.

(2) Includes loan fees of: $741, and $342 for the three months ended March 31, 2013, and 2012, respectively. Prepayment penalty fees of $954, and $869 are included in interest income for the three months ended March 31, 2013, and 2012, respectively.

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

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Net Interest Income and Net Interest Margin Reconciliations (Non-GAAP)

We use certain non-GAAP financial measures to provide supplemental information regarding our performance. Net interest income for the three months ended March 31, 2013, and 2012 include a yield adjustment of $4.4 million, and $4.7 million, respectively, related to discount accretion on covered loans. As a result, these yield adjustments are reflected in the Company s net interest margin. We believe that presenting net interest income and the net interest margin excluding these yield adjustments provides additional clarity to the users of financial statements regarding core net interest income and net interest margin.

(Dollars in thousands)	Three Months Ended March 31, 2013 Average Balance	2013 Interest	2013 Yield	2012 Average Balance	2012 Interest	2012 Yield
Total interest-earning assets (TE)	$ 5,944,645	$ 60,845	4.15%	$ 6,083,922	$ 68,238	4.53%
Discount on acquired loans	24,075	(4,393)		50,155	(4,692)	
Total interest-earning assets, excluding SJB loan discount and yield adjustment	$ 5,968,720	$ 56,452	3.83%	$ 6,134,077	$ 63,546	4.16%
Net interest income and net interest margin (TE)		$ 56,621	3.86%		$ 60,775	4.04%
Yield adjustment to interest income from discount accretion		(4,393)			(4,692)	
Net interest income and net interest margin (TE), excluding yield adjustment		$ 52,228	3.54%		$ 56,083	3.69%

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

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

	Comparision of Three Months Ended March 31, 2013 Compared to 2012 Increase (Decrease) Due to Volume	Rate	Rate/ Volume	Total
	(Dollars in thousands)			
Interest income:				
Taxable investment securities	$ 813	$ (2,970)	$ (266)	$ (2,423)
Tax-advantaged securities	(172)	(86)	3	(255)
Investment in FHLB stock	(19)	349	(77)	253
Fed funds sold & interest-earning deposits with other institutions	(193)	132	(89)	(150)
Loans HFS	(4)	96	(95)	(3)
Loans	(1,084)	(3,363)	72	(4,375)
Yield adjustment from discount accretion	(2,776)	5,161	(2,684)	(299)
Total interest income	(3,435)	(681)	(3,136)	(7,252)
Interest expense:				
Savings deposits	(77)	(213)	15	(275)

Time deposits	(60)	(88)	11	(137)
Other borrowings	(1,575)	(1,701)	449	(2,827)
Total interest expense	(1,712)	(2,002)	475	(3,239)
Net interest income	$ (1,723)	$ 1,321	$ (3,611)	$ (4,013)

Excluding the impact of the yield adjustment on covered loans, our net interest margin (tax equivalent) was 3.54% for the three months ended March 31, 2013, compared to 3.60% for the three months ended December 31, 2012, and 3.69% for the three months ended March 31, 2012. Total average earning asset yields (excluding discount) decreased to 3.83% for the three months ended March 31, 2013, from 3.87% for the three months ended December 31, 2012, and 4.16% for the three months ended March 31, 2012. Total cost of funds decreased to 0.31% for the three months ended March 31, 2013, from 0.32% for the three months ended December 31, 2012, and 0.52% for the three months ended March 31, 2012.

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The average balance of total loans decreased $74.7 million to $3.40 billion for the three months ended March 31, 2013, compared to $3.48 billion for the same period in 2012. The average yield on loans was 4.97% for the three months ended March 31, 2013, compared to 5.32% for the same period in 2012. Lower rates on mortgages have resulted in larger volumes of refinancings, which have impacted the prepayment speeds within our current portfolio. We also continued to see competitive pressure on rates in all classes of loans, particularly commercial real estate secured loans. We earned $954,000 in loan prepayment penalty fees for the three months ended March 31, 2013, compared with $751,000 for the three months ended March 31, 2012.

Total average earning assets of $5.94 billion decreased $139.3 million, or 2.29%, from $6.08 billion for the three months ended March 31, 2012. This decrease was principally due to a $192.1 million decrease in interest-earning cash to $92.2 million, compared to $284.3 million for the same period in 2012 as a result of prepaying $250.0 million of FHLB advances during the third quarter of 2012 and $68.6 million redemption of junior subordinated debentures through March 31, 2013. The average investment in FHLB stock also decreased $15.9 million to $56.3 million for the three months ended March 31, 2013, compared to $72.2 million for the same period in 2012. The total average loan balance, net of discount, also decreased $48.6 million. These decreases were partially offset by an increase of $124.7 million in lower yielding investment securities to $2.42 billion for the three months ended March 31, 2013, compared to $2.29 billion for the same period in 2012. The yield on investment securities continued to decline, partially driven by the Federal Reserve Bank s ongoing stimulus program of purchasing longer term debt in the open market.

In general, we stop accruing interest on a loan after its principal or interest becomes 90 days or more past due. When a loan is placed on non-accrual, all interest previously accrued but not collected is charged against earnings. There was no interest income that was accrued and not reversed on non-accrual loans at March 31, 2013 and 2012. As of March 31, 2013 and 2012, we had $55.1 million and $55.3 million of non-covered non-accrual loans, respectively. Had non-covered nonaccrual loans for which interest was no longer accruing complied with the original terms and conditions, interest income would have been approximately $1.3 million and $594,000 greater for the three months ended March 31, 2013 and 2012, respectively.

Fees collected on loans are an integral part of the loan pricing decision. Net loan fees and the direct costs associated with the origination of loans are deferred and deducted from total loans on our balance sheet. Net deferred loan fees are recognized in interest income over the term of the loan using the effective-yield method. We recognized loan fee income of $741,000 for the three months ended March 31, 2013, compared to $342,000 for the three months ended March 31, 2012.

Interest income on investments of $12.3 million for the three months ended March 31, 2013, decreased $2.7 million, or 17.89%, from $15.0 million for the three months ended March 31, 2012. Total yield (TE) on investments was 2.39% for the three months ended March 31, 2013, compared to 3.03% for the same period in 2012. We have been strategically reinvesting our cash flow from our investment portfolio, carefully weighing current rates and overall interest rate risks and we continually adjust our investment strategies in response to the changing interest rate environment. During the first quarter we identified 13 securities with a par value of $94.2 million and a weighted average yield of approximately 2.05% that were experiencing accelerated prepayment speeds that were causing an ongoing deterioration in yield. We elected to sell these securities and recognized a net gain on sale of $2.1 million. We used the sale proceeds to reinvest in additional securities. During the first quarter of 2013, we purchased $159.2 million in MBS with an average yield of 1.81% and an average duration of about 4 years. We also purchased $34.8 million in SBA Pools with an average yield of 2.09% and $8.2 million in municipal securities with an average tax-equivalent yield of 3.16%.

Interest expense of $4.2 million for the three months ended March 31, 2013 decreased $3.2 million, or 43.40%, compared to $7.5 million for the same period in 2012. The average rate paid on interest-bearing liabilities decreased 27 basis points, to 0.54% in the three months ended March 31, 2013 from 0.81% in 2012 as a result of the low interest rate environment that we are currently experiencing as well as the mix of interest-bearing liabilities.

Contributing to the decline in interest expense was lower rates paid on deposits as reflected by the decrease in our average cost of interest-bearing deposits (0.21% for the three months ended March 31, 2013, compared to 0.27% for the same period in 2012). Average noninterest-bearing deposits grew to $2.32 billion, or 49.75% of total average deposits for the three months ended March 31, 2013, compared to $2.08 billion, or 44.75% of total average deposits for the same period in 2012. The decrease in rates paid on total deposits (0.11% for the three months ended March 31, 2013 compared to 0.14% for the same period in 2012) also contributed to our lower cost of funds.

Other borrowings typically have higher interest costs than interest-bearing deposits. The $2.8 million decrease in interest from other borrowings during the three months ended March 31, 2013 was due to the redemption of $250.0 million of fixed rate loans from the FHLB during the third quarter of 2012, and $68.6 million redemption of junior subordinated debentures through March 31, 2013. The FHLB loans carried an average coupon rate of 3.39% and a weighted average remaining life of 2.6 years. We also repaid $100.0 million of FHLB loans, with a coupon rate of 2.89%, at the end of December, 2011. On January 7, 2012, we redeemed all outstanding debentures and trust preferred securities issued by First Coastal Capital Trust II for a total consideration of approximately $6.8 million. During 2012, we redeemed $41.2 million of CVB Statutory

Trust I junior subordinated debentures bearing interest at 2.85% above the 90-day LIBOR. During the three months ended March, 2013, we redeemed $20.6 million, or 50%, of the outstanding capital and common securities issued by the Company s trust subsidiary, CVB Statutory Trust II. The remaining 50% of outstanding capital and common securities issued by CVB Statutory Trust II was redeemed on April 7, 2013.

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Provision for Credit Losses

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

Our provision for credit losses on non-covered loans was zero for the three months ended March 31, 2013 and 2012. We believe the allowance is appropriate at March 31, 2013. We periodically assess the quality of our portfolio to determine whether additional provisions for credit losses are necessary. The ratio of the allowance for credit losses to total non-covered net loans as of March 31, 2013 and December 31, 2012 was 2.89% and 2.84%, respectively.

No assurance can be given that economic conditions which adversely affect the Company s service areas or other circumstances will not be reflected in increased provisions for credit losses in the future, as the nature of this process requires considerable judgment. Net charge-offs totaled $223,000 during the three months ended March 31, 2013, compared to $2.0 million for the same period in 2012. See Risk Management Credit Risk herein.

SJB loans acquired in the FDIC-assisted transaction were initially recorded at their fair value and are covered by a loss sharing agreement with the FDIC. Due to the timing of the acquisition and the October 16, 2009 fair value estimate, there was no provision for credit losses on the covered SJB loans in 2009. During the three months ended March 31, 2013 and 2012, there was zero and $31,000, respectively, in net charge-offs for loans in excess of the amount originally expected in the fair value of the loans at acquisition. Our provision for credit losses on covered SJB loans was zero for the three months ended 2013, compared to provision of $31,000 for credit losses for the same period in 2012. An offsetting adjustment was recorded to the FDIC loss sharing asset based on the appropriate loss sharing percentage.

Noninterest Income

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

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

	For the Three Months Ended March 31, 2013	2012	Variance
		(Dollars in thousands)	
Noninterest income:			
Service charges on deposit accounts	$ 3,826	$ 4,124	$ (298)
Trust and investment services	2,005	2,185	(180)
Bankcard services	839	919	(80)
BOLI income	743	750	(7)
Gain on sale of investment securities, net	2,094		2,094
Decrease in FDIC loss sharing asset, net	(4,023)	(2,944)	(1,079)
Gain on OREO	564	182	382
Loss on loans held-for-sale		(1,219)	1,219
Other	697	1,259	(562)
Total noninterest income	$ 6,745	$ 5,256	$ 1,489

Noninterest income of $6.7 million for the three months ended March 31, 2013 increased $1.5 million, or 28.33%, over noninterest income of $5.3 million for the same period in 2012. This year-over-year increase was primarily due to a $2.1 million net pre-tax gain on the sale of investment securities with a par value of $94.2 million that were experiencing accelerated prepayment speeds, resulting in a deterioration in yield, compared to zero gain on sale of securities for the same period in 2012. The net gain on sale of securities was somewhat offset by a $4.0 million net decrease in the FDIC loss sharing asset during the first quarter of 2013, compared to a $2.9 million net decrease in the first quarter of 2012. We recorded a $1.2 million impairment charge for a large covered held-for-sale note during the first quarter of 2012.

CitizensTrust consists of Wealth Management and Investment Services income. The Wealth Management Group provides a variety of services, which include asset management, financial planning, estate planning, retirement planning, private and corporate trustee services, and probate services. Investment Services provides self-directed brokerage, 401(k) plans, mutual funds, insurance and other non-insured investment products. At March 31, 2013, CitizensTrust had approximately $2.24 billion in assets under management and administration, including $1.68 billion in assets under management. CitizensTrust generated fees of $2.0 million for the three months ended March 31, 2013, compared to $2.2 million for the same period in 2012.

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The Bank invests in Bank-Owned Life Insurance (BOLI). BOLI involves the purchasing of life insurance by the Bank on a selected group of employees. The Bank is the owner and beneficiary of these policies. BOLI is recorded as an asset at its cash surrender value. Increases in the cash value of these policies, as well as insurance proceeds received, are recorded in noninterest income and are not subject to income tax, as long as they are held for the life of the covered parties. BOLI income of $743,000 for the three months ended March 31, 2013 decreased $7,000, or 0.93% from the same period in 2012.

Other noninterest income of $697,000 for the three months ended March 31, 2013 decreased $562,000, or 44.64%, compared to $1.3 million for the same period in 2012. This decrease was primarily due to a $426,000 decrease in swap fee income.

Noninterest Expense

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

	For the Three Months Ended March 31,		
	2013	**2012**	**Variance**
	(Dollars in thousands)		
Noninterest expense:			
Salaries and employee benefits	$ 17,300	$ 16,721	$ 579
Occupancy	2,622	2,847	(225)
Equipment	1,060	1,101	(41)
Professional services	1,596	1,991	(395)
Software licenses and maintenance	1,152	909	243
Stationary and supplies	988	949	39
Promotion	1,258	1,251	7
Amortization of intangibles	438	816	(378)
OREO expense	330	730	(400)
Regulatory assessments	890	942	(52)
Loan expense	663	440	223
Other	2,501	1,515	986
Total noninterest expense	$ 30,798	$ 30,212	$ 586

Our ability to control noninterest expenses in relation to asset growth can be measured in terms of total noninterest expense as a percentage of average assets. Noninterest expense measured as a percentage of average assets was 1.97% for the three months ended March 31, 2013, compared to 1.85% for the same period in 2012.

Our ability to control noninterest expenses in relation to the level of total revenue (net interest income before provision for credit losses plus noninterest income) is measured by the efficiency ratio and indicates the percentage of net revenue that is used to cover expenses. For the three months ended March 31, 2013, the efficiency ratio was 50.21%, compared to 47.31% for the same period in 2012.

The overall increase of $586,000 in noninterest expense for the three months ended March 31, 2013 was primarily attributable to a $1.0 million accrual for potential interest and penalties associated with previous years federal and state income tax returns included in other expense and $579,000 in salaries and related expenses due to increases in employee benefits and payroll taxes. The increases in expenses were partially offset by decreases of $400,000 in OREO expense, $395,000 in professional services, $378,000 in amortization of intangibles, and $225,000 in occupancy expense.

The $395,000 decrease in professional services expense was primarily due to a $576,000 decrease in other professional services, offset by an $181,000 increase in legal expenses associated with credit and collection issues, the federal securities class action litigation, and other litigation issues in which the Company is involved. See Part II, Item 1 Legal Proceedings .

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Income Taxes

The Company s effective tax rate for the three months ended March 31, 2013 was 29.21%, compared to 33.82% for the same period in 2012. Our effective tax rate varies depending upon tax-advantaged income as well as available tax credits. We benefited from $1.4 million of enterprise zone tax credits reflected during the three months ended March 31, 2013.

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

RESULTS BY BUSINESS SEGMENTS

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

Business Financial and Commercial Banking Centers

Key measures we use to evaluate the Business Financial and Commercial Banking Center s performance are included in the following table for the three months ended March 31, 2013 and 2012. The table also provides additional significant segment measures useful to understanding the performance of this segment.

	For the Three Months Ended March 31, 2013	2012
	(Dollars in thousands)	
Key Measures:		
Statement of Operations		
Interest income (1)	$ 41,747	$ 44,018
Interest expense (1)	2,572	3,148
Net interest income	$ 39,175	$ 40,870
Noninterest income	5,106	5,983
Noninterest expense	11,577	11,898
Segment pre-tax profit	$ 32,704	$ 34,955
Balance Sheet		
Average loans	$ 2,600,153	$ 2,601,090
Average interest-bearing deposits and customer repurchases	$ 2,635,719	$ 2,866,246
Yield on loans (2)	5.53%	5.82%
Rate paid on interest-bearing deposits and customer repurchases	0.23%	0.29%

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

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

For the three months ended March 31, 2013, Business Financial and Commercial Banking Centers segment pre-tax profit decreased by $2.3 million, or 6.44%, compared to the same period last year. This was primarily due to a decrease in net interest income of $1.7 million, or 4.15%, compared to the first quarter of 2012. Noninterest income decreased $877,000, or 14.66% for the three months ended March 31, 2013, compared to the same period in 2012. The decrease in net interest income was due to a decrease of $2.3 million in interest income, offset by a decrease of $576,000 in interest expense. The decrease in net interest income was primarily due to a 29 basis point decrease in the loan yield during the first quarter of 2013, compared to the same period in 2012.

Treasury

Key measures we use to evaluate the Treasury s performance are included in the following table for the three months ended March 31, 2013 and 2012. The table also provides additional significant segment measures useful to understanding the performance of this segment.

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	For the Three Months Ended March 31, 2013	2012
	(Dollars in thousands)	
Key Measures:		
Statement of Operations		
Interest income(1)	$ 12,788	$ 15,363
Interest expense(1)	12,931	14,576
Net interest income	$ (143)	$ 787
Noninterest income	2,094	
Noninterest expense	184	195
Debt termination		
Segment pre-tax profit	$ 1,767	$ 592
Balance Sheet		
Average investments	$ 2,418,279	$ 2,293,612
Average interest-bearing deposits	$ 240,002	$ 240,001
Average borrowings	$ 225,629	$ 448,704
Yield on investments-TE	2.39%	3.03%
Non-tax equivalent yield	2.30%	2.64%
Rate paid on borrowings	4.15%	3.96%

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

For the three months ended March 31, 2013, the Company s Treasury department reported pre-tax income of $1.8 million. This increase was primarily due to a $2.1 million net pre-tax gain on sale of securities during the first quarter of 2013. This increase was partially offset by a $2.6 million reduction in interest income due to a 64 basis point decrease in yield on investments (TE) and a $124.7 million increase in average investments in 2013. Interest expense decreased $1.7 million primarily due to a $223.1 million decrease in average borrowings compared to the same period in 2012.

Other

	For the Three Months Ended March 31, 2013	2012
	(Dollars in thousands)	
Key Measures:		
Statement of Operations		
Interest income(1)	$ 13,149	$ 15,631
Interest expense(1)	(2,408)	(1,314)
Net interest income	$ 15,557	$ 16,945
Provision for cedit losses		
Noninterest income	(455)	(727)
Noninterest expense	19,037	18,119
Pre-tax loss	$ (3,935)	$ (1,901)
Balance Sheet		
Average loans	$ 777,672	$ 832,680
Average interest-bearing deposits and customer repurchases	$ 4,001	$ 378
Yield on loans	5.53%	6.31%

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

The Company s administration and other operating departments reported pre-tax loss of $3.9 million for the three months ended March 31, 2013. This represented an increase in pre-tax loss of $2.0 million or 106.97%, from a pre-tax loss of $1.9 million for the same period in 2012. The increase in pre-tax loss was primarily attributed to a decrease of $1.4 million in net interest income and an increase of $917,000 in noninterest expense due to a $1.0 million accrual for potential interest and penalties associated with previous years federal and state income tax returns included in other expense.

ANALYSIS OF FINANCIAL CONDITION

The Company reported total assets of $6.27 billion at March 31, 2013. This represented a decrease of $97.6 million, or 1.53%, from total assets of $6.36 billion at December 31, 2012. Earning assets totaled $5.94 billion at March 31, 2013. This represented a decrease of $99.3 million, or 1.65%, from total earning assets of $6.04 billion at December 31, 2012. The decrease in earning assets during the first quarter of 2013 was primarily due to $79.3 million decrease in loans and $58.8 million decrease in investment securities. Total liabilities were $5.50 billion at March 31, 2013, down $102.8 million, or 1.84%, from total liabilities of $5.60 billion at December 31, 2012. Total equity increased $5.2 million, or 0.69%, to $768.2 million at March 31, 2013, compared to total equity of $763.0 million at December 31, 2012.

Investment Securities

The Company maintains a portfolio of investment securities to provide interest income and to serve as a source of liquidity for its ongoing operations. The tables below set forth information concerning the composition of the investment securities portfolio at March 31, 2013 and December 31, 2012.

At March 31, 2013, we reported total investment securities of $2.39 billion. This represented a decrease of $58.8 million, or 2.40%, from total investment securities of $2.45 billion at December 31, 2012. Investment securities comprise 38.19% of the Company s total earning assets at March 31, 2013. During the first quarter of 2013, we identified 13 securities with a par value of $94.2 million that were experiencing accelerated prepayment speeds that were causing an ongoing deterioration in yield. We elected to sell these securities and recognized a net gain on sale of $2.1 million. No securities were sold during the first quarter of 2012.

At March 31, 2013, securities held as available-for-sale had a fair value of $2.39 billion with an amortized cost of $2.33 billion. At March 31, 2013, the net unrealized holding gain on securities was $60.8 million and that resulted in accumulated other comprehensive income of $35.3 million (net of $25.5 million in deferred taxes). At December 31, 2012, the Company had a pre-tax net unrealized gain on total investment securities of $74.6 million and accumulated other comprehensive income of $43.3 million (net of deferred taxes of $31.3 million).

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

	March 31, 2013				
	Amortized Cost	Gross Unrealized Holding Gain	Gross Unrealized Holding Loss	Fair Value	Total Percent
	(Dollars in thousands)				
Investment securities available-for-sale:					
Government agency	$ 391,336	$ 845	$ (1,543)	$ 390,638	16.34%
Residential mortgage-backed securities	874,913	21,139	(3,415)	892,637	37.34%
CMO s / REMIC s residential	470,694	7,439	(556)	477,577	19.98%
Municipal bonds	587,949	37,264	(414)	624,799	26.13%
Other securities	5,000	22		5,022	0.21%
Total investment securities	$ 2,329,892	$ 66,709	$ (5,928)	$ 2,390,673	100.00%

	December 31, 2012				
	Amortized Cost	Gross Unrealized Holding Gain	Gross Unrealized Holding Loss	Fair Value	Total Percent
	(Dollars in thousands)				
Investment securities available-for-sale:					
Government agency	$ 357,960	$ 1,588	$ (248)	$ 359,300	14.67%
Residential mortgage-backed securities	862,196	25,529	(127)	887,598	36.24%
CMO s / REMIC s residential	565,968	7,402	(1,410)	571,960	23.35%

Municipal bonds	583,692	41,920	(183)	625,429	25.53%
Other securities	5,000	100		5,100	0.21%
Total investment securities	$ 2,374,816	$ 76,539	$ (1,968)	$ 2,449,387	100.00%

The weighted-average yield (TE) on the investment portfolio at March 31, 2013 was 2.36% with a weighted-average life of 3.5 years. This compares to a weighted-average yield of 2.47% at December 31, 2012 with a weighted-average life of 3.1 years and a yield of 2.80 % at March 31, 2012 with a weighted-average life of 3.9 years. The weighted average life is the average number of years that each dollar of unpaid principal due remains outstanding. Average life is computed as the weighted-average time to the receipt of all future cash flows, using as the weights the dollar amounts of the principal paydowns.

Approximately 74% of the securities in the total investment portfolio, at March 31, 2013, are issued by the U.S government or U.S. government-sponsored agencies and enterprises which have the implied guarantee payment of principal and interest. As of March 31, 2013, approximately $162.1 million in U.S. government agency bonds are callable.

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

	March 31, 2013					
	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Gross Unrealized Holding Losses	Fair Value	Gross Unrealized Holding Losses	Fair Value	Gross Unrealized Holding Losses
	(Dollars in thousands)					
Held-to-maturity:						
CMO	$	$	$	$	$	$
Available-for-sale:						
Government agency	$ 182,843	$ 1,543	$	$	$ 182,843	$ 1,543
Residential mortgage-backed securities	173,748	3,415			173,748	3,415
CMO / REMICs residential	45,399	539	5,460	17	50,859	556
Municipal bonds	26,788	343	2,207	71	28,995	414
Other securities						
Total	$ 428,778	$ 5,840	$ 7,667	$ 88	$ 436,445	$ 5,928

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

The tables above show the Company s investment securities gross unrealized losses and fair value by investment category and length of time that individual securities have been in a continuous unrealized loss position, at March 31, 2013 and December 31, 2012. The unrealized losses on these securities were primarily attributed to changes in interest rates. The issuers of these securities have not, to our knowledge, established any cause for default on these securities. These securities have fluctuated in value since their purchase dates as market rates have fluctuated.

However, we have the ability and the intention to hold these securities until their fair values recover to cost or maturity. As such, management does not deem these securities to be other-than-temporarily-impaired except for one investment security classified as held-to-maturity. A summary of our analysis of these securities and the unrealized losses is described more fully in Note 5 Investment Securities in the notes to the unaudited condensed consolidated financial statements. Economic trends may adversely affect the value of the portfolio of investment securities that we hold.

During the three months ended March 31, 2013 and 2012, we recorded zero other-than-temporary impairment recognized on the held-to-maturity investment security.

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Loans

At March 31, 2013, we reported total loans and lease finance receivables, net of deferred loan fees and discount, of $3.37 billion. This represents a decrease of $79.3 million, or 2.30%, from total loans, net of deferred loan fees, of $3.45 billion at December 31, 2012. Non-covered loans and covered loans decreased by $62.8 million and $16.5 million, respectively, for the three months ended March 31, 2013. $49.1 million of the $62.8 million decrease in non-covered loans was attributed to our Dairy and Livestock lending sector. The majority of the decline in dairy loans was due to seasonality.

Total loans, net of deferred loan fees, comprise 56.73% of our total earning assets. The following tables present our loan portfolio, excluding held-for-sale loans, segregated into covered versus non-covered loans, by category as of March 31, 2013 and December 31, 2012.

	March 31, 2013		
	Non-Covered Loans	**Covered Loans**	**Total**
		(Dollars in thousands)	
Commercial and industrial	$ 532,941	$ 25,314	$ 558,255
Real estate:			
Construction	55,703	1,061	56,764
Commercial real estate	1,996,198	160,069	2,156,267
SFR mortgage	162,022	1,321	163,343
Consumer	44,116	5,967	50,083
Municipal lease finance receivables	109,727		109,727
Auto and equipment leases, net of unearned discount	12,422		12,422
Dairy and livestock	278,502		278,502
Agribusiness	5,370	5,870	11,240
Gross loans	3,197,001	199,602	3,396,603
Less:			
Purchase accounting discount		(20,908)	(20,908)
Deferred loan fees, net	(7,487)		(7,487)
Gross loans, net of deferred loan fees and discount	3,189,514	178,694	3,368,208
Less: Allowance for credit losses	(92,218)		(92,218)
Net loans	$ 3,097,296	$ 178,694	$ 3,275,990
Allowance for credit losses as a % of loans, net of deferred loan fees	2.89%		

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	December 31, 2012		
	Non-Covered Loans	Covered Loans	Total
	(Dollars in thousands)		
Commercial and industrial	$ 547,422	$ 26,149	$ 573,571
Real estate:			
Construction	59,721	1,579	61,300
Commercial real estate	1,990,107	179,428	2,169,535
SFR mortgage	159,288	1,415	160,703
Consumer	47,557	6,337	53,894
Municipal lease finance receivables	105,767		105,767
Auto and equipment leases, net of unearned discount	12,716		12,716
Dairy and livestock	327,579		327,579
Agribusiness	9,081	5,651	14,732
Gross loans	3,259,238	220,559	3,479,797
Less:			
Purchase accounting discount		(25,344)	(25,344)
Deferred loan fees, net	(6,925)		(6,925)
Gross loans, net of deferred loan fees and discount	3,252,313	195,215	3,447,528
Less: Allowance for credit losses	(92,441)		(92,441)
Net loans	$ 3,159,872	$ 195,215	$ 3,355,087

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

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

Our loan portfolio is from a variety of areas throughout our marketplace. The following is the breakdown of our total held-for-investment loans and commercial real estate loans by region as of March 31, 2013.

	March 31, 2013			
			Commercial	
Non-Covered Loans by Market Area	Total Non-Covered Loans		Real Estate Loans	
	(Dollars in thousands)			
Los Angeles County	$ 1,198,804	37.5%	$ 808,143	40.5%
Inland Empire	601,204	18.8%	483,652	24.2%
Central Valley	646,987	20.2%	390,820	19.6%
Orange County	455,543	14.2%	182,514	9.1%
Other Areas (1)	294,463	9.3%	131,069	6.6%
	$ 3,197,001	100.0%	$ 1,996,198	100.0%

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

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Covered Loans by Market Area	March 31, 2013 Total Covered Loans			Covered Commercial Real Estate Loans	
	(Dollars in thousands)				
Los Angeles County	$ 14,194	7.1%	$	9,554	6.0%
Inland Empire	1,034	0.5%		47	
Central Valley	173,133	86.8%		144,466	90.3%
Orange County					
Other Areas (1)	11,241	5.6%		6,002	3.7%
	$ 199,602	100.0%	$	160,069	100.0%

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

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

Non-Covered Commercial and SFR Real Estate Loans (Dollars in thousands)		March 31, 2013 *Loan Balance*	*Percent*	*Percent Owner-Occupied (1)*	*Average Loan Balance*
Single-family residential	Direct	$ 63,236	2.9%	100.0%	$ 403
Single-family residential	Mortgage Pools	98,786	4.6%	100.0%	255
Multi-family		115,914	5.4%		1,035
Industrial		561,522	26.0%	34.5%	893
Office		364,036	16.9%	27.7%	968
Retail		337,800	15.7%	10.2%	1,320
Medical		133,737	6.2%	35.2%	1,592
Secured by farmland		147,726	6.8%	100.0%	2,052
Other		335,463	15.5%	49.9%	1,321
		$ 2,158,220	100.0%	39.5%	1,126

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

In the table above, Single family residential-Direct represents those single-family residence loans that we have made directly to our customers. These loans totaled $63.2 million. In addition, we have purchased pools of owner-occupied single-family loans from real estate lenders, Single family residential-Mortgage Pools, totaling $98.8 million. These loans were purchased with average FICO scores predominantly ranging from 700 to over 800 and overall original loan-to-value ratios of 60% to 80%. These pools were purchased to diversify our loan portfolio. Due to market conditions, we have not purchased any mortgage pools since August 2007.

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

Covered Commercial and SFR Real	March 31, 2013 *Loan Balance*	*Percent*	*Percent Owner-*	*Average Loan*

Estate Loans				*Occupied (1)*	*Balance*
(Dollars in thousands)					
Single-family residential	Direct	$ 1,321	0.8%	100.0%	$ 189
Single-family residential	Mortgage Pools				
Multi-family		4,156	2.6%		1,039
Industrial		32,143	19.9%	50.5%	554
Office		16,441	10.2%	39.9%	484
Retail		19,364	12.0%	31.8%	645
Medical		14,804	9.2%	82.7%	987
Secured by farmland		11,451	7.1%	100.0%	327
Other		61,710	38.2%	46.8%	949
		$ 161,390	100.0%	51.3%	742

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

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As of March 31, 2013, the Company had $55.7 million in non-covered construction loans. This represents 1.74% of total non-covered gross loans outstanding of $3.20 billion. Of this $55.7 million in construction loans, approximately 10.93%, or $6.1 million, were for single-family residences, residential land loans, and multi-family land development loans. The remaining construction loans, totaling $49.6 million, were related to commercial construction. The average balance of any single construction loan was approximately $2.1 million. Our construction loans are located throughout our marketplace as can be seen in the table below

As of March 31, 2013, the Company had $56.8 million in construction loans, both non-covered and covered. This represents 1.67% of gross loans outstanding of $3.40 billion. The following table presents a break-down of our non-covered construction loans excluding held for sale loans by county and type.

Non-Covered

Construction Loans *(Dollars in thousands)*	**March 31, 2013**		**SFR & Multi-family**			
	Land Development		**Construction**		**Total**	
Los Angeles County	$ 2,824	56.5%	$		$ 2,824	46.4%
Inland Empire	883	17.7%			883	14.5%
Central Valley	864	17.3%	1,095	100.0%	1,959	32.1%
Orange County						
Other Areas (1)	42 4	8.5%			424	7.0%
	$ 4,995	100.0%	$ 1,095	100.0%	$ 6,090	100.0%
Total Nonperforming	$		$		$	

	Commercial					
	Land Development		**Construction**		**Total**	
Los Angeles County	$ 731	12.4%	$ 24,898	56.9%	$ 25,629	51.7%
Inland Empire	832	14.2%	7,651	17.5%	8,483	17.1%
Central Valley	4,317	73.4%	564	1.3%	4,881	9.8%
Orange County						
Other Areas (1)			10,620	24.3%	10,620	21.4%
	$ 5,880	100.0%	$ 43,733	100.0%	$ 49,613	100.0%
Total Nonperforming	$		$ 10,663	24.4%	$ 10,663	21.5%

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

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

Covered

Construction Loans (Dollars in thousands)	**March 31, 2013**		**SFR & Multi-family**			
	Land Development		**Construction**		**Total**	
Central Valley	$ 32	100.0%	$ 1,029	100.0%	$ 1,061	100.0%

$ 32	100.0%	$	1,029	100.0%	$	1,061	100.0%

There were no covered commercial construction loans outstanding as of March 31, 2013.

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Nonperforming Assets (Non-Covered)

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

		March 31, 2013		December 31, 2012
		(Dollars in thousands)		
Nonaccrual loans	$	25,563	$	26,688
Troubled debt restructured loans (nonperforming)		29,566		31,309
Other real estate owned (OREO)		13,341		14,832
Total nonperforming assets	$	68,470	$	72,829
Troubled debt restructured performing loans	$	57,591	$	50,392
Percentage of nonperforming assets to total loans outstanding, net of deferred fees & OREO		2.14%		2.23%
Percentage of nonperforming assets to total assets		1.09%		1.14%

We had loans with a gross balance of $112.7 million classified as impaired as of March 31, 2013. This balance included nonperforming loans of $55.1 million. Impaired loans which were restructured in a troubled debt restructuring represented $87.2 million, of which $29.6 million were nonperforming and $57.6 million were performing, as of March 31, 2013. Of the $29.6 million in nonperforming TDRs, $14.5 million are not paying in accordance with the modified terms at March 31, 2013 and the remaining $15.0 million have either not demonstrated repayment performance for a sustained period and/or we have not received all necessary documents to determine the borrower s ability to meet all future principal and interest payments under the modified terms. As of December 31, 2012, we had impaired loans with a balance of $108.4 million. Impaired loans measured 3.53% of total non-covered loans as of March 31, 2013, compared to 3.33% as of December 31, 2012.

Of the total impaired loans as of March 31, 2013, $80.3 million were considered collateral dependent and measured using the fair value of the collateral based on current appraisals (obtained within 1 year). The amount of impaired loans measured using the present value of expected future cash flows discounted at the loans effective rate were $32.4 million.

At March 31, 2013 and December 31, 2012, TDRs of $57.6 million and $50.4 million, respectively, were classified as accruing restructured loans, respectively. At March 31, 2013, performing TDRs were comprised of 14 commercial real estate loans of $21.5 million, two construction loans of $16.9 million, 13 dairy and livestock loans of $16.0 million, seven single-family residential loans of $2.0 million, and eight commercial and industrial loans of $1.2 million. The performing restructurings were granted in response to borrower financial difficulty, and generally provide for a modification of loan repayment terms. The performing restructured loans represent the only impaired loans accruing interest at each respective date. A performing restructured loan is reasonably assured of repayment and is performing according to the modified terms

At March 31, 2013 and December 31, 2012, there was $1.8 million and $1.4 million of related allowance on TDRs, respectively. Impairment amounts identified are typically charged off against the allowance at the time a probable loss is determined. There were no charge-offs of TDRs for the three months ended March 31, 2013 and 2012.

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

At March 31, 2013, we had $13.3 million in OREO, a decrease of $1.5 million from the seven OREO properties totaling $14.8 million at December 31, 2012. During the three months ended March, 31, 2013, we sold three OREO properties with a carrying value of $1.4 million, realizing a net gain on sale of $136,000. There were no additions to OREO during the first quarter of 2013. We now have four non-covered OREO properties.

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

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Non-Performing Assets & Delinquency Trends

(Non-Covered Loans)

	March 31, 2013	December 31, 2012	September 30, 2012	June 30, 2012	March 31, 2012
			(Dollars in thousands)		
Nonperforming loans					
Residential construction and land	$	$	$	$	$ 920
Commercial construction and land	10,620	10,663	17,708	17,904	8,349
Residential mortgage	11,561	13,102	12,321	12,469	13,129
Commercial real estate	19,964	21,039	21,354	23,084	27,238
Commercial and industrial	3,387	3,136	3,896	4,622	4,082
Dairy and livestock	9,371	9,842	10,345	3,394	1,200
Agribusiness					
Consumer	161	215	364	388	308
Auto and equipment leases	65			4	86
Total	55,129	57,997	65,988	61,865	55,312
% of total gross loans	1.73%	1.78%	2.04%	1.95%	1.74%
Past due 30-89 days					
Residential construction and land					
Commercial construction and land					
Residential mortgage	824	107	650		4,109
Commercial real estate	1,820		298	1,041	5,798
Commercial and industrial	2,026	690	286	176	1,317
Dairy and livestock					
Agribusiness			170		
Consumer	63	82	72	36	13
Auto and equipment leases		8	213		
Total	4,733	887	1,689	1,253	11,237
% of total gross loans	0.15%	0.03%	0.05%	0.04%	0.35%
OREO					
Residential construction and land					
Commercial construction and land	12,513	12,513	7,117	7,117	7,117
Commercial real estate	828	2,319	3,153	2,407	4,173
Commercial and industrial			203	203	137
Residential mortgage				667	
Consumer					
Auto and equipment leases					
Total	13,341	14,832	10,473	10,394	11,427
Total nonperforming, past due, and OREO	$ 73,203	$ 73,716	$ 78,150	$ 73,512	$ 77,976
% of total gross loans	2.30%	2.27%	2.42%	2.32%	2.45%

We had $55.1 million in non-covered nonperforming loans, defined as nonaccrual loans and nonperforming TDRs, at March 31, 2013, or 1.73% of total non-covered loans. This compares to $58.0 million in nonperforming loans at December 31, 2012 and $55.3 million in nonperforming loans at March 31, 2012. Six customer relationships make up $30.2 million, or 54.82%, of our nonperforming loans at March 31, 2013. Three of these customer relationships are commercial real estate developers (owner/non-owner occupied); and the primary collateral for these loans is commercial real estate properties. The other three customer relationships are in the dairy and livestock industry; and the collateral is primarily the dairy farm property and the dairy livestock. These six customer relationships have had total charge-offs of $5.1 million and have $2.4 million of related allowance at March 31, 2013.

The economic downturn has had an impact on our market area and on our loan portfolio. We continually monitor these conditions in determining our estimates of needed reserves. However, we cannot predict the extent to which the deterioration in general economic conditions, real estate values, increases in general rates of interest, and changes in the financial conditions or business of a borrower may adversely affect a borrower s ability to pay. See Risk Management Credit Risk herein.

Nonperforming Assets-Covered

Loans acquired through the SJB acquisition are accounted for under ASC Topic 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality* (ASC 310-30). Covered loans accounted for under ASC 310-30 are generally considered accruing and performing

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loans as the loans accrete interest income over the estimated life of the loan when cash flows are reasonably estimable. Accordingly, acquired impaired loans that are contractually past due are still considered to be accruing and performing loans. If the timing and amount of future cash flows is not reasonably estimable, the loans may be classified as nonperforming loans and interest income is not recognized until the timing and amount of future cash flows can be reasonably estimated. As of March 31, 2013, there were no covered loans considered as nonperforming as described above. There were two properties in covered OREO totaling $857,000 as of March 31, 2013, compared to three properties totaling $1.1 million as of December 31, 2012.

Deposits

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

Total deposits were $4.69 billion at March 31, 2013. This represented a decrease of $87.8 million, or 1.84%, over total deposits of $4.77 billion at December 31, 2012. The composition of deposits is as follows:

	March 31, 2013		December 31, 2012	
	(Dollars in thousands)			
Noninterest bearing deposits				
Demand deposits	$ 2,366,719	50.5%	$ 2,420,993	50.7%
Interest-bearing deposits				
Savings deposits	1,607,541	34.3%	1,638,827	34.3%
Time deposits	711,901	15.2%	714,167	15.0%
Total deposits	$ 4,686,161	100.0%	$ 4,773,987	100.0%

The amount of noninterest-bearing demand deposits in relation to total deposits is an integral element in achieving a low cost of funds. Demand deposits totaled $2.37 billion at March 31, 2013, representing a decrease of $54.3 million, or 2.24%, from demand deposits of $2.42 billion at December 31, 2012. Noninterest-bearing demand deposits represented 50.50% of total deposits as of March 31, 2013, compared to 50.71% of total deposits as of December 31, 2012.

Savings deposits, which include savings, interest-bearing demand, and money market accounts, totaled $1.61 billion at March 31, 2013, representing a decrease of $31.3 million, or 1.91%, from savings deposits of $1.64 billion at December 31, 2012.

Time deposits totaled $711.9 million at March 31, 2013. This represented a decrease of $2.3 million, or 0.32%, from total time deposits of $714.2 billion at December 31, 2012.

Other Borrowed Funds

In order to enhance the Bank s spread between its cost of funds and interest-earning assets, we first seek noninterest-bearing deposits (the lowest cost of funds to the Company). Next, we pursue growth in interest-bearing deposits, and finally, we supplement the growth in deposits with borrowed funds (borrowings and customer repurchase agreements). Average borrowed funds, as a percent of average total funding (total deposits plus borrowed funds) was 13.99% for the three months ended March 31, 2013, compared to 17.53% for the same period in 2012.

At March 31, 2013, borrowed funds totaled $699.1 million. This represented a decrease of $939,000, or 0.13%, from total borrowed funds of $698.2 million at December 31, 2012.

In November 2006, we began a repurchase agreement product with our customers. This product, known as Citizens Sweep Manager, sells our investment securities overnight to our customers under an agreement to repurchase them the next day. These repurchase agreements are with customers who have other banking relationships with us. As of March 31, 2013 and December 31, 2012, total customer repurchases were $500.1 million and $473.2 million, respectively, with weighted average interest rates of 0.28% and 0.28%, respectively.

We entered into borrowing agreements with the FHLB. We had outstanding balances of $199.0 million and $198.9 million under these agreements at March 31, 2013 and December 31, 2012, respectively. The weighted average interest rate was 4.52% at March 31, 2013 and December 31, 2012. The FHLB holds certain investment securities and loans as collateral available for borrowings.

At March 31, 2013, $2.31 billion of loans and $2.30 billion of investment securities, at carrying value, were pledged to secure public deposits, short and long-term borrowings, and for other purposes as required or permitted by law.

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Aggregate Contractual Obligations

The following table summarizes our contractual commitments as of March 31, 2013:

			Maturity by Period		
	Total	Less Than One Year	One Year Through Three Years	Four Years Through Five Years	Over Five Years
			(Dollars in thousands)		
Deposits (1)	$ 4,686,161	$ 4,669,561	$ 12,635	$ 300	$ 3,665
Customer repurchase agreements (1)	500,115	500,115			
FHLB advance (1)	199,002			199,002	
Junior subordinated debentures (1)	46,393				46,393
Deferred compensation	9,259	1,098	1,592	967	5,602
Operating leases	18,576	5,202	6,793	4,345	2,236
Advertising agreements	4,649	1,049	1,600	1,600	400
Total	$ 5,464,155	$ 5,177,025	$ 22,620	$ 206,214	$ 58,296

(1) Amounts exclude accrued interest.

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

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

FHLB advance represent the amount that is due to the FHLB. This advance has a fixed maturity date of November 28, 2016.

Junior subordinated debentures represent the amounts that are due from the Company to CVB Statutory Trust II & CVB Statutory Trust III. The debentures have the same maturity as the Trust Preferred Securities. CVB Statutory Trust II matures in 2034, and became callable in whole or in part in January 2009. CVB Statutory Trust III, which matures in 2036, became callable in whole or in part in March 2011.

On January 7, 2013 we redeemed $20.6 million, or 50%, of the outstanding capital and common securities issued by the Company s trust subsidiary, CVB Statutory Trust II. On April 7, 2013, we redeemed the remaining $20.6 million of the outstanding capital and common securities issued by CVB Statutory Trust II.

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

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

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

Off-Balance Sheet Arrangements

The following table summarizes the off-balance sheet arrangements at March 31, 2013:

			Maturity by Period		
	Total	Less Than One	One Year to Three	Four Years to Five	After Five

		Year	Years	Years	Years
			(Dollars in thousands)		
Commitments to extend credit	$ 593,408	$ 438,268	$ 80,236	$ 16,507	$ 58,397
Obligations under letters of credit	41,303	36,116	5,187		
Total	$ 634,711	$ 474,384	$ 85,423	$ 6,507	$ 58,397

As of March 31, 2013, we had commitments to extend credit of approximately $593.4 million, and obligations under letters of credit of $41.3 million. Commitments to extend credit are agreements to lend to customers, provided there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Commitments are generally variable rate, and many of these commitments are expected to expire without being drawn upon. As such, the total commitment amounts do not necessarily represent future cash requirements. We use the same credit underwriting policies in granting or accepting such commitments or contingent obligations as we do for on-balance sheet instruments, which consist of evaluating customers creditworthiness individually. The Company had a reserve for undisbursed commitments of $8.6 million as of March 31, 2013 and December 31, 2012 included in other liabilities.

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

Liquidity and Cash Flow

Since the primary sources and uses of funds for the Company are loans and deposits, the relationship between gross loans and total deposits provides a useful measure of the Bank s liquidity. Typically, the closer the ratio of loans to deposits is to 100%, the more reliant we are on loan portfolio interest and principal payments to provide for short-term liquidity needs. Since repayment of loans tends to be less predictable than the maturity of investments and other liquid resources, the higher the loans to deposit ratio the less liquid are the Company s assets. For the first three months of 2013, the loan to deposit ratio averaged 72.35% compared to an average ratio of 73.73% for the same period in 2012. The ratio of loans to deposits and customer repurchases averaged 64.93% for the first three months of 2013 and 66.07% for the same period in 2012.

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

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

At March 31, 2013, approximately $24.2 million of the Bank s equity was unrestricted and available to be paid as dividends to CVB. Management of the Company believes that such restrictions will not have any current impact on the ability of CVB to meet its ongoing cash obligations. As of March 31, 2013, neither the Bank nor CVB had any material commitments for capital expenditures.

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

Net cash provided by operating activities totaled $8.3 million for the first three months of 2013, compared to $34.6 million for the same period last year. The decrease in cash provided by operating activities was primarily attributed to an increase in income taxes as well as a decrease in interest and dividends received, partially offset by a decrease in interest paid,

Net cash provided by investing activities totaled $136.0 million for the first three months of 2013, compared to net cash used of $133.1 million for the same period in 2012. The cash provided by investing activities was primarily the result of a decrease in purchases of investment securities, an increase in proceeds from sale of investment securities and a decrease in loan and lease finance receivables, partially offset by a decrease in proceeds from maturity of investment securities during the first three months of 2013.

Net cash used in financing activities totaled $107.5 million for the first three months of 2013, compared to net cash provided by financing activities of $29.5 million for the same period last year. The cash used in financing activities during the first three months of 2013 was primarily due to a decrease in total deposits, the redemption of $26.0 million of other borrowings and $20.6 million for repayment of junior subordinated debentures in 2013, partially offset by an increase in customer repurchase agreements.

At March 31, 2013, cash and cash equivalents totaled $135.3 million. This represented a decrease of $141.0 million, or 51.04%, from $276.3 million at March 31, 2012 and a decrease of $36.8 million, or 37.43%, from $98.4 million at December 31, 2012.

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Capital Resources

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

The Company s equity capital was $768.2 million at March 31, 2013. This represented an increase of $5.2 million, or 0.69%, from equity capital of $763.0 million at December 31, 2012. The increase during the first three months of 2013 resulted primarily from $21.6 million in net earnings, partially offset by a decrease of $8.0 million in other comprehensive income, net of tax, resulting from the change in fair value of our investment portfolio, $8.9 million of common stock dividends declared, and $537,000 for shares issued pursuant to our stock-based compensation plan.

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

The Bank and the Company are required to meet risk-based capital standards set by their respective regulatory authorities. The risk-based capital standards require the achievement of a minimum ratio of total capital to risk-weighted assets of 8.0% (of which at least 4.0% must be Tier 1 capital). In addition, the regulatory authorities require the highest rated institutions to maintain a minimum leverage ratio of 4.0%. To be considered well-capitalized for bank regulatory purposes, the Bank and the Company are required to have a Tier 1 risk-based capital ratio equal to or greater than 6%, a total risk-based capital ratio equal to or greater than 10% and a Tier 1 leverage ratio equal to or greater than 5%. At March 31, 2013, the Bank and the Company exceeded the minimum risk-based capital ratios and leverage ratios required to be considered well-capitalized for regulatory purposes.

During the first three months of 2013, the Board of Directors of the Company declared a quarterly common stock cash dividend of $0.085 per share. Dividends are payable at the discretion of the Board of Directors and there can be no assurance that the Board of Directors will continue to pay dividends at the same rate, or at all, in the future. CVB s ability to pay cash dividends to its shareholders is subject to restrictions under federal and California law, including restrictions imposed by the FRB and covenants set forth in various agreements we are a party to including covenants set forth in our junior subordinated debentures.

In July 2008, our Board of Directors authorized the repurchase of up to 10,000,000 shares of our common stock. During the first three months of 2013, we repurchased zero of our common stock outstanding. As of March 31, 2013, we have 7,765,171 shares of our common stock remaining that are eligible for repurchase.

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

			March 31, 2013		December 31, 2012	
Capital Ratios	**Adequately Capitalized Ratios**	**Well Capitalized Ratios**	**CVB Financial Corp.**	**Citizens Business Bank**	**CVB Financial Corp.**	**Citizens Business Bank**
Tier 1 leverage capital ratio	4.00%	5.00%	11.54%	11.12%	11.50%	11.21%
Tier 1 risk-based capital ratio	4.00%	6.00%	18.36%	17.69%	18.23%	17.77%
Total risk-based capital ratio	8.00%	10.00%	19.63%	18.96%	19.49%	19.03%

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RISK MANAGEMENT

We have adopted a Risk Management Plan which seeks to implement the proper control and management of all risk factors inherent in the operation of the Company and the Bank. Specifically, credit risk, interest rate risk, liquidity risk, counterparty risk, transaction risk, compliance risk, strategic risk, reputation risk, cybersecurity risk, price risk and foreign exchange risk, can all affect the market risk exposure of the Company. These specific risk factors are not mutually exclusive. It is recognized that any product or service offered by us may expose the Bank to one or more of these risks. Our Risk Management Committee and Risk Management Division monitor these risks to minimize exposure to the Company.

Credit Risk

Credit risk is defined as the risk to earnings or capital arising from an obligor s failure to meet the terms of any contract or otherwise fail to perform as agreed. Credit risk is found in all activities where success depends on a counter party, issuer, or borrower performance. Credit risk arises through the extension of loans and leases, certain securities, and letters of credit.

Severe hurricanes, storms, earthquakes and other weather conditions, as well as natural disasters and problems related to possible climate changes, may from time-to-time cause or create the risk of damage to facilities, buildings, property or other assets of Bank customers, borrowers or municipal debt issuers. This could in turn affect their financial condition or results of operations and as a consequence their ability or capacity to repay debt or fulfill other obligations to the Bank. While we do not currently have reason to believe that any of the Bank s loans or municipal securities are materially impaired as a result of such damage, there can be no assurance that this will continue to be the case, particularly where recent storms and natural disasters whose impact is still being evaluated by the concerned parties.

Credit risk in the investment portfolio and correspondent bank accounts is in part addressed through defined limits in the Company s policy statements. In addition, certain securities carry insurance to enhance the credit quality of the bond. Limitations on industry concentration, aggregate customer borrowings, geographic boundaries and standards on loan quality also are designed to reduce loan credit risk. Senior Management, Directors Committees, and the Board of Directors are provided with information to appropriately identify, measure, control and monitor the credit risk of the Company.

The general loan policy is updated annually and approved by the Board of Directors. It prescribes underwriting guidelines and procedures for all loan categories in which the Bank participates to establish risk tolerance and parameters that are communicated throughout the Bank to ensure consistent and uniform lending practices. The underwriting guidelines include, among other things, approval limitation and hierarchy, documentation standards, loan-to-value limits, debt coverage ratio, overall credit-worthiness of the borrower, guarantor support, etc. All loan requests considered by the Bank should be for a clearly defined legitimate purpose with a determinable primary source, as well as alternate sources of repayment. All loans should be supported by appropriate documentation including, current financial statements, credit reports, collateral information, guarantor asset verification, tax returns, title reports, appraisals (where appropriate), and other documents of quality that will support the credit.

The major lending categories are commercial and industrial loans, owner-occupied and non owner-occupied commercial real estate loans, construction loans, dairy and livestock loans, agricultural loans, residential real estate loans, and various consumer loan products. Loans underwritten to borrowers within these diverse categories require underwriting and documentation suited to the unique characteristics and inherent risks involved.

Commercial and industrial loans require credit structures that are tailored to the specific purpose of the business loan, involving a thorough analysis of the borrower s business, cash flow, collateral, industry risks, economic risks, credit, character, and guarantor support. Owner-occupied real estate loans are primarily based upon the capacity and stability of the cash flow generated by the occupying business and the market value of the collateral, among other things. Non owner-occupied real estate is typically underwritten to the income produced by the subject property and many considerations unique to the various types of property (i.e. office, retail, warehouse, shopping center, medical, etc.), as well as, the financial support provided by sponsors in recourse transactions. Construction loans will often depend on the specific characteristics of the project, the market for the specific development, real estate values, and the equity and financial strength of the sponsors. Dairy and livestock loans and agricultural loans are largely predicated on the revenue cycles and demand for milk and crops, commodity prices, collateral values of herd, feed, and income-producing dairies or croplands, and the financial support of the guarantors. Underwriting of residential real estate and consumer loans are generally driven by personal income and debt service capacity, credit history and scores, and collateral values.

Implicit in lending activities is the risk that losses will occur and that the amount of such losses will vary over time. Consequently, we maintain an allowance for credit losses by charging a provision for credit losses to earnings. Loans, including impaired loans, determined to be losses are charged against the allowance for credit losses. Our allowance for credit losses is maintained at a level considered by us to be appropriate to provide for estimated probable losses inherent in the existing portfolio. In this regard, it is important to note that the Bank s practice with regard to impaired loans, including modified loans or troubled debt restructurings that are classified as impaired, is to generally charge off any impairment amount against the ALLL upon evaluating the

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loan using one of the three methods described in ASC 310-10-35 at the time a probable loss becomes recognized. As such, the Bank s specific allowance for impaired loans, including troubled debt restructurings, is relatively low as a percentage of impaired loans outstanding since any known impairment amount will generally have been charged off.

The allowance for credit losses is based upon estimates of probable losses inherent in the loan and lease portfolio. The nature of the process by which we determine the appropriate allowance for credit losses requires the exercise of considerable judgment. The amount actually observed in respect of these losses can vary significantly from the estimated amounts. We employ a systematic methodology that is intended to reduce the differences between estimated and actual losses.

Central to our credit risk management is its loan risk rating system. The originating credit officer assigns borrowers an initial risk rating, which is reviewed and possibly changed by Credit Management. The risk rating is based primarily on an analysis of each borrower s financial capacity in conjunction with industry and economic trends. Credit approvals are made based upon our evaluation of the inherent credit risk specific to the transaction and are reviewed for appropriateness by senior line and Credit Management personnel. Credits are monitored by line and Credit Management personnel for deterioration in a borrower s financial condition, which would impact the ability of the borrower to perform under the contract. Risk ratings may be adjusted as necessary.

Loans are risk rated into the following categories: Pass, Pass Watch List, Special Mention, Substandard, Doubtful, and Loss. Each of these groups is assessed and appropriate amounts used in determining the adequacy of our allowance for losses. The Impaired and Doubtful loans are analyzed on an individual basis for allowance amounts. The other categories have formulae used to determine the needed allowance amount.

The Company obtains a quarterly independent credit review by engaging an outside party to review a sample of our loans and leases. The primary purpose of this review is to evaluate our existing loan ratings and provide an assessment as to the effectiveness of our allowance process.

Our methodology for assessing the appropriateness of the allowance is conducted on a regular basis and considers all loans. The systematic methodology consists of two major phases.

In the first phase, individual loans are reviewed to identify loans for impairment. A loan is generally considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the original contractual terms of the loan. A loan for which there is an insignificant delay in the amount of payments is not considered an impaired loan. Utilizing one of the three methods described in ASC 310-10-35-22, impairment is measured based on either the expected future cash flows discounted at each loan s effective interest rate, the fair value of the loan s collateral if the loan is collateral dependent, or an observable market price of the loan (if one exists). Upon measuring the loan s impairment, we then take appropriate steps to ensure an appropriate level of allowance is present or established, including possible charge-off.

The Bank evaluates a loan s collectability from information developed through our loan risk rating system and process, and other sources of information that asset management in monitoring loan performance (e.g. past due loan reports). The Bank then identifies loans for evaluation of impairment and establishes specific allowances in cases where we have identified significant conditions or circumstances related to a credit that we believe indicates the probability that a loss has been incurred. We perform a detailed analysis of these loans, including, but not limited to, cash flows, appraisals of the collateral, conditions of the marketplace for liquidating the collateral and assessment of the guarantors. We then determine the impairment under ASC 310-10, which requires judgment and estimates, and allocate a portion of the allowance for losses as a specific allowance for each of these loans, or charge off the impairment amount as described above. The eventual outcomes may differ from the estimates used to determine the impairment amount.

The second phase is conducted by evaluating or segmenting the remainder of the loan portfolio into groups or pools of loans with similar characteristics in accordance with ASC No. 450-10, Contingencies. In this second phase, groups or pools of homogeneous loans are reviewed to determine a portfolio formula allowance. In the case of the portfolio formula allowance, homogeneous portfolios, such as small business loans, consumer loans, agricultural loans, and real estate loans, are aggregated or pooled in determining the appropriate allowance. The risk assessment process in this case emphasizes trends in the different portfolios for delinquency, loss, and other behavioral characteristics of the subject portfolios.

Included in this second phase is our consideration of known relevant internal and external factors that may affect a loan s collectability. This includes our estimates of the amounts necessary for concentrations, economic uncertainties, the volatility of the market value of collateral, and other relevant factors. We perform an evaluation of various conditions, the effects of which are not directly measured in the determination of the formula and specific allowances. The evaluation of the inherent loss with respect to these conditions is subject to a higher degree of uncertainty because they are not identified with specific problem credits or portfolio segments. The conditions evaluated include, but are not limited to the following conditions that existed as of the balance sheet date:

then-existing general economic and business conditions affecting the key lending areas of the Company,

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- then-existing economic and business conditions of areas outside the lending areas, such as other sections of the United States,
- credit quality trends (including trends in past due loans, adversely graded loans, and nonperforming loans expected to result from existing conditions),
- collateral values, including changes in the value of underlying collateral for collateral-dependent loans,
- the existence and effect of any concentrations of credit, and changes in the level of such concentrations,
- changes in loan volumes,
- specific industry conditions within portfolio segments,
- recent loss experience in particular segments of the portfolio,
- duration of the current business cycle,
- the effect of external factors such as legal and regulatory requirements, including bank regulatory examination results and findings of the Company s external credit examiners.

We review these conditions in discussion with our senior credit officers. To the extent that any of these conditions is evidenced by a specifically identifiable problem credit or portfolio segment as of the evaluation date, our estimate of the effect of such condition may be reflected as a specific allowance applicable to such credit or portfolio segment. Where any of these conditions is not evidenced by a specifically identifiable problem credit or portfolio segment as of the evaluation date, our evaluation of the inherent loss related to such condition is reflected in the second phase of the allowance. Although we have allocated a portion of the allowance to specific loan categories, the appropriateness of the allowance must be considered in its entirety.

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.

We maintain an allowance for inherent credit losses that is increased by a provision for credit losses charged against operating results. The allowance for credit losses is also increased by recoveries on loans previously charged-off and reduced by actual loan losses charged to the allowance. We recorded zero provision for credit losses for the three months ended March 31, 2013 and 2012.

The allowance for credit losses was $92.2 million as of March 31, 2013. This represents a decrease of $223,000, or 0.24%, compared to the allowance for credit losses of $92.4 million as of December 31, 2012.

The table below presents a comparison of net credit losses, the provision for credit losses, and the resulting allowance for credit losses for the nine months ended March 31, 2013 and 2012.

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Summary of Credit Loss Experience

(Non-Covered Loans)

	As of and For the Three Months Ended March 31, 2013	2012
	(Dollars in thousands)	
Allowance for credit losses at beginning of period	$ 92,441	$ 93,964
Loans charged-off:		
Real estate loans	142	530
Commercial and industrial	357	560
Dairy and livestock/Agribusiness		1,150
Consumer, auto and other loans	47	85
Total loans charged-off	546	2,325
Recoveries:		
Construction	126	27
Real estate loans	71	221
Commercial and industrial	99	62
Dairy and livestock/Agribusiness	14	
Consumer, auto and other loans	13	4
Total loans recovered	323	314
Charge-offs, net of recoveries	223	2,011
Other reallocation		(31)
Provision for credit losses		
Allowance for credit losses at end of period	$ 92,218	$ 91,922
Summary of reserve for unfunded commitments:		
Reserve for unfunded commitments at beginning of period	$ 8,588	$ 9,588
Provision for unfunded commitments		
Reserve for unfunded commitments at end of period	$ 8,588	$ 9,588
Amount of total loans at end of period (1)	$ 3,189,514	$ 3,186,013
Average total loans outstanding (1)	$ 3,197,413	$ 3,176,919
Net loans charged-off to average total loans	0.01%	0.06%
Net loans charged-off to total loans at end of period	0.01%	0.06%
Allowance for credit losses to average total loans	2.88%	2.89%
Allowance for credit losses to total loans at end of period	2.89%	2.89%
Net loans charged-off to allowance for credit losses	0.24%	2.19%
Net loans charged-off to provision for credit losses		

(1) Net of deferred loan origination fees.

During the three months ended March 31, 2013, there was zero net charge-offs for covered loans in excess of the amount originally expected in the fair value of the loans at acquisition. During the first quarter of 2012, there was $31,000 in net charge-offs for covered loans, resulting in a $31,000 provision for credit losses on the covered SJB loans. An offsetting adjustment was recorded to the FDIC loss-sharing asset based on the appropriate loss-sharing percentage.

While we believe that the allowance at March 31, 2013, was appropriate to absorb losses from any known or inherent risks in the portfolio, no assurance can be given that economic conditions, conditions of our borrowers, or natural disasters, which adversely affect our service areas or other circumstances or conditions, including those defined above, will not be reflected in increased provisions for credit losses in the future.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market Risk

In the normal course of its business activities, we are exposed to market risks, including price and liquidity risk. Market risk is the potential for loss from adverse changes in market rates and prices, such as interest rates (interest rate risk). Liquidity risk arises from the possibility that we may not be able to satisfy current or future commitments or that we may be more reliant on alternative funding sources such as long-term debt. Financial products that expose us to market risk include securities, loans, deposits, debt, and derivative financial instruments.

Counterparty Risk

Recent developments in the financial markets have placed an increased awareness of Counterparty Risks. These risks occur when a financial institution has an indebtedness or potential for indebtedness to another financial institution. We have assessed our Counterparty Risk with the following results:

- We do not have any investments in the preferred stock of any other company.
- We have one issuance of a trust preferred security totaling $5.0 million with a large financial institution.
- Most of our investment securities are either municipal securities, callable agencies or securities backed by mortgages, Fannie Mae, Freddie Mac, SBA or FHLB.
- All of our commercial line insurance policies are with companies with the highest AM Best ratings of A or above.
- We have no significant exposure to our Cash Surrender Value of Life Insurance since the Cash Surrender Value balance is with insurance companies that carry an AM Best rating of A- or greater and only one company has a B+ rating.
- We have no significant Counterparty exposure related to derivatives such as interest rate swaps with a major financial institution as our agreement requires the Counterparty to post cash collateral for mark-to-market balances due to us.
- We believe our risk of loss associated with our counterparty borrowers related to interest rate swaps is generally mitigated as the loans with swaps are underwritten to take into account potential additional exposure.
- We have $446.0 million in Fed Funds lines of credit with other banks. All of these banks are major U.S. banks, each with over $20.0 billion in assets. We rely on these funds for overnight borrowings. We currently have no outstanding Fed Funds balance.
- Our secured borrowing capacity with the FHLB was $2.10 billion, of which $1.88 billion was available as of March 31, 2013.

Interest Rate Risk

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

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

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

Approximately $1.37 billion, or 60%, of the total investment portfolio at March 31, 2013 consisted of securities backed by mortgages. The final maturity of these securities can be affected by the speed at which the underlying mortgages repay. Mortgages tend to repay faster as interest rates fall, and slower as interest rates rise. As a result, we may be subject to a prepayment risk resulting from greater funds available for reinvestment at a time when available yields are lower. Conversely, we may be subject to extension risk resulting, as lesser amounts would be available for reinvestment at a time when available yields are higher. Prepayment risk includes the risk associated with the payment of an investment s principal faster than originally intended. Extension risk is the risk associated with the payment of an investment s principal over a longer time period than originally anticipated. In addition, there can be greater risk of price volatility for mortgage-backed securities as a result of anticipated prepayment or extension risk.

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

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

The following depicts the Company s net interest income sensitivity analysis as of March 31, 2013:

Simulated Rate Changes	Estimated Net Interest Income Sensitivity (1)
+ 200 basis points	(0.32%)
- 100 basis points	(0.63%)

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

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

Liquidity Risk

Liquidity risk is the risk to earnings or capital resulting from our inability to meet obligations when they come due without incurring unacceptable losses. It includes the ability to manage unplanned decreases or changes in funding sources and to recognize or address changes in market conditions that affect our ability to liquidate assets quickly and with minimum loss of value. Factors considered in liquidity risk management are stability of the deposit base; marketability, maturity, and pledging of investments; and the demand for credit.

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

Management has a Liquidity Committee that meets quarterly. The Committee analyzes the cash flows from loans, investments, deposits and borrowings. In addition, the Company has a Balance Sheet Management Committee of the Board of Directors that meets monthly to review the Company s balance sheet position and liquidity which includes, but is not limited to a: (i) Liquidity Report; (ii) Capital Volatility Report; (iii) Investment Portfolio Activities Report; (iv) Sources and Uses of Funds Report and (v) Balance Sheet Management Policy Report. On a periodic basis, projected cash flows are analyzed and stressed to determine potential liquidity issues. A contingency plan contains the steps the Company would take to mitigate a liquidity crisis. Results of the cash flows are reported to the Balance Sheet Management Committee on a periodic basis.

Transaction Risk

Transaction risk is the risk to earnings or capital arising from problems in service or product delivery. This risk is significant within any bank and is interconnected with other risk categories in most activities throughout the Company. Transaction risk is a function of internal controls, information systems, associate integrity, and operating processes. It arises daily throughout the Company as transactions are processed. It pervades all divisions, departments and centers and is inherent in all products and services we offer.

In general, transaction risk is defined as high, medium or low by the internal audit process. The audit plan ensures that high risk areas are reviewed annually. We utilize internal auditors and independent professional service firms to test key controls of operational processes and to audit information systems, compliance management program, loan review and trust services.

The key to monitoring transaction risk is in the design, documentation and implementation of well defined procedures. Any system of controls, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, but not absolute, assurances of the effectiveness of these systems and controls, and that the objectives of these controls have been met.

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Compliance Risk

Compliance risk is the risk to earnings or capital arising from violations of, or non-conformance with, laws, rules, regulations, prescribed practices, or ethical standards. Compliance risk also arises in situations where the laws or rules governing certain products or activities of the Bank s customers may be ambiguous or untested. Compliance risk exposes us to fines, civil money penalties, payment of damages, and the voiding of contracts. Compliance risk can also lead to a diminished reputation, reduced business value, limited business opportunities, lessened expansion potential, and lack of contract enforceability.

There is no single or primary source of compliance risk. It is inherent in every activity. Frequently, it blends into operational risk and transaction risk. A portion of this risk is sometimes referred to as legal risk. This is not limited solely to risk from failure to comply with consumer protection laws; it encompasses all laws, as well as prudent ethical standards and contractual obligations. It also includes the exposure to litigation from all aspects of banking, traditional and non-traditional.

Our Risk Management Policy and Program and the Code of Ethical Conduct are cornerstones for controlling compliance risk. An integral part of controlling this risk is the proper training of associates. The Chief Risk Officer is responsible for developing and executing a comprehensive compliance training program. The Chief Risk Officer seeks to provide our associates with adequate training relevant to their job functions to enhance compliance with banking laws and regulations.

Our Risk Management Policy and Program includes an audit program aimed at identifying problems and ensuring that problems are corrected. The audit program includes two levels of review. One is in-depth audits performed by our internal audit department under the direction of the Chief Risk Officer and supplemented by independent external firms, and the other is periodic monitoring performed by the Risk Management Division. Each year, an Audit Plan for the Company is developed and approved by the Audit Committee of the Board.

The Company utilizes independent external firms to conduct compliance audits as a means of identifying weaknesses in the compliance program. The annual Audit Plan includes a review of selected centers and departments.

The Risk Management Division conducts periodic monitoring of our compliance efforts with a special focus on those areas that expose us to compliance risk. The purpose of the periodic monitoring is to verify whether our associates are adhering to established policies and procedures. The Chief Risk Officer will notify the appropriate department head and the Management Compliance Committee, the Audit Committee and the Risk Management Committee of any material exceptions found and noted.

We recognize that customer complaints can often identify weaknesses in our compliance program which could expose us to risk. Therefore, we try to ensure that all complaints are given prompt attention. Our Risk Management Policy and Program include provisions on how customer complaints are to be addressed. The Chief Risk Officer reviews formal complaints to determine if a significant compliance risk exists and communicates those findings to the Risk Management Committee.

Strategic Risk

Strategic risk is the risk to earnings or capital arising from adverse decisions or improper implementation of strategic decisions. This risk is a function of the compatibility between an organization s goals, the resources deployed against those goals and the quality of implementation.

Strategic risks are identified as part of the strategic planning process. Offsite strategic planning sessions, including members of the Board of Directors and Senior Leadership, are held annually. The strategic review consists of an economic assessment, competitive analysis, industry outlook and legislative and regulatory review.

A primary measurement of strategic risk is peer group analysis. Key performance ratios are compared to three separate peer groups to identify any sign of weakness and potential opportunities. The peer group consists of:

1. Banks of comparable size

2. High performing banks

3. A list of specific banks

Another measure is the comparison of the actual results of previous strategic initiatives against the expected results established prior to implementation of each strategy.

The corporate strategic plan is formally presented to all center managers and department managers at an annual leadership conference.

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Reputation Risk

Reputation risk is the risk to capital and earnings arising from negative public opinion. This affects the Bank s ability to establish new relationships or services, or continue servicing existing relationships. It can expose the Bank to litigation and, in some instances, financial loss.

Cybersecurity and Fraud Risk

Cybersecurity and fraud risk refers to the risk of failures, interruptions of services, or breaches of security with respect to the Company s or the Bank s communication, information, operations, financial control, customer internet banking, data processing systems or applications. In addition, the Company and the Bank rely primarily on third party providers to develop, manage, maintain and protect these systems and applications. Any such failures, interruptions or fraud or security breaches, depending on the scope, duration, affected system(s) or customers(s), could expose the Company and/or the Bank to financial loss, reputation damage, litigation, or regulatory action.

Price and Foreign Exchange Risk

Price risk arises from changes in market factors that affect the value of traded instruments. Foreign exchange risk is the risk to earnings or capital arising from movements in foreign exchange rates.

Our current exposure to price risk is nominal. We do not have trading accounts. Consequently, the level of price risk within the investment portfolio is limited to the need to sell securities for reasons other than trading. The section of this policy pertaining to liquidity risk addresses this risk.

We maintain deposit accounts with various foreign banks. Our Interbank Liability Policy seeks to limit the balance in any of these accounts to an amount that does not in our judgment present a significant risk to our earnings from changes in the value of foreign currencies.

Our asset liability model seeks to calculate the market value of the Bank s equity. In addition, management prepares, on a monthly basis, a capital volatility report that compares changes in the market value of the investment portfolio. We have as our target to always be well-capitalized by regulatory standards.

The Balance Sheet Management Policy requires the submission of a Fair Value Matrix Report to the Balance Sheet Management Committee on a quarterly basis. The report seeks to calculate the economic value of equity under different interest rate scenarios, revealing the level or price risk of the Bank s interest sensitive asset and liability portfolios.

ITEM 4. CONTROLS AND PROCEDURES

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

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

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PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Certain lawsuits and claims arising in the ordinary course of business have been filed or are pending against us or our affiliates. Where appropriate, we establish reserves in accordance with FASB guidance over contingencies (ASC 450). The outcome of litigation and other legal and regulatory matters is inherently uncertain, however, and it is possible that one or more of the legal or regulatory matters currently pending or threatened could have a material adverse effect on our liquidity, consolidated financial position, and/or results of operations. As of March 31, 2013, the Company does not have any litigation reserves.

In addition, the Company is involved in the following significant legal actions and complaints.

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

In the wake of the Company s disclosure of the SEC investigation, on August 23, 2010, a purported shareholder class action complaint was filed against the Company in an action captioned Lloyd v. CVB Financial Corp., et al., Case No. CV 10-06256-MMM, in the United States District Court for the Central District of California. Along with the Company, Christopher D. Myers (President and Chief Executive Officer) and Edward J. Biebrich, Jr. (our former Chief Financial Officer) were also named as defendants. On September 14, 2010, a second purported shareholder class action complaint was filed against the Company, in an action originally captioned Englund v. CVB Financial Corp., et al., Case No. CV 10-06815-RGK, in the United States District Court for the Central District of California. The Englund complaint named the same defendants as the Lloyd complaint and made allegations substantially similar to those included in the Lloyd complaint. On January 21, 2011, the Court consolidated the two actions for all purposes under the Lloyd action now captioned as Case No. CV 10-06256-MMM (PJWx). That same day, the Court also appointed the Jacksonville Police and Fire Pension Fund (the Jacksonville Fund) as lead plaintiff in the consolidated action and approved the Jacksonville Fund s selection of lead counsel for the plaintiffs in the consolidated action. On March 7, 2011, the Jacksonville Fund filed a consolidated complaint naming the same defendants and alleging violations by all defendants of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder and violations by the individual defendants of Section 20(a) of the Exchange Act. Specifically, the complaint alleges that defendants misrepresented and failed to disclose conditions adversely affecting the Company throughout the purported class period, which is alleged to be between October 21, 2009 and August 9, 2010. The consolidated complaint seeks compensatory damages and other relief in favor of the purported class.

Following the filing by each side of various motions and memoranda and a hearing on August 29, 2011, the District Court issued a ruling on January 12, 2012, granting defendants motion to dismiss the consolidated complaint, but the ruling provided the plaintiffs with leave to file an amended complaint within 45 days of the date of the order. On February 27, 2012, the plaintiffs filed a first amended complaint against the same defendants, and once again, following filings by both sides and another hearing on June 4, 2012, the District Court issued a ruling on August 21, 2012, granting defendants motion to dismiss the first amended complaint, but providing the plaintiffs with leave to file another amended complaint within 30 days of the ruling. On September 20, 2012, the plaintiffs filed a second amended complaint against the same defendants, and the Company filed its third motion to dismiss on October 25, 2012. The District Court held a hearing on the Company s third motion to dismiss on February 25, 2013, and subsequent to the end of the first quarter of 2013, on May 9, 2013, the District Court issued an order again dismissing the plaintiffs complaint, but providing the plaintiffs with leave to file a third amended complaint within 30 days. The Company intends to continue to vigorously contest the plaintiff s allegations in this case.

On February 28, 2011, a purported and related shareholder derivative complaint was filed in an action captioned Sanderson v. Borba, et al., Case No. CIVRS1102119, in California State Superior Court in San Bernardino County. The complaint names as defendants the members of our board of directors and also refers to unnamed defendants allegedly responsible for the conduct alleged. The Company is included as a nominal defendant. The complaint alleges breaches of fiduciary duties, abuse of control, gross mismanagement and corporate waste. Specifically, the complaint alleges, among other things, that defendants engaged in accounting manipulations in order to falsely portray the Company s financial results in connection with its commercial real estate portfolio. Plaintiff seeks compensatory and exemplary damages to be paid by the defendants and awarded to the Company, as well as other relief. On June 20, 2011, defendants filed a demurrer requesting dismissal of the derivative complaint. Following the filing by each side of additional motions, the parties have subsequently filed repeated notices to postpone the Court s hearing on the defendants demurrer, pending resolution of the federal securities shareholder class action complaint, and these postponements are currently extended to at least September 11, 2013.

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

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ITEM 1A. RISK FACTORS

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

From time to time, global or national financial events or developments could result in economic uncertainty, cause volatility in global stock markets, and/or have a significant impact on economic conditions, including the credit risk and interest rate risk environments, which in turn could have a material adverse effect on our business, financial condition, liquidity, results of operations and ability to make distributions to our shareholders.

Examples of recent global and national events and developments that could have one or more of the impacts or effects described above may include; Standard & Poor s decision in 2011 to downgrade the U.S. Government s credit rating (and the possibility of similar actions by other statistical rating agencies), downgrades of sovereign debt of other nations, lack of global liquidity, uncertainty and possible economic turmoil resulting from concerns about government debt levels, changes in the terms or cost of deposit insurance, changes in tax laws, currency values and the risk of economic contraction in the U.S., Europe and/or Asia. These events could create global or national financial dislocation, and cause the credit risk on our loans and other assets, and the interest rates on our borrowings and our cost of capital, to increase, decrease or fluctuate significantly. These adverse consequences could extend to the borrowers of the loans that we own and originate and, as a result, could materially and adversely affect returns on our investments, the ability of our borrowers to continue to pay their debt service or refinance and repay their loans and other obligations as they become due and our ability to continue to originate assets on favorable terms. Any such adverse consequences could also result in significant volatility in global stock markets, which could cause the market price of our common stock to decrease. In addition, there may be other events and developments, similar in consequence or concern, that we cannot currently predict and whose current or future impact or effect on the Company and the Bank cannot be precisely quantified.

We and our customers are exposed to internal and external fraud risks and cybersecurity risks, and the Bank may incur increasing costs and liability in an effort to minimize those risks and to respond to fraud and/or cyber incidents. While the Bank seeks to implement anti-fraud and cyber-security measures that we believe are commercially reasonable, it is possible that, regardless of the Bank s responsibility for a security breach or fraud loss, the Bank could be held liable for any such breach or loss. We have security measures and processes in place in an effort to protect against these fraud and cyber-security risks but fraud and cyber-attacks are rapidly evolving and we may not be able to anticipate or prevent all such attacks. Any fraud or other compromise of our security could result in a violation of privacy or other laws, significant legal and financial exposure, loss of Bank or customer funds, damage to our reputation, and a loss of confidence in our security measures, which could harm our business or financial condition.

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

On July 16, 2008, our Board of Directors approved a program to repurchase up to 10,000,000 shares of our common stock (such number will not be adjusted for stock splits, stock dividends, and the like) in the open market or in privately negotiated transactions, at times and at prices considered appropriate by us, depending upon prevailing market conditions and other corporate and legal considerations. There is no expiration date for our current stock repurchase program. There were no issuer repurchases of the Company s common stock as part of its repurchase program in the first quarter of 2013. As of March 31, 2013, there were 7,765,171 shares remaining to be purchased.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not Applicable

ITEM 4. MINE SAFETY DISCLOSURES

Not Applicable

ITEM 5. OTHER INFORMATION

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ITEM 6. EXHIBITS

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

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

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SIGNATURES

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

CVB FINANCIAL CORP.

(Registrant)

Date: May 10, 2013

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

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