

CITY NATIONAL CORP  
Form 10-Q  
August 08, 2014  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended June 30, 2014

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

For the transition period from        to

Commission file number 1-10521

**CITY NATIONAL CORPORATION**

(Exact name of registrant as specified in its charter)

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**Delaware**  
(State of Incorporation)

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

**City National Plaza**

**555 South Flower Street, Los Angeles, California, 90071**

(Address of principal executive offices)(Zip Code)

**(213) 673-7700**

(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

As of July 31, 2014, there were 55,014,359 shares of Common Stock outstanding (including unvested restricted shares).



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

| (in thousands, except share amounts)  | June 30,<br>2014<br>(Unaudited) | December 31,<br>2013 |
|---|---------------------------------|----------------------|
| <b>Assets</b>   |                                 |                      |
| Cash and due from banks   | \$ 586,273                      | \$ 183,227           |
| Due from banks - interest-bearing   | 554,044                         | 552,719              |
| Federal funds sold and securities purchased under resale agreements   | 200,000                         | 200,000              |
| Securities available-for-sale - cost \$5,324,611 and \$6,267,691 at June 30, 2014 and December 31, 2013, respectively:          |                                 |                      |
| Securities pledged as collateral  | 11,721                          | 12,376               |
| Held in portfolio   | 5,316,771                       | 6,228,741            |
| Securities held-to-maturity - fair value \$3,441,984 and \$2,883,935 at June 30, 2014 and December 31, 2013, respectively:      |                                 |                      |
| Securities pledged as collateral  | 531,400                         |                      |
| Held in portfolio   | 2,886,953                       | 2,957,843            |
| Trading securities  | 86,097                          | 82,357               |
| Loans and leases, excluding covered loans   | 18,474,788                      | 17,170,438           |
| Less: Allowance for loan and lease losses   | 311,276                         | 302,584              |
| Loans and leases, excluding covered loans, net  | 18,163,512                      | 16,867,854           |
| Covered loans, net of allowance for loan losses   | 596,667                         | 700,989              |
| Net loans and leases  | 18,760,179                      | 17,568,843           |
| Premises and equipment, net   | 205,168                         | 198,398              |
| Deferred tax asset  | 208,184                         | 217,990              |
| Goodwill  | 642,622                         | 642,622              |
| Customer-relationship intangibles, net  | 37,680                          | 40,621               |
| Affordable housing investments  | 200,570                         | 188,207              |
| Customers acceptance liability  | 2,018                           | 10,521               |
| Other real estate owned (\$17,944 and \$25,481 covered by FDIC loss share at June 30, 2014 and December 31, 2013, respectively) | 22,213                          | 38,092               |
| FDIC indemnification asset  | 68,038                          | 89,227               |
| Other assets  | 499,161                         | 506,167              |
| <b>Total assets</b>   | <b>\$ 30,819,092</b>            | <b>\$ 29,717,951</b> |
| <b>Liabilities</b>  |                                 |                      |
| Demand deposits   | \$ 16,690,688                   | \$ 16,058,968        |
| Interest checking deposits  | 2,196,536                       | 2,467,890            |
| Money market deposits   | 6,681,238                       | 6,022,457            |
| Savings deposits  | 469,932                         | 441,521              |
| Time deposits-under \$100,000   | 167,268                         | 176,488              |
| Time deposits-\$100,000 and over  | 445,863                         | 512,113              |
| <b>Total deposits</b>   | <b>26,651,525</b>               | <b>25,679,437</b>    |
| Short-term borrowings   | 160,337                         | 3,889                |
| Long-term debt  | 627,768                         | 735,968              |
| Reserve for off-balance sheet credit commitments  | 24,787                          | 33,944               |

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|  |               |               |
|--|---------------|---------------|
| Acceptances outstanding  | 2,018         | 10,521        |
| Other liabilities  | 452,955       | 473,438       |
| Total liabilities  | 27,919,390    | 26,937,197    |
| <b>Redeemable noncontrolling interest</b>  | 46,549        | 39,768        |
| <b>Commitments and contingencies</b>   |               |               |
| <b>Shareholders' equity</b>  |               |               |
| Preferred stock, par value \$1.00 per share; 5,000,000 shares authorized; 275,000 shares issued at June 30, 2014 and December 31, 2013                               | 267,616       | 267,616       |
| Common stock, par value \$1.00 per share; 75,000,000 shares authorized; 54,956,839 and 54,667,295 shares issued at June 30, 2014 and December 31, 2013, respectively | 54,957        | 54,667        |
| Additional paid-in capital   | 556,284       | 541,210       |
| Accumulated other comprehensive income (loss)  | 2,100         | (15,641)      |
| Retained earnings  | 1,994,646     | 1,918,163     |
| Treasury shares, at cost - 385,163 and 483,523 shares at June 30, 2014 and December 31, 2013, respectively   | (22,450)      | (25,029)      |
| Total common shareholders' equity  | 2,585,537     | 2,473,370     |
| Total shareholders' equity   | 2,853,153     | 2,740,986     |
| Total liabilities and shareholders' equity   | \$ 30,819,092 | \$ 29,717,951 |

See accompanying Notes to the Unaudited Consolidated Financial Statements.

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**CITY NATIONAL CORPORATION**  
**CONSOLIDATED STATEMENTS OF INCOME**  
**(Unaudited)**

| (in thousands, except per share amounts)   | For the three months ended<br>June 30, |                | For the six months ended<br>June 30, |                |
|--|--|----------------|--------------------------------------|----------------|
|  | 2014                                   | 2013           | 2014                                 | 2013           |
| <b>Interest income</b>   |  |                |                                      |                |
| Loans and leases   | \$ 186,999                             | \$ 174,059     | \$ 356,696                           | \$ 344,349     |
| Securities   | 43,471                                 | 41,223         | 85,046                               | 85,486         |
| Due from banks - interest-bearing  | 378                                    | 158            | 820                                  | 270            |
| Federal funds sold and securities purchased under resale agreements                    | 1,477                                  | 1,555          | 2,848                                | 2,690          |
| Total interest income  | 232,325                                | 216,995        | 445,410                              | 432,795        |
| <b>Interest expense</b>  |  |                |                                      |                |
| Deposits   | 2,060                                  | 2,990          | 4,194                                | 5,930          |
| Federal funds purchased and securities sold under repurchase agreements                |  | 123            |                                      | 400            |
| Subordinated debt  | 6,117                                  | 6,117          | 12,221                               | 12,223         |
| Other long-term debt   | 5,046                                  | 4,722          | 10,095                               | 9,701          |
| Other short-term borrowings  |  | 124            |                                      | 549            |
| Total interest expense   | 13,223                                 | 14,076         | 26,510                               | 28,803         |
| <b>Net interest income</b>   | <b>219,102</b>                         | <b>202,919</b> | <b>418,900</b>                       | <b>403,992</b> |
| (Reversal of) provision for credit losses on loans and leases, excluding covered loans | (1,000)                                |                | (1,000)                              |                |
| (Reversal of) provision for losses on covered loans                                    | (1,461)                                | (11,927)       | 3,194                                | (2,035)        |
| Net interest income after provision  | 221,563                                | 214,846        | 416,706                              | 406,027        |
| <b>Noninterest income</b>  |  |                |                                      |                |
| Trust and investment fees  | 54,599                                 | 49,830         | 107,905                              | 96,483         |
| Brokerage and mutual fund fees   | 14,240                                 | 8,107          | 24,282                               | 16,173         |
| Cash management and deposit transaction charges  | 12,128                                 | 12,880         | 24,161                               | 25,889         |
| International services   | 11,483                                 | 10,911         | 21,878                               | 20,530         |
| FDIC loss sharing expense, net   | (24,161)                               | (26,477)       | (31,244)                             | (30,829)       |
| Gain on disposal of assets   | 6,838                                  | 949            | 9,664                                | 2,063          |
| Gain on sale of securities   | 5,367                                  | 5,790          | 7,489                                | 6,836          |
| Other  | 20,853                                 | 20,401         | 38,460                               | 38,774         |
| Impairment loss on securities:   |  |                |                                      |                |
| Total other-than-temporary impairment loss on securities                               | (565)                                  | (422)          | (565)                                | (422)          |
| Less: Portion of loss recognized in other comprehensive income                         | 317                                    | 240            | 317                                  | 240            |
| Net impairment loss recognized in earnings   | (248)                                  | (182)          | (248)                                | (182)          |
| Total noninterest income   | 101,099                                | 82,209         | 202,347                              | 175,737        |
| <b>Noninterest expense</b>   |  |                |                                      |                |
| Salaries and employee benefits   | 138,859                                | 127,168        | 275,692                              | 255,363        |
| Net occupancy of premises  | 16,595                                 | 16,205         | 32,689                               | 32,194         |
| Legal and professional fees  | 18,393                                 | 13,514         | 31,343                               | 25,466         |
| Information services   | 9,463                                  | 9,183          | 18,809                               | 18,574         |
| Depreciation and amortization  | 7,885                                  | 8,249          | 15,713                               | 16,421         |
| Amortization of intangibles  | 1,454                                  | 1,931          | 2,941                                | 3,863          |
| Marketing and advertising  | 8,982                                  | 8,293          | 18,757                               | 16,269         |
| Office services and equipment  | 5,287                                  | 5,034          | 10,197                               | 9,980          |
| Other real estate owned  | 2,372                                  | 4,385          | 3,805                                | 9,635          |

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|   |                  |                  |                   |                   |
|---|------------------|------------------|-------------------|-------------------|
| FDIC assessments  | 2,765            | 3,663            | 4,156             | 9,144             |
| Other operating   | 13,567           | 13,804           | 26,413            | 25,860            |
| Total noninterest expense                                   | 225,622          | 211,429          | 440,515           | 422,769           |
| Income before income taxes                                  | 97,040           | 85,626           | 178,538           | 158,995           |
| Income taxes  | 29,829           | 25,422           | 56,117            | 46,683            |
| <b>Net income</b>   | <b>\$ 67,211</b> | <b>\$ 60,204</b> | <b>\$ 122,421</b> | <b>\$ 112,312</b> |
| Less: Net income attributable to noncontrolling interest    | 510              | 463              | 1,209             | 1,048             |
| <b>Net income attributable to City National Corporation</b> | <b>\$ 66,701</b> | <b>\$ 59,741</b> | <b>\$ 121,212</b> | <b>\$ 111,264</b> |
| Less: Dividends on preferred stock                          | 4,094            | 2,406            | 8,188             | 4,812             |
| <b>Net income available to common shareholders</b>          | <b>\$ 62,607</b> | <b>\$ 57,335</b> | <b>\$ 113,024</b> | <b>\$ 106,452</b> |
| Net income per common share, basic                          | \$ 1.13          | \$ 1.05          | \$ 2.04           | \$ 1.95           |
| Net income per common share, diluted                        | \$ 1.11          | \$ 1.04          | \$ 2.01           | \$ 1.94           |
| Weighted average common shares outstanding, basic           | 54,957           | 54,105           | 54,824            | 53,919            |
| Weighted average common shares outstanding, diluted         | 55,632           | 54,477           | 55,541            | 54,280            |
| Dividends per common share                                  | \$ 0.33          | \$ 0.25          | \$ 0.66           | \$ 0.25           |

See accompanying Notes to the Unaudited Consolidated Financial Statements.



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## CITY NATIONAL CORPORATION

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited)

| (in thousands)  | For the three months ended<br>June 30, |            | For the six months ended<br>June 30, |            |
|---|--|------------|--------------------------------------|------------|
|   | 2014                                   | 2013       | 2014                                 | 2013       |
| Net income  | \$ 67,211                              | \$ 60,204  | \$ 122,421                           | \$ 112,312 |
| Other comprehensive income (loss), net of tax:                        |  |            |                                      |            |
| Securities available-for-sale:  |  |            |                                      |            |
| Net unrealized gains (losses) arising during the period               | 9,764                                  | (64,693)   | 22,317                               | (76,502)   |
| Reclassification adjustment for net gains included in net income      | (3,117)                                | (2,783)    | (4,392)                              | (3,299)    |
| Non-credit related impairment loss                                    | (184)                                  | (140)      | (184)                                | (140)      |
| Net change on cash flow hedges  |  | (21)       |                                      | (56)       |
| Total other comprehensive income (loss)                               | 6,463                                  | (67,637)   | 17,741                               | (79,997)   |
| Comprehensive income (loss)   | \$ 73,674                              | \$ (7,433) | \$ 140,162                           | \$ 32,315  |
| Less: Comprehensive income attributable to noncontrolling interest    | 510                                    | 463        | 1,209                                | 1,048      |
| Comprehensive income (loss) attributable to City National Corporation | \$ 73,164                              | \$ (7,896) | \$ 138,953                           | \$ 31,267  |

See accompanying Notes to the Unaudited Consolidated Financial Statements.

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

| (in thousands)   | For the six months ended<br>June 30, |             |
|--|--------------------------------------|-------------|
|  | 2014                                 | 2013        |
| <b>Cash Flows From Operating Activities</b>  |                                      |             |
| Net income   | \$ 122,421                           | \$ 112,312  |
| Adjustments to net income:   |                                      |             |
| (Reversal of) provision for credit losses on loans and leases, excluding covered loans | (1,000)                              |             |
| (Reversal of) provision for losses on covered loans                                    | 3,194                                | (2,035)     |
| Amortization of intangibles  | 2,941                                | 3,863       |
| Depreciation and amortization  | 15,713                               | 16,421      |
| Share-based employee compensation expense  | 10,636                               | 10,535      |
| Deferred income tax benefit  | (2,934)                              | (1,514)     |
| Gain on disposal of assets   | (9,664)                              | (2,063)     |
| Gain on sale of securities   | (7,489)                              | (6,836)     |
| Impairment loss on securities  | 248                                  | 182         |
| Other, net   | 14,926                               | 23,488      |
| Net change in:   |                                      |             |
| Trading securities   | (3,802)                              | 67,568      |
| Other assets and other liabilities, net  | (22,414)                             | 45,924      |
| Net cash provided by operating activities  | 122,776                              | 267,845     |
| <b>Cash Flows From Investing Activities</b>  |                                      |             |
| Purchase of securities available-for-sale  | (820,540)                            | (698,457)   |
| Sales of securities available-for-sale   | 626,055                              | 1,251,056   |
| Maturities and paydowns of securities available-for-sale                               | 1,133,677                            | 1,454,644   |
| Purchase of securities held-to-maturity  | (537,894)                            | (123,549)   |
| Maturities and paydowns of securities held-to-maturity                                 | 75,409                               | 16,336      |
| Loan originations, net of principal collections  | (1,171,116)                          | (813,453)   |
| Net payments for premises and equipment  | (22,614)                             | (29,523)    |
| Other investing activities, net  | 19,224                               | 31,527      |
| Net cash (used in) provided by investing activities                                    | (697,799)                            | 1,088,581   |
| <b>Cash Flows From Financing Activities</b>  |                                      |             |
| Net increase in deposits   | 972,088                              | 149,402     |
| Net increase (decrease) in federal funds purchased                                     | 50,000                               | (1,214,200) |
| Issuance of long-term debt   | 18,070                               | 16,456      |
| Repayment of long-term debt  | (19,765)                             | (221,899)   |
| Proceeds from exercise of stock options  | 16,387                               | 17,838      |
| Tax benefit from exercise of stock options   | 3,240                                | 3,383       |
| Cash dividends paid  | (44,374)                             | (18,351)    |
| Other financing activities, net  | (16,252)                             | (1,901)     |
| Net cash provided by (used in) financing activities                                    | 979,394                              | (1,269,272) |
| Net increase in cash and cash equivalents  | 404,371                              | 87,154      |
| Cash and cash equivalents at beginning of year   | 935,946                              | 415,405     |
| Cash and cash equivalents at end of period   | \$ 1,340,317                         | \$ 502,559  |
| <b>Supplemental Disclosures of Cash Flow Information:</b>                              |                                      |             |
| Cash paid during the period for:   |                                      |             |
| Interest   | \$ 26,484                            | \$ 32,147   |
| Income taxes   | 55,461                               | 11,471      |

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Non-cash investing activities:

|  |    |       |    |        |
|--|----|-------|----|--------|
| Transfer of loans to other real estate owned | \$ | 4,131 | \$ | 14,629 |
|--|----|-------|----|--------|

See accompanying Notes to the Unaudited Consolidated Financial Statements.

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## CITY NATIONAL CORPORATION

## CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY

(Unaudited)

| (in thousands, except share amounts)                       | Common<br>shares<br>issued | Preferred<br>stock | Common<br>stock | Additional<br>paid-in<br>capital | Accumulated<br>other<br>comprehensive<br>income (loss) | Retained<br>earnings | Treasury<br>shares | Total<br>shareholders<br>equity |
|--|----------------------------|--------------------|-----------------|----------------------------------|--|----------------------|--------------------|---------------------------------|
| Balance, January 1, 2013                                   | 53,885,886                 | \$ 169,920         | \$ 53,886       | \$ 490,339                       | \$ 86,582  | \$ 1,738,957         | \$ (34,366)        | \$ 2,505,318                    |
| Net income (1)   |                            |                    |                 |                                  |  | 111,264              |                    | 111,264                         |
| Other comprehensive loss, net of tax                       |                            |                    |                 |                                  | (79,997)   |                      |                    | (79,997)                        |
| Issuance of shares under<br>share-based compensation plans | 387,708                    |                    | 388             | 5,291                            |  |                      | 9,070              | 14,749                          |
| Share-based employee<br>compensation expense               |                            |                    |                 | 8,737                            |  |                      |                    | 8,737                           |
| Tax benefit from share-based<br>compensation plans         |                            |                    |                 | 2,919                            |  |                      |                    | 2,919                           |
| Dividends:   |                            |                    |                 |                                  |  |                      |                    |                                 |
| Preferred  |                            |                    |                 |                                  |  | (4,812)              |                    | (4,812)                         |
| Common   |                            |                    |                 |                                  |  | (13,684)             |                    | (13,684)                        |
| Net change in deferred<br>compensation plans               |                            |                    |                 | 690                              |  |                      |                    | 690                             |
| Change in redeemable<br>noncontrolling interest            |                            |                    |                 | (416)                            |  |                      |                    | (416)                           |
| Balance, June 30, 2013                                     | 54,273,594                 | \$ 169,920         | \$ 54,274       | \$ 507,560                       | \$ 6,585   | \$ 1,831,725         | \$ (25,296)        | \$ 2,544,768                    |
| Balance, January 1, 2014                                   | 54,667,295                 | \$ 267,616         | \$ 54,667       | \$ 541,210                       | \$ (15,641)  | \$ 1,918,163         | \$ (25,029)        | \$ 2,740,986                    |
| Net income (1)   |                            |                    |                 |                                  |  | 121,212              |                    | 121,212                         |
| Other comprehensive income, net of<br>tax                  |                            |                    |                 |                                  | 17,741   |                      |                    | 17,741                          |
| Issuance of shares under<br>share-based compensation plans | 289,544                    |                    | 290             | 9,653                            |  |                      | 2,581              | 12,524                          |
| Share-based employee<br>compensation expense               |                            |                    |                 | 8,875                            |  |                      |                    | 8,875                           |
| Tax benefit from share-based<br>compensation plans         |                            |                    |                 | 3,306                            |  |                      |                    | 3,306                           |
| Dividends:   |                            |                    |                 |                                  |  |                      |                    |                                 |
| Preferred  |                            |                    |                 |                                  |  | (8,188)              |                    | (8,188)                         |
| Common   |                            |                    |                 |                                  |  | (36,541)             |                    | (36,541)                        |
| Net change in deferred<br>compensation plans               |                            |                    |                 | 741                              |  |                      | (2)                | 739                             |
| Change in redeemable<br>noncontrolling interest            |                            |                    |                 | (7,501)                          |  |                      |                    | (7,501)                         |
| Balance, June 30, 2014                                     | 54,956,839                 | \$ 267,616         | \$ 54,957       | \$ 556,284                       | \$ 2,100   | \$ 1,994,646         | \$ (22,450)        | \$ 2,853,153                    |

(1) Net income excludes net income attributable to redeemable noncontrolling interest of \$1,209 and \$1,048 for the six month periods ended June 30, 2014 and 2013, respectively. Redeemable noncontrolling interest is reflected in the mezzanine section of the consolidated balance sheets. See Note 17 of the Notes to the Unaudited Consolidated Financial Statements.

See accompanying Notes to the Unaudited Consolidated Financial Statements.

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**CITY NATIONAL CORPORATION**

**NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

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

*Organization*

City National Corporation (the Corporation) is the holding company for City National Bank (the Bank). The Bank delivers banking, trust and investment services through 77 offices in Southern California, the San Francisco Bay area, Nevada, New York City, Nashville, Tennessee and Atlanta, Georgia. As of June 30, 2014, the Corporation had four consolidated investment advisory affiliates and one unconsolidated subsidiary, Business Bancorp Capital Trust I. Because the Bank comprises substantially all of the business of the Corporation, references to the Company mean the Corporation and the Bank together. The Corporation is approved as a financial holding company pursuant to the Gramm-Leach-Bliley Act of 1999.

*Consolidation*

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

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

*Use of Estimates*

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

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

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

*Basis of Presentation*

The Company is on the accrual basis of accounting for income and expenses. The results of operations reflect any adjustments, all of which are of a normal recurring nature, unless otherwise disclosed in this Form 10-Q, and which, in the opinion of management, are necessary for a fair presentation of the results for the periods presented. In accordance with the usual practice of banks, assets and liabilities of individual trust, agency and fiduciary funds have not been included in the financial statements. These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013.

The results for the 2014 interim periods are not necessarily indicative of the results expected for the full year. The Company has not made any significant changes in its critical accounting policies or in its estimates and assumptions from those disclosed in its 2013 Annual Report other than the adoption of new accounting pronouncements and other authoritative guidance that became effective for the Company on or after January 1, 2014. Refer to *Accounting Pronouncements* for discussion of accounting pronouncements adopted in 2014.

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

*Accounting Pronouncements*

The following is a summary of accounting pronouncements that became effective during the six months ended June 30, 2014:

- In February 2013, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) 2013-04, *Liabilities (Topic 405): Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation is Fixed at the Reporting Date* ( ASU 2013-04 ). ASU 2013-04 provides guidance for the recognition, measurement and disclosure of obligations resulting from joint and several liability arrangements. Examples of obligations within the scope of the ASU include debt arrangements, other contractual obligations and settled litigation. ASU 2013-04 requires entities to measure obligations resulting from joint and several liability arrangements for which the total amount of the obligation within the scope of the guidance is fixed at the reporting date, as the sum of (1) the amount the reporting entity agreed to pay on the basis of its arrangement among its co-obligors, and (2) any additional amount the reporting entity expects to pay on behalf of its co-obligors. Required disclosures include a description of the joint-and-several arrangement and the total outstanding amount of the obligation for all joint parties. Adoption of the new guidance on January 1, 2014 did not have a significant impact on the Company's consolidated financial statements.
- In July 2013, the FASB issued ASU 2013-11, *Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*. The new guidance requires an entity to present liabilities for unrecognized tax benefits in the statement of financial position as a reduction to a deferred tax asset for a net operating loss



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carryforward or a tax credit carryforward, except as follows: (1) to the extent a net operating loss carryforward or tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position, or (2) the tax law of the applicable jurisdiction does not require the entity to use and the entity does not intend to use the deferred tax asset for such purpose. In these situations, the unrecognized tax benefit should be presented in the balance sheet as a liability and should not be combined with deferred tax assets. Adoption of the new guidance on January 1, 2014 did not have a significant impact on the Company's consolidated financial statements.

The following is a summary of recently issued accounting pronouncements:

- In January 2014, the FASB issued ASU 2014-01, *Investments-Equity Method and Joint Ventures (Topic 323), Accounting for Investments in Qualified Affordable Housing Projects* (ASU 2014-01). ASU 2014-01 permits an entity to make an accounting policy election to apply a proportionate amortization method to the low income housing tax credit investments if certain conditions are met. Under the proportionate amortization method, an investor amortizes the initial cost of the

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

investment in proportion to the tax credits and other tax benefits received, and recognizes the amortization in the income statement as a component of income taxes attributable to continuing operations. The ASU becomes effective for the Company for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. The provisions of ASU 2014-01 must be applied retrospectively to all periods presented. Early adoption is permitted. The Company is assessing the impact of the new guidance on its consolidated financial statements.

- In January 2014, the FASB issued ASU 2014-04, *Receivables-Troubled Debt Restructurings by Creditors (Subtopic 310-40), Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure* ( ASU 2014-04 ). ASU 2014-04 requires entities to reclassify consumer mortgage loans collateralized by residential real estate to OREO when either (1) the creditor obtains legal title to the residential real estate property or (2) the borrower conveys all interest in the property to the creditor to satisfy the loan by completing a deed in lieu of foreclosure or similar agreement. The ASU becomes effective for the Company for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. Entities will have the option of adopting the guidance using either a modified retrospective transition method or a prospective transition method. Early adoption is permitted. Adoption of the new guidance is not expected to have a significant impact on the Company's consolidated financial statements.
- In April 2014, the FASB issued ASU 2014-08, *Presentation of Financial Statements (Topic 205) and Property, Plant and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity* ( ASU 2014-08 ). ASU 2014-08 raises the threshold for a disposal to qualify as a discontinued operation and requires new disclosures of both discontinued operations and certain other disposals that do not meet the definition of a discontinued operation. Under the revised standard, a discontinued operation is (1) a component of an entity or group of components that has been disposed of by sale, disposed of other than by sale or is classified as held for sale that represents a strategic shift that has or will have a major effect on an entity's operations and financial results or (2) an acquired business or nonprofit activity that is classified as held for sale on the date of the acquisition. ASU 2014-08 is effective for annual periods beginning on or after December 15, 2014, and interim periods therein. The new guidance will be applied prospectively. Early adoption is permitted. Adoption of the new guidance is not expected to have a significant impact on the Company's consolidated financial statements.
- In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers: Topic 606* ( ASU 2014-09 ). The standard outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The ASU outlines a five-step process for applying the new revenue model and expands required disclosures on revenue recognition. The ASU is effective for annual reporting periods, and interim reporting periods within those periods, beginning after December 15, 2016. Entities have the option of using either a full or modified retrospective approach for adoption. Early application is not permitted. The Company is assessing the impact of the new guidance on its consolidated financial statements.
- In June 2014, the FASB issued ASU 2014-11, *Transfers and Servicing (Topic 860), Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures* ( ASU 2014-11 ). ASU 2014-11 aligns the accounting for repurchase-to-maturity transactions and repurchase agreements executed as a repurchase financing with the accounting for other repurchase agreements. Going forward, these transactions will all be accounted for as secured borrowings. Under the new guidance, parties to a repurchase financing transaction will be required to separately account for the initial transfer of the financial asset and the related repurchase agreement. The initial transfer of the financial asset would be accounted for as a sale by the transferor only if all criteria for derecognition have been met. ASU 2014-11 requires new or expanded disclosures for repurchase agreements and similar transactions accounted for as secured borrowings. The ASU becomes effective for the Company for the first interim or annual period beginning after December 15, 2014. Adoption of the new guidance is not expected to have a significant impact on the Company's consolidated financial statements.



Table of Contents**Note 2. Fair Value Measurements**

The following tables summarize assets and liabilities measured at fair value as of June 30, 2014 and December 31, 2013 by level in the fair value hierarchy:

| (in thousands)                             | Fair Value Measurements at Reporting Date Using |   |  |  |
|--|---|---|--|--|
|  | Balance as of<br>June 30,<br>2014               | Quoted Prices in<br>Active Markets<br>Level 1 | Significant Other<br>Observable<br>Inputs<br>Level 2 | Significant<br>Unobservable<br>Inputs<br>Level 3 |
| <b>Measured on a Recurring Basis</b>       |   |   |  |  |
| <b>Assets</b>                              |   |   |  |  |
| Securities available-for-sale:             |   |   |  |  |
| U.S. Treasury                              | \$ 36,258                                       | \$ 36,258                                     | \$   | \$   |
| Federal agency - Debt                      | 1,026,516                                       |   | 1,026,516  |  |
| Federal agency - MBS                       | 123,229   |   | 123,229  |  |
| CMOs - Federal agency                      | 3,539,319                                       |   | 3,539,319  |  |
| CMOs - Non-agency                          | 26,903  |   | 26,903   |  |
| State and municipal                        | 392,593   |   | 388,976  | 3,617  |
| Other debt securities                      | 177,987   |   | 177,987  |  |
| Equity securities and mutual funds         | 5,687   | 5,687   |  |  |
| Trading securities                         | 86,097  | 77,516  | 8,581  |  |
| Derivative assets (1)                      | 43,264  | 3,355   | 39,344   | 565  |
| <b>Total assets at fair value</b>          | <b>\$ 5,457,853</b>                             | <b>\$ 122,816</b>                             | <b>\$ 5,330,855</b>                                  | <b>\$ 4,182</b>                                  |
| <b>Liabilities</b>                         |   |   |  |  |
| Derivative liabilities                     | \$ 41,708                                       | \$ 2,594                                      | \$ 39,114  | \$   |
| Contingent consideration liability         | 34,463  |   |  | 34,463   |
| FDIC clawback liability                    | 14,079  |   |  | 14,079   |
| Other liabilities                          | 949   |   | 949  |  |
| <b>Total liabilities at fair value (2)</b> | <b>\$ 91,199</b>                                | <b>\$ 2,594</b>                               | <b>\$ 40,063</b>                                     | <b>\$ 48,542</b>                                 |
| <b>Redeemable noncontrolling interest</b>  | <b>\$ 46,549</b>                                | <b>\$</b>                                     | <b>\$</b>  | <b>\$ 46,549</b>                                 |
| <b>Measured on a Nonrecurring Basis</b>    |   |   |  |  |
| <b>Assets</b>                              |   |   |  |  |
| Other real estate owned (3)                | \$ 7,849  | \$  | \$   | \$ 7,849   |
| <b>Total assets at fair value</b>          | <b>\$ 7,849</b>                                 | <b>\$</b>                                     | <b>\$</b>  | <b>\$ 7,849</b>                                  |

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

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

(3) Includes covered OREO.



Table of Contents**Note 2. Fair Value Measurements (Continued)**

| (in thousands)                             | Fair Value Measurements at Reporting Date Using |   |  |  |
|--|---|---|--|--|
|  | Balance as of<br>December 31,<br>2013           | Quoted Prices in<br>Active Markets<br>Level 1 | Significant Other<br>Observable<br>Inputs<br>Level 2 | Significant<br>Unobservable<br>Inputs<br>Level 3 |
| <b>Measured on a Recurring Basis</b>       |   |   |  |  |
| <b>Assets</b>                              |   |   |  |  |
| Securities available-for-sale:             |   |   |  |  |
| U.S. Treasury                              | \$ 35,335                                       | \$ 35,335                                     | \$   | \$   |
| Federal agency - Debt                      | 1,410,536                                       |   | 1,410,536  |  |
| Federal agency - MBS                       | 157,226   |   | 157,226  |  |
| CMOs - Federal agency                      | 3,997,298                                       |   | 3,997,298  |  |
| CMOs - Non-agency                          | 37,462  |   | 37,462   |  |
| State and municipal                        | 415,995   |   | 412,362  | 3,633  |
| Other debt securities                      | 178,822   |   | 178,822  |  |
| Equity securities and mutual funds         | 8,443   | 8,443   |  |  |
| Trading securities                         | 82,357  | 80,659  | 1,698  |  |
| Derivative assets (1)                      | 34,613  | 3,487   | 31,126   |  |
| <b>Total assets at fair value</b>          | <b>\$ 6,358,087</b>                             | <b>\$ 127,924</b>                             | <b>\$ 6,226,530</b>                                  | <b>\$ 3,633</b>                                  |
| <b>Liabilities</b>                         |   |   |  |  |
| Derivative liabilities                     | \$ 32,970                                       | \$ 3,333                                      | \$ 29,637  | \$   |
| Contingent consideration liability         | 49,900  |   |  | 49,900   |
| FDIC clawback liability                    | 11,967  |   |  | 11,967   |
| Other liabilities                          | 1,044   |   | 1,044  |  |
| <b>Total liabilities at fair value (2)</b> | <b>\$ 95,881</b>                                | <b>\$ 3,333</b>                               | <b>\$ 30,681</b>                                     | <b>\$ 61,867</b>                                 |
| <b>Redeemable noncontrolling interest</b>  | <b>\$ 39,768</b>                                | <b>\$</b>                                     | <b>\$</b>  | <b>\$ 39,768</b>                                 |
| <b>Measured on a Nonrecurring Basis</b>    |   |   |  |  |
| <b>Assets</b>                              |   |   |  |  |
| Collateral dependent impaired loans (3):   |   |   |  |  |
| Commercial real estate mortgages           | \$ 1,220  | \$  | \$   | 1,220  |
| Residential mortgages                      | 1,300   |   |  | 1,300  |
| Other real estate owned (4)                | 18,251  |   |  | 18,251   |
| Private equity and alternative investments | 895   |   |  | 895  |
| <b>Total assets at fair value</b>          | <b>\$ 21,666</b>                                | <b>\$</b>                                     | <b>\$</b>  | <b>\$ 21,666</b>                                 |

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

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

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

(4) Includes covered OREO.

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At June 30, 2014, \$5.46 billion, or approximately 18 percent, of the Company's total assets were recorded at fair value on a recurring basis, compared with \$6.36 billion, or 21 percent, at December 31, 2013. The majority of these financial assets were valued using Level 1 or Level 2 inputs. Less than one percent of total assets were measured using Level 3 inputs. At June 30, 2014, \$91.2 million of the Company's total liabilities were recorded at fair value using mostly Level 2 or Level 3 inputs, compared with \$95.9 million at December 31, 2013. There were no transfers between Level 1 and Level 2 of the fair value hierarchy for assets or liabilities measured on a recurring basis during the six months ended June 30, 2014. At June 30, 2014, \$7.8 million of the Company's total assets were recorded at fair value on a nonrecurring basis, compared with \$21.7 million at December 31, 2013. These assets represent less than one percent of total assets and were measured using Level 3 inputs.

Table of Contents**Note 2. Fair Value Measurements (Continued)***Recurring Fair Value Measurements*

Assets and liabilities for which fair value measurement is based on significant unobservable inputs are classified as Level 3 in the fair value hierarchy. The following table provides a reconciliation of the beginning and ending balances for Level 3 assets and liabilities measured at fair value on a recurring basis for the six months ended June 30, 2014 and 2013.

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

| (in thousands)                            | For the six months ended<br>June 30, 2014 |                    |  |                               |
|---|---|--------------------|--|-------------------------------|
|   | Securities<br>Available-for-<br>Sale      | Equity<br>Warrants | Contingent<br>Consideration<br>Liability | FDIC<br>Clawback<br>Liability |
| Balance, beginning of period              | \$ 3,633                                  | \$                 | \$ (49,900)                              | \$ (11,967)                   |
| Total realized/unrealized gains (losses): |   |                    |  |                               |
| Included in earnings                      |   | 78                 |  | (2,112)                       |
| Included in other comprehensive<br>income | (16)                                      |                    |  |                               |
| Additions                                 |   | 489                |  |                               |
| Settlements                               |   | (2)                | 16,250                                   |                               |
| Other (1)                                 |   |                    | (813)                                    |                               |
| Balance, end of period                    | \$ 3,617                                  | \$ 565             | \$ (34,463)                              | \$ (14,079)                   |

| (in thousands)                            | For the six months ended<br>June 30, 2013 |  |                               |
|---|---|--|-------------------------------|
|   | Securities<br>Available-for-<br>Sale      | Contingent<br>Consideration<br>Liability | FDIC<br>Clawback<br>Liability |
| Balance, beginning of period              | \$ 65,187                                 | \$ (47,724)                              | \$ (9,970)                    |
| Total realized/unrealized gains (losses): |   |  |                               |
| Included in earnings                      |   |  | (1,083)                       |
| Included in other comprehensive income    | 233                                       |  |                               |
| Settlements                               | (3,655)                                   |  |                               |
| Other (1)                                 | 74  | (1,076)                                  |                               |
| Balance, end of period                    | \$ 61,839                                 | \$ (48,800)                              | \$ (11,053)                   |

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

Redeemable noncontrolling interest is classified as Level 3 in the fair value hierarchy and measured on a recurring basis. Redeemable noncontrolling interest is valued based on a combination of factors, including but not limited to, observable valuation of firms similar to the



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affiliates, multiples of revenue or profit, unique investment products or performance track records, strength in the marketplace, projected discounted cash flow scenarios, strategic value of affiliates to other entities, as well as unique sources of value specific to an individual firm. The methodology used to fair value these interests is consistent with the industry practice of valuing similar types of instruments. Refer to Note 17, *Noncontrolling Interest*, for a rollforward of activity for the six months ended June 30, 2014 and 2013.

Table of Contents**Note 2. Fair Value Measurements (Continued)**

Level 3 assets measured at fair value on a recurring basis include municipal auction rate securities that are classified in securities available-for-sale. Municipal auction rate securities were valued using an average yield on California variable rate notes that were comparable in credit rating and maturity to the securities held, plus a liquidity premium. Level 3 assets measured at fair value also include equity warrants in private companies obtained in association with certain loan transactions. Equity warrants are classified as derivative assets and are measured at fair value on a recurring basis. The Black-Scholes option pricing model is used to value the warrants. Key inputs to the valuation model include current share estimated fair value, strike price, volatility, expected life, risk-free interest rate, market and liquidity discounts. Several of the inputs to the valuation model incorporate assumptions by management that are not observable in the market, consequently, the valuation of warrants is classified in Level 3 of the fair value hierarchy. The grant date fair value of a warrant is deemed to be a loan fee and is recognized in interest income over the life of the loan as an adjustment to loan yield. Refer to Note 11, *Derivative Instruments*, for additional discussion of Equity Warrants. During the six months ended June 30, 2013, Level 3 assets measured on a recurring basis also included a collateralized debt obligation senior note classified as an available-for-sale security. This security was sold during the fourth quarter of 2013.

Level 3 liabilities measured at fair value on a recurring basis consist of contingent consideration and an FDIC clawback liability that are included in other liabilities. As part of its acquisition of Rochdale Investment Management, LLC and associated entities (collectively, Rochdale), the Company entered into a contingent consideration arrangement that requires the Company to pay additional cash consideration to Rochdale's former shareholders at certain points in time over the six years after the date of acquisition if certain criteria, such as revenue growth and pre-tax margin, are met. During the first quarter of 2014, the Company made its first contingent consideration payment to Rochdale's former shareholders for approximately \$16.3 million. The fair value of the remaining contingent consideration was estimated using a probability-weighted discounted cash flow model. Although the acquisition agreement does not set a limit on the total payment, the Company estimates that the remaining consideration payment could be in the range of \$16 million to \$58 million, but will ultimately be determined based on actual future results. The contingent consideration liability is remeasured to fair value at each reporting date until its settlement.

The FDIC clawback liability was valued using the discounted cash flow method based on the terms specified in loss-sharing agreements with the FDIC, the actual FDIC payments collected, and the following unobservable inputs: (1) risk-adjusted discount rate reflecting the Bank's credit risk, plus a liquidity premium, (2) prepayment assumptions, and (3) credit assumptions.

Equity warrants with a fair value of \$0.6 million were obtained during the six months ended June 30, 2014. There were no other purchases, sales, or transfers out of Level 3 assets measured on a recurring basis during the six months ended June 30, 2014 and 2013. Paydowns totaling \$3.7 million were received on Level 3 assets measured on a recurring basis for the six months ended June 30, 2013.

*Nonrecurring Fair Value Measurements*

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



Table of Contents**Note 2. Fair Value Measurements (Continued)**

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

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

| (in thousands)          | Fair Value at<br>June 30,<br>2014 | Valuation<br>Method   | Unobservable Inputs   |
|-------------------------|-----------------------------------|-----------------------|---|
| Other real estate owned | \$ 7,849                          | Third-party appraisal | <ul style="list-style-type: none"> <li>- Fair values are primarily based on unadjusted appraised values.</li> <li>- A limited number of properties were valued using comparable sales values or broker opinions, or a combination of these approaches, resulting in discounts to appraised values ranging from 14% to 31%.</li> </ul> |

Under the cost recovery approach, fair value represents an estimate of the amount of an asset expected to be recovered. The Company only employs the cost recovery approach for assets that are not readily marketable and for which minimal market-based information exists.

For assets measured at fair value on a nonrecurring basis, the following table presents the total net gains and losses, which include charge-offs, recoveries, specific reserves, OREO valuation write-downs and write-ups, gains and losses on sales of OREO, and impairment write-downs on private equity investments, recognized in the three and six months ended June 30, 2014 and 2013:

| (in thousands)                             | For the three months ended<br>June 30, |            | For the six months ended<br>June 30, |            |
|--|--|------------|--------------------------------------|------------|
|  | 2014                                   | 2013       | 2014                                 | 2013       |
| Collateral dependent impaired loans:       |  |            |                                      |            |
| Commercial real estate mortgages           | \$                                     | \$ 148     | \$ (5)                               | \$ 293     |
| Residential mortgages                      | 74                                     | (230)      | 74                                   | (221)      |
| Home equity loans and lines of credit      |  |            |                                      | 116        |
| Installment                                |  |            |                                      | (138)      |
| Other real estate owned (1)                | 1,006                                  | (1,857)    | 1,067                                | (4,711)    |
| Private equity and alternative investments |  |            |                                      | (399)      |
| Total net gains (losses) recognized        | \$ 1,080                               | \$ (1,939) | \$ 1,136                             | \$ (5,060) |

(1) Net gains and losses on OREO include amounts related to covered OREO, a significant portion of which is payable to or reimbursable by the FDIC.

*Fair Value of Financial Instruments*

A financial instrument is broadly defined as cash, evidence of an ownership interest in another entity, or a contract that imposes a contractual obligation on one entity and conveys a corresponding right to a second entity to require delivery or exchange of a financial instrument. Refer to Note 1, *Summary of Significant Accounting Policies*, in the Company's 2013 Form 10-K for additional information on fair value measurements.

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

Table of Contents**Note 2. Fair Value Measurements (Continued)**

The following tables summarize the carrying amounts and estimated fair values of those financial instruments that are reported at amortized cost in the Company's consolidated balance sheets. The tables also provide information on the level in the fair value hierarchy for inputs used in determining the fair value of those financial instruments. Most financial assets and financial liabilities for which carrying amount equals fair value are considered by the Company to be Level 1 measurements in the fair value hierarchy.

| (in millions)                                | Carrying Amount | Total Fair Value | June 30, 2014 |             |          |
|--|-----------------|------------------|---------------|-------------|----------|
|  |                 |                  | Level 1       | Level 2     | Level 3  |
| <b>Financial Assets:</b>                     |                 |                  |               |             |          |
| Cash and due from banks                      | \$ 586.3        | \$ 586.3         | \$ 586.3      | \$          |          |
| Due from banks - interest bearing            | 554.0           | 554.0            | 554.0         |             |          |
| Securities purchased under resale agreements | 200.0           | 203.7            |               | 203.7       |          |
| Securities held-to-maturity                  | 3,418.4         | 3,442.0          |               | 3,442.0     |          |
| Loans and leases, net of allowance           | 18,163.5        | 18,738.1         |               |             | 18,738.1 |
| Covered loans, net of allowance              | 596.7           | 645.9            |               |             | 645.9    |
| FDIC indemnification asset                   | 68.0            | 54.9             |               |             | 54.9     |
| Investment in FHLB and FRB stock             | 58.4            | 58.4             |               | 58.4        |          |
| <b>Financial Liabilities:</b>                |                 |                  |               |             |          |
| Deposits                                     | \$ 26,651.5     | \$ 26,653.6      | \$            | \$ 26,038.4 | \$ 615.2 |
| Federal funds purchased                      | 50.0            | 50.0             | 50.0          |             |          |
| Other short-term borrowings                  | 110.3           | 110.3            |               | 105.0       | 5.3      |
| Long-term debt                               | 627.8           | 700.3            |               | 612.2       | 88.1     |

| (in millions)                                | Carrying Amount | Total Fair Value | December 31, 2013 |             |          |
|--|-----------------|------------------|-------------------|-------------|----------|
|  |                 |                  | Level 1           | Level 2     | Level 3  |
| <b>Financial Assets:</b>                     |                 |                  |                   |             |          |
| Cash and due from banks                      | \$ 183.2        | \$ 183.2         | \$ 183.2          | \$          |          |
| Due from banks - interest bearing            | 552.7           | 552.7            | 552.7             |             |          |
| Securities purchased under resale agreements | 200.0           | 200.5            |                   | 200.5       |          |
| Securities held-to-maturity                  | 2,957.8         | 2,883.9          |                   | 2,883.9     |          |
| Loans and leases, net of allowance           | 16,867.9        | 17,362.9         |                   |             | 17,362.9 |
| Covered loans, net of allowance              | 701.0           | 739.5            |                   |             | 739.5    |
| FDIC indemnification asset                   | 89.2            | 74.3             |                   |             | 74.3     |
| Investment in FHLB and FRB stock             | 64.4            | 64.4             |                   | 64.4        |          |
| <b>Financial Liabilities:</b>                |                 |                  |                   |             |          |
| Deposits                                     | \$ 25,679.4     | \$ 25,682.2      | \$                | \$ 24,990.8 | \$ 691.4 |
| Other short-term borrowings                  | 3.9             | 3.9              |                   |             | 3.9      |
| Long-term debt                               | 736.0           | 788.9            |                   | 697.8       | 91.1     |

Following is a description of the methods and assumptions used in estimating the fair values of these financial instruments:

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

*Securities purchased under resale agreements* The fair value of securities purchased under term resale agreements is determined using a combination of quoted market prices and observable market inputs such as interest rates and credit spreads.

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**Note 2. Fair Value Measurements (Continued)**

*Securities held-to-maturity* For securities held-to-maturity, the fair value is generally determined by quoted market prices, where available, or on observable market inputs appropriate for the type of security.

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

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

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

*Investment in FHLB and FRB stock* Investments in Federal Home Loan Bank of San Francisco ( FHLB ) and Federal Reserve Bank ( FRB ) stock are recorded at cost. Ownership of these securities is restricted to member banks and the securities do not have a readily determinable market value. Purchases and sales of these securities are at par value with the issuer. The fair value of investments in FHLB and FRB stock is equal to the carrying amount.

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

*Federal funds purchased* The carrying amount is a reasonable estimate of fair value.



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

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

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

Table of Contents**Note 3. Securities**

At June 30, 2014, the Company had total securities of \$8.83 billion, comprised of securities available-for-sale at fair value of \$5.33 billion, securities held-to-maturity at amortized cost of \$3.42 billion and trading securities at fair value of \$86.1 million. At December 31, 2013, the Company had total securities of \$9.28 billion, comprised of securities available-for-sale at fair value of \$6.24 billion, securities held-to-maturity at amortized cost of \$2.96 billion and trading securities at fair value of \$82.4 million.

The following is a summary of amortized cost and estimated fair value for the major categories of securities available-for-sale and securities held-to-maturity at June 30, 2014 and December 31, 2013:

| (in thousands)                          | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair Value   |
|---|-------------------|------------------------------|-------------------------------|--------------|
| <b>June 30, 2014</b>                    |                   |                              |                               |              |
| <b>Securities available-for-sale:</b>   |                   |                              |                               |              |
| U.S. Treasury                           | \$ 36,213         | \$ 45                        | \$                            | \$ 36,258    |
| Federal agency - Debt                   | 1,027,192         | 815                          | (1,491)                       | 1,026,516    |
| Federal agency - MBS                    | 121,501           | 3,305                        | (1,577)                       | 123,229      |
| CMOs - Federal agency                   | 3,552,834         | 28,089                       | (41,604)                      | 3,539,319    |
| CMOs - Non-agency                       | 27,168            | 135                          | (400)                         | 26,903       |
| State and municipal                     | 384,359           | 8,335                        | (101)                         | 392,593      |
| Other debt securities                   | 174,723           | 3,264                        |                               | 177,987      |
| Total debt securities                   | 5,323,990         | 43,988                       | (45,173)                      | 5,322,805    |
| Equity securities and mutual funds      | 621               | 5,066                        |                               | 5,687        |
| Total securities available-for-sale     | \$ 5,324,611      | \$ 49,054                    | \$ (45,173)                   | \$ 5,328,492 |
| <b>Securities held-to-maturity (1):</b> |                   |                              |                               |              |
| Federal agency - Debt                   | \$ 302,918        | \$ 4,319                     | \$ (856)                      | \$ 306,381   |
| Federal agency - MBS                    | 554,421           | 9,328                        | (4,058)                       | 559,691      |
| CMOs - Federal agency                   | 1,883,461         | 23,027                       | (16,534)                      | 1,889,954    |
| State and municipal                     | 579,473           | 13,067                       | (4,949)                       | 587,591      |
| Other debt securities                   | 98,080            | 291                          | (4)                           | 98,367       |
| Total securities held-to-maturity       | \$ 3,418,353      | \$ 50,032                    | \$ (26,401)                   | \$ 3,441,984 |
| <b>December 31, 2013</b>                |                   |                              |                               |              |
| <b>Securities available-for-sale:</b>   |                   |                              |                               |              |
| U.S. Treasury                           | \$ 35,312         | \$ 23                        | \$                            | \$ 35,335    |
| Federal agency - Debt                   | 1,417,509         | 938                          | (7,911)                       | 1,410,536    |
| Federal agency - MBS                    | 156,399           | 3,615                        | (2,788)                       | 157,226      |
| CMOs - Federal agency                   | 4,037,348         | 30,721                       | (70,771)                      | 3,997,298    |
| CMOs - Non-agency                       | 38,383            | 127                          | (1,048)                       | 37,462       |
| State and municipal                     | 407,312           | 8,806                        | (123)                         | 415,995      |
| Other debt securities                   | 175,091           | 3,731                        |                               | 178,822      |
| Total debt securities                   | 6,267,354         | 47,961                       | (82,641)                      | 6,232,674    |
| Equity securities and mutual funds      | 337               | 8,106                        |                               | 8,443        |
| Total securities available-for-sale     | \$ 6,267,691      | \$ 56,067                    | \$ (82,641)                   | \$ 6,241,117 |

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| <b>Securities held-to-maturity (1):</b>  |           |                  |           |              |           |                 |           |                  |
|--|-----------|------------------|-----------|--------------|-----------|-----------------|-----------|------------------|
| Federal agency - Debt                    | \$        | 178,413          | \$        | 133          | \$        | (5,122)         | \$        | 173,424          |
| Federal agency - MBS                     |           | 445,360          |           | 1,005        |           | (11,930)        |           | 434,435          |
| CMOs - Federal agency                    |           | 1,781,219        |           | 1,839        |           | (40,621)        |           | 1,742,437        |
| State and municipal                      |           | 454,155          |           | 421          |           | (19,014)        |           | 435,562          |
| Other debt securities                    |           | 98,696           |           |              |           | (619)           |           | 98,077           |
| <b>Total securities held-to-maturity</b> | <b>\$</b> | <b>2,957,843</b> | <b>\$</b> | <b>3,398</b> | <b>\$</b> | <b>(77,306)</b> | <b>\$</b> | <b>2,883,935</b> |

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

Table of Contents**Note 3. Securities (Continued)**

Proceeds from sales of securities available-for-sale were \$15.0 million and \$626.1 million for the three and six months ended June 30, 2014, respectively, compared with \$0.2 million and \$1.25 billion for the three and six months ended June 30, 2013. There were no sales of securities held-to-maturity during the three and six months ended June 30, 2014 and 2013. The following table provides the gross realized gains and losses on the sales and calls of securities (including trading securities):

| (in thousands)        | For the three months ended<br>June 30, |          | For the six months ended<br>June 30, |          |
|-----------------------|--|----------|--------------------------------------|----------|
|                       | 2014                                   | 2013     | 2014                                 | 2013     |
| Gross realized gains  | \$ 5,368                               | \$ 5,790 | \$ 7,970                             | \$ 6,836 |
| Gross realized losses | (1)                                    |          | (481)                                |          |
| Net realized gains    | \$ 5,367                               | \$ 5,790 | \$ 7,489                             | \$ 6,836 |

Interest income on securities for the three months ended June 30, 2014 and 2013 is comprised of: (i) taxable interest income of \$37.5 million and \$36.7 million, respectively (ii) nontaxable interest income of \$6.0 million and \$4.4 million, respectively, and (iii) dividend income of \$16 thousand and \$0.1 million, respectively. Interest income on securities for the six months ended June 30, 2014 and 2013 is comprised of: (i) taxable interest income of \$73.5 million and \$76.6 million, respectively (ii) nontaxable interest income of \$11.5 million and \$8.8 million, respectively, and (iii) dividend income of \$25 thousand and \$0.1 million, respectively.

The following table provides the expected remaining maturities of debt securities included in the securities portfolio at June 30, 2014, except for maturities of mortgage-backed securities which are allocated according to the average life of expected cash flows. Average expected maturities will differ from contractual maturities because of the amortizing nature of the loan collateral and prepayment behavior of borrowers.

| (in thousands)                           | One year or<br>less | Over 1 year<br>through<br>5 years | Over 5 years<br>through<br>10 years | Over 10<br>years | Total        |
|--|---------------------|-----------------------------------|-------------------------------------|------------------|--------------|
| <b>Securities available-for-sale:</b>    |                     |                                   |                                     |                  |              |
| U.S. Treasury                            | \$ 23,194           | \$ 13,064                         | \$                                  | \$               | \$ 36,258    |
| Federal agency - Debt                    | 639,733             | 347,513                           | 39,270                              |                  | 1,026,516    |
| Federal agency - MBS                     |                     | 105,432                           | 17,797                              |                  | 123,229      |
| CMOs - Federal agency                    | 98,070              | 3,236,456                         | 204,793                             |                  | 3,539,319    |
| CMOs - Non-agency                        | 2,237               | 24,666                            |                                     |                  | 26,903       |
| State and municipal                      | 100,959             | 288,314                           |                                     | 3,320            | 392,593      |
| Other                                    | 58,751              | 119,236                           |                                     |                  | 177,987      |
| Total debt securities available-for-sale | \$ 922,944          | \$ 4,134,681                      | \$ 261,860                          | \$ 3,320         | \$ 5,322,805 |
| Amortized cost                           | \$ 919,336          | \$ 4,135,324                      | \$ 265,930                          | \$ 3,400         | \$ 5,323,990 |
| <b>Securities held-to-maturity:</b>      |                     |                                   |                                     |                  |              |
| Federal agency - Debt                    | \$                  | \$ 26,000                         | \$ 86,170                           | \$ 190,748       | \$ 302,918   |
| Federal agency - MBS                     |                     | 75,854                            | 467,171                             | 11,396           | 554,421      |
| CMOs - Federal agency                    |                     | 805,601                           | 1,077,860                           |                  | 1,883,461    |
| State and municipal                      |                     | 80,107                            | 399,352                             | 100,014          | 579,473      |
| Other                                    |                     | 98,080                            |                                     |                  | 98,080       |

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|  |    |    |           |    |           |    |         |    |           |
|--|----|----|-----------|----|-----------|----|---------|----|-----------|
| Total debt securities held-to-maturity at amortized cost | \$ | \$ | 1,085,642 | \$ | 2,030,553 | \$ | 302,158 | \$ | 3,418,353 |
|--|----|----|-----------|----|-----------|----|---------|----|-----------|

Table of Contents**Note 3. Securities (Continued)***Impairment Assessment*

The Company performs a quarterly assessment of debt and equity securities in its investment portfolio to determine whether a decline in fair value below amortized cost is other-than-temporary. The Company's impairment assessment of debt securities takes the following factors into consideration: the length of time and the extent to which the market value has been less than cost; the financial condition and near-term prospects of the issuer, including events specific to the issuer or industry; defaults or deferrals of scheduled interest and principal payments; external credit ratings; and whether the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis. For equity securities, the evaluation of whether an impairment is other than temporary is based on whether and when an equity security will recover in value and whether the Company has the intent and ability to hold the equity security until the anticipated recovery in value occurs. If a decline in fair value is determined to be other-than-temporary, the cost basis of the individual security is written down to fair value which then becomes the security's new cost basis. The new cost basis is not adjusted for subsequent recoveries in fair value.

Other-than-temporary impairment losses on equity securities are recognized in earnings. For debt securities, if the Company intends to sell an impaired security or it is more likely than not it will be required to sell a security prior to recovery of its amortized cost, an impairment loss is recognized in earnings for the entire difference between the amortized cost and fair value of the security on the measurement date. If the Company does not intend to sell the security or it is not more likely than not it will be required to sell the security prior to recovery of its amortized cost, the credit loss component of impairment is recognized in earnings. Impairment associated with factors other than credit, such as market liquidity, is recognized in other comprehensive income, net of tax.

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

The Company recorded impairment losses in earnings on securities available-for-sale of \$0.2 million for the three and six months ended June 30, 2014 and 2013, respectively. The Company recognized \$0.3 million and \$0.2 million of non-credit-related other-than-temporary impairment in accumulated other comprehensive income or loss ( AOCI ) on non-agency CMO securities classified as available-for-sale at June 30, 2014 and 2013, respectively. No impairment losses were recognized in earnings or AOCI for securities held-to-maturity during the three and six months ended June 30, 2014 and 2013.

The following table summarizes the changes in cumulative credit-related other-than-temporary impairment recognized in earnings for debt securities for the three and six months ended June 30, 2014 and 2013. Credit-related other-than-temporary impairment that was recognized in earnings is reflected as an Initial credit-related impairment if the period reported is the first time the security had a credit impairment. A credit-related other-than-temporary impairment is reflected as a Subsequent credit-related impairment if the period reported is not the first time the security had a credit impairment. Cumulative impairment is reduced for securities with previously recognized credit-related impairment that were sold or redeemed during the period. Cumulative impairment is further adjusted for other changes in expected cash flows.

**For the three months ended  
June 30,**

**For the six months ended  
June 30,**

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| (in thousands)   | 2014 |         | 2013 |       | 2014 |         | 2013 |          |
|--|------|---------|------|-------|------|---------|------|----------|
| Balance, beginning of period   | \$   | 4,549   | \$   | 3,676 | \$   | 4,549   | \$   | 16,486   |
| Subsequent credit-related impairment   |      | 248     |      | 182   |      | 248     |      | 182      |
| Reduction for securities sold or redeemed  |      | (2,402) |      |       |      | (2,402) |      | (12,761) |
| Reduction for increase in expected cash flows on securities for which OTTI was previously recognized |      |         |      | (204) |      |         |      | (253)    |
| Balance, end of period   | \$   | 2,395   | \$   | 3,654 | \$   | 2,395   | \$   | 3,654    |

Table of Contents**Note 3. Securities (Continued)**

The following table provides a summary of the gross unrealized losses and fair value of investment securities that are not deemed to be other-than-temporarily impaired aggregated by investment category and length of time that the securities have been in a continuous unrealized loss position as of June 30, 2014 and December 31, 2013. The table also includes investment securities that had both a credit-related impairment recognized in earnings and a non-credit-related impairment recognized in AOCI.

| (in thousands)                        | Less than 12 months |                           | 12 months or greater |                           | Total        |                           |
|---------------------------------------|---------------------|---------------------------|----------------------|---------------------------|--------------|---------------------------|
|                                       | Fair Value          | Estimated Unrealized Loss | Fair Value           | Estimated Unrealized Loss | Fair Value   | Estimated Unrealized Loss |
| <b>June 30, 2014</b>                  |                     |                           |                      |                           |              |                           |
| <b>Securities available-for-sale:</b> |                     |                           |                      |                           |              |                           |
| Federal agency - Debt                 | \$ 104,163          | \$ 31                     | \$ 312,696           | \$ 1,460                  | \$ 416,859   | \$ 1,491                  |
| Federal agency - MBS                  | 17,834              | 70                        | 42,442               | 1,507                     | 60,276       | 1,577                     |
| CMOs - Federal agency                 | 615,321             | 1,909                     | 1,299,169            | 39,695                    | 1,914,490    | 41,604                    |
| CMOs - Non-agency                     |                     |                           | 13,610               | 400                       | 13,610       | 400                       |
| State and municipal                   | 1,720               | 4                         | 5,194                | 97                        | 6,914        | 101                       |
| Total securities available-for-sale   | \$ 739,038          | \$ 2,014                  | \$ 1,673,111         | \$ 43,159                 | \$ 2,412,149 | \$ 45,173                 |
| <b>Securities held-to-maturity:</b>   |                     |                           |                      |                           |              |                           |
| Federal agency - Debt                 | \$                  | \$                        | \$ 76,094            | \$ 856                    | \$ 76,094    | \$ 856                    |
| Federal agency - MBS                  | 27,802              | 154                       | 123,966              | 3,904                     | 151,768      | 4,058                     |
| CMOs - Federal agency                 | 619,017             | 8,334                     | 362,367              | 8,200                     | 981,384      | 16,534                    |
| State and municipal                   | 46,463              | 283                       | 140,436              | 4,666                     | 186,899      | 4,949                     |
| Other debt securities                 | 24,437              | 4                         |                      |                           | 24,437       | 4                         |
| Total securities held-to-maturity     | \$ 717,719          | \$ 8,775                  | \$ 702,863           | \$ 17,626                 | \$ 1,420,582 | \$ 26,401                 |
| <b>December 31, 2013</b>              |                     |                           |                      |                           |              |                           |
| <b>Securities available-for-sale:</b> |                     |                           |                      |                           |              |                           |
| Federal agency - Debt                 | \$ 1,026,142        | \$ 7,911                  |                      |                           | \$ 1,026,142 | \$ 7,911                  |
| Federal agency - MBS                  | 17,962              | 85                        | 43,492               | 2,703                     | 61,454       | 2,788                     |
| CMOs - Federal agency                 | 1,637,994           | 35,922                    | 728,101              | 34,849                    | 2,366,095    | 70,771                    |
| CMOs - Non-agency                     | 10,056              | 319                       | 8,483                | 729                       | 18,539       | 1,048                     |
| State and municipal                   | 16,521              | 39                        | 4,266                | 84                        | 20,787       | 123                       |
| Total securities available-for-sale   | \$ 2,708,675        | \$ 44,276                 | \$ 784,342           | \$ 38,365                 | \$ 3,493,017 | \$ 82,641                 |
| <b>Securities held-to-maturity:</b>   |                     |                           |                      |                           |              |                           |
| Federal agency - Debt                 | \$ 156,290          | \$ 5,122                  |                      |                           | \$ 156,290   | \$ 5,122                  |
| Federal agency - MBS                  | 321,090             | 10,513                    | 15,338               | 1,417                     | 336,428      | 11,930                    |
| CMOs - Federal agency                 | 1,539,464           | 36,435                    | 63,276               | 4,186                     | 1,602,740    | 40,621                    |
| State and municipal                   | 347,305             | 14,190                    | 41,102               | 4,824                     | 388,407      | 19,014                    |
| Other debt securities                 | 98,077              | 619                       |                      |                           | 98,077       | 619                       |
| Total securities held-to-maturity     | \$ 2,462,226        | \$ 66,879                 | \$ 119,716           | \$ 10,427                 | \$ 2,581,942 | \$ 77,306                 |

At June 30, 2014, the Company had \$2.41 billion of securities available-for-sale and \$1.42 billion of securities held-to-maturity in an unrealized loss position. The debt securities in an unrealized loss position totaled 520 and included 22 federal agency debt securities, 29 federal agency



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MBS securities, 140 federal agency CMOs, 2 non-agency CMOs, 325 state and municipal securities and 2 other debt securities.

At December 31, 2013, the Company had \$3.49 billion of securities available-for-sale and \$2.58 billion of securities held-to-maturity in an unrealized loss position. The debt securities in an unrealized loss position totaled 809 and included 47 federal agency debt securities, 44 federal agency MBS, 182 federal agency CMOs, 4 non-agency CMOs, 520 state and municipal securities and 12 other debt securities.

Table of Contents**Note 4. Other Investments***FHLB and FRB Stock*

The Company's investment in stock issued by the FHLB and FRB totaled \$58.4 million and \$64.4 million at June 30, 2014 and December 31, 2013, respectively. Ownership of government agency securities is restricted to member banks, and the securities do not have readily determinable market values. The Company records investments in FHLB and FRB stock at cost in Other assets of the consolidated balance sheets and evaluates these investments for impairment. The Company expects to recover the full amount invested in FHLB and FRB stock.

*Private Equity and Alternative Investments*

The Company has ownership interests in a limited number of private equity, venture capital, real estate and hedge funds that are not publicly traded and do not have readily determinable fair values. These investments are carried at cost in the Other assets section of the consolidated balance sheets and are net of impairment write-downs, if applicable. The Company's investments in these funds totaled \$29.7 million at June 30, 2014 and \$34.0 million at December 31, 2013. A summary of investments by fund type is provided below:

| (in thousands)<br>Fund Type        | June 30,<br>2014 | December 31,<br>2013 |
|------------------------------------|------------------|----------------------|
| Private equity and venture capital | \$ 18,411        | \$ 20,298            |
| Real estate                        | 7,623            | 7,646                |
| Hedge                              | 1,733            | 2,733                |
| Other                              | 1,981            | 3,275                |
| Total                              | \$ 29,748        | \$ 33,952            |

Management reviews these investments quarterly for impairment. The impairment assessment includes a review of the most recent financial statements and investment reports for each fund and discussions with fund management. An impairment loss is recognized if it is deemed probable that the Company will not recover the cost of an investment. The impairment loss is recognized in Other noninterest income in the consolidated statements of income. The new cost basis of the investment is not adjusted for subsequent recoveries in value. The Company recognized no impairment losses on other investments during the three and six months ended June 30, 2014. The Company recognized no impairment losses on other investments during the three months ended June 30, 2013, and recognized impairment losses of \$0.4 million during the six months ended June 30, 2013.

Table of Contents**Note 5. Loans, Allowance for Loan and Lease Losses, and Reserve for Off-Balance Sheet Credit Commitments**

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

**Loans and Leases**

| (in thousands) (1)                             | June 30,<br>2014 | December 31,<br>2013 |
|--|------------------|----------------------|
| Commercial                                     | \$ 8,230,112     | \$ 7,562,300         |
| Commercial real estate mortgages               | 3,464,918        | 3,223,001            |
| Residential mortgages                          | 4,814,435        | 4,554,311            |
| Real estate construction                       | 457,557          | 367,004              |
| Home equity loans and lines of credit          | 716,816          | 709,344              |
| Installment                                    | 183,518          | 151,955              |
| Lease financing                                | 607,432          | 602,523              |
| Loans and leases, excluding covered loans      | 18,474,788       | 17,170,438           |
| Less: Allowance for loan and lease losses      | (311,276)        | (302,584)            |
| Loans and leases, excluding covered loans, net | 18,163,512       | 16,867,854           |
| Covered loans                                  | 605,770          | 716,911              |
| Less: Allowance for loan losses                | (9,103)          | (15,922)             |
| Covered loans, net                             | 596,667          | 700,989              |
| Total loans and leases                         | \$ 19,080,558    | \$ 17,887,349        |
| Total loans and leases, net                    | \$ 18,760,179    | \$ 17,568,843        |

(1) Commercial loans as of December 31, 2013 have been corrected to include \$158.2 million of loans that were previously reported as lease financing.

The loan amounts above include unamortized fees, net of deferred costs, of \$1.1 million and \$2.3 million as of June 30, 2014 and December 31, 2013, respectively.

Concentrations of credit risk arise when a number of clients are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic conditions. Although the Company's lending activities are predominantly in California, and to a lesser extent, New York and Nevada, the Company has various specialty lending businesses that lend to businesses located throughout the United States of America. Excluding covered loans, at June 30, 2014, California represented 73 percent of total loans outstanding and New York and Nevada represented 9 percent and 2 percent, respectively. The remaining 16 percent of total loans outstanding represented other states. Although the Company has a diversified loan portfolio, a substantial portion of the loan portfolio and credit performance depends on the economic stability of Southern California. Credit performance also depends, to a lesser extent, on economic conditions in the San Francisco Bay area, New York and Nevada.

Within the Company's covered loan portfolio at June 30, 2014, the five states with the largest concentration were California (35 percent), Texas (12 percent), Nevada (7 percent), Arizona (6 percent) and Ohio (5 percent). The remaining 35 percent of total covered loans outstanding

represented other states.

Table of Contents**Note 5. Loans, Allowance for Loan and Lease Losses, and Reserve for Off-Balance Sheet Credit Commitments (Continued)***Covered Loans*

Covered loans represent loans acquired from the FDIC that are subject to loss-sharing agreements. Covered loans were \$605.8 million as of June 30, 2014 and \$716.9 million as of December 31, 2013. Covered loans, net of allowance for loan losses, were \$596.7 million at June 30, 2014 and \$701.0 million at December 31, 2013.

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

| (in thousands)                        | June 30,<br>2014 | December 31,<br>2013 |
|---------------------------------------|------------------|----------------------|
| Commercial                            | \$ 6,992         | \$ 10,009            |
| Commercial real estate mortgages      | 568,902          | 666,628              |
| Residential mortgages                 | 5,525            | 4,976                |
| Real estate construction              | 20,742           | 31,184               |
| Home equity loans and lines of credit | 3,342            | 3,695                |
| Installment                           | 267              | 419                  |
| Covered loans                         | 605,770          | 716,911              |
| Less: Allowance for loan losses       | (9,103)          | (15,922)             |
| Covered loans, net                    | \$ 596,667       | \$ 700,989           |

The following table provides information on covered loans and loss-sharing terms by acquired entity:

| (in thousands)   | Imperial<br>Capital<br>Bank | 1st Pacific<br>Bank | Sun West<br>Bank | Nevada<br>Commerce<br>Bank | Total      |
|--|-----------------------------|---------------------|------------------|----------------------------|------------|
| <b>Covered loans as of:</b>                              |                             |                     |                  |                            |            |
| June 30, 2014  | \$ 536,292                  | \$ 32,320           | \$ 13,651        | \$ 23,507                  | \$ 605,770 |
| December 31, 2013  | 630,754                     | 40,110              | 18,761           | 27,286                     | 716,911    |
| <b>As of June 30, 2014:</b>                              |                             |                     |                  |                            |            |
| FDIC indemnification asset                               | \$ 57,624                   | \$ 2,368            | \$ 4,137         | \$ 3,909                   | \$ 68,038  |
| FDIC clawback liability                                  |                             | 12,122              | 1,925            | 32                         | 14,079     |
| <b>Expiration date of FDIC loss sharing:</b>             |                             |                     |                  |                            |            |
| Commercial (1)   | 12/31/2016                  | 6/30/2015           | 6/30/2015        | 6/30/2016                  |            |
| Residential  | 12/31/2019                  | 5/31/2020           | 5/31/2020        | 4/30/2021                  |            |
| <b>Termination date of FDIC loss-sharing agreements:</b> |                             |                     |                  |                            |            |
| Commercial (1)   | 12/19/2017                  | 5/8/2018            | 5/29/2018        | 6/30/2019                  |            |
| Residential  | 12/31/2019                  | 5/31/2020           | 5/31/2020        | 4/30/2021                  |            |

(1) The Company is subject to sharing 80 percent of its recoveries with the FDIC up to the last day of the quarter in which the termination dates of the commercial loss-sharing agreements occur.

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

Table of Contents**Note 5. Loans, Allowance for Loan and Lease Losses, and Reserve for Off-Balance Sheet Credit Commitments (Continued)**

The excess of cash flows expected to be collected over the carrying value of the underlying acquired impaired loans is referred to as the accretable yield. This amount is not reported in the consolidated balance sheets but is accreted into interest income over the remaining estimated lives of the underlying pools of loans. Changes in the accretable yield for acquired impaired loans were as follows for the six months ended June 30, 2014 and 2013:

| (in thousands)                                  | For the six months ended |            |  |
|---|--------------------------|------------|--|
|   |                          | June 30,   |  |
|   | 2014                     | 2013       |  |
| Balance, beginning of period                    | \$ 219,018               | \$ 295,813 |  |
| Accretion                                       | (24,907)                 | (33,221)   |  |
| Reclassifications from nonaccretable difference | 18,965                   | 15,978     |  |
| Disposals and other                             | (16,198)                 | (24,605)   |  |
| Balance, end of period                          | \$ 196,878               | \$ 253,965 |  |

The factors that most significantly affect estimates of cash flows expected to be collected, and accordingly the accretable yield balance, include: (i) changes in credit assumptions, including both credit loss amounts and timing; (ii) changes in prepayment assumptions; and (iii) changes in interest rates for variable-rate loans. Reclassifications between accretable yield and nonaccretable difference may vary from period to period as the Company periodically updates its cash flow projections. The reclassification of nonaccretable difference to accretable yield during 2014 was principally driven by positive changes in cash flows, resulting mainly from changes in credit assumptions.

The Company recorded an indemnification asset related to its FDIC-assisted acquisitions, which represents the present value of the expected reimbursement from the FDIC for expected losses on acquired loans, OREO and unfunded commitments. The difference between the carrying value of the FDIC indemnification asset and the undiscounted cash flow that the Company expects to collect from the FDIC is accreted or amortized into noninterest income up until the expiration date of the FDIC loss sharing. Refer to the preceding table for a list of expiration dates of FDIC loss sharing by acquired entity. The FDIC indemnification asset is reviewed on a quarterly basis and adjusted based on changes in cash flow projections. The FDIC indemnification asset from all FDIC-assisted acquisitions was \$68.0 million at June 30, 2014 and \$89.2 million at December 31, 2013.

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

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

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ongoing credit review process. As conditions change, the Company's level of provisioning and the allowance for loan and lease losses and reserve for off-balance sheet credit commitments may change.

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



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**Note 5. Loans, Allowance for Loan and Lease Losses, and Reserve for Off-Balance Sheet Credit Commitments (Continued)**

For commercial, non-homogenous loans that are not impaired, the Bank derives loss factors for each risk grade and loan type via a process that begins with estimates of probable losses inherent in the portfolio based upon various statistical analyses. The factors considered in the analysis include loan type, migration analysis, in which historical delinquency and credit loss experience is applied to the portfolio, as well as analyses that reflect current trends and conditions. Each portfolio of smaller balance homogeneous loans, including residential first mortgages, installment, revolving credit and most other consumer loans, is collectively evaluated for loss potential. The quantitative portion of the allowance for loan and lease losses is adjusted for qualitative factors to account for model imprecision and to incorporate the range of probable outcomes inherent in the estimates used for the allowance. The qualitative portion of the allowance attempts to incorporate the risks inherent in the portfolio, economic uncertainties, competition, and regulatory requirements and other subjective factors such as changes in underwriting standards. It also considers overall portfolio indicators, including current and historical credit losses; delinquent, nonperforming and criticized loans; portfolio concentrations; trends in volumes and terms of loans; and economic trends in the broad market and in specific industries.

A portion of the allowance for loan and lease losses is attributed to impaired loans that are individually measured for impairment. This measurement is based on the present value of expected future cash flows discounted using the loan's contractual effective rate, the fair value of collateral or the secondary market value of the loan.

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

Table of Contents**Note 5. Loans, Allowance for Loan and Lease Losses, and Reserve for Off-Balance Sheet Credit Commitments (Continued)**

The following is a summary of activity in the allowance for loan and lease losses and period-end recorded investment balances of loans evaluated for impairment, excluding covered loans, for the three and six months ended June 30, 2014 and 2013. Activity is provided by loan portfolio segment which is consistent with the Company's methodology for determining the allowance for loan and lease losses.

| (in thousands)  | Commercial<br>(1) | Commercial<br>Real Estate<br>Mortgages | Residential<br>Mortgages | Real Estate<br>Construction | Home Equity<br>Loans and Lines<br>of Credit | Installment | Qualitative | Total      |
|---|-------------------|--|--------------------------|-----------------------------|---|-------------|-------------|------------|
| <b>Three months ended<br/>June 30, 2014</b>                                   |                   |  |                          |                             |   |             |             |            |
| <b>Allowance for loan and<br/>lease losses:</b>                               |                   |  |                          |                             |   |             |             |            |
| Beginning balance   | \$ 121,574        | \$ 51,361                              | \$ 11,595                | \$ 6,468                    | \$ 6,419                                    | \$ 1,824    | \$ 106,549  | \$ 305,790 |
| Charge-offs   | (12,862)          |  |                          |                             | (149)                                       | (142)       |             | (13,153)   |
| Recoveries  | 7,503             | 27                                     | 190                      | 687                         | 43  | 1,068       |             | 9,518      |
| Net (charge-offs)<br>recoveries   | (5,359)           | 27                                     | 190                      | 687                         | (106)                                       | 926         |             | (3,635)    |
| (Reversal of) provision<br>for credit losses                                  | 711               | (737)                                  | (1,489)                  | 36                          | 262   | (466)       | 683         | (1,000)    |
| Transfers from reserve<br>for off-balance sheet<br>credit commitments         | 9,353             |  |                          |                             |   |             | 768         | 10,121     |
| Ending balance  | \$ 126,279        | \$ 50,651                              | \$ 10,296                | \$ 7,191                    | \$ 6,575                                    | \$ 2,284    | \$ 108,000  | \$ 311,276 |
| <b>Six months ended<br/>June 30, 2014</b>                                     |                   |  |                          |                             |   |             |             |            |
| <b>Allowance for loan and<br/>lease losses:</b>                               |                   |  |                          |                             |   |             |             |            |
| Beginning balance   | \$ 117,103        | \$ 50,678                              | \$ 11,540                | \$ 6,351                    | \$ 6,677                                    | \$ 1,842    | \$ 108,393  | \$ 302,584 |
| Charge-offs   | (14,821)          | (5)                                    | (482)                    |                             | (165)                                       | (188)       |             | (15,661)   |
| Recoveries  | 9,235             | 127                                    | 225                      | 5,075                       | 202   | 1,332       |             | 16,196     |
| Net (charge-offs)<br>recoveries   | (5,586)           | 122                                    | (257)                    | 5,075                       | 37  | 1,144       |             | 535        |
| (Reversal of) provision<br>for credit losses                                  | 5,409             | (149)                                  | (987)                    | (4,235)                     | (139)                                       | (702)       | (197)       | (1,000)    |
| Transfers from (to)<br>reserve for off-balance<br>sheet credit<br>commitments | 9,353             |  |                          |                             |   |             | (196)       | 9,157      |
| Ending balance  | \$ 126,279        | \$ 50,651                              | \$ 10,296                | \$ 7,191                    | \$ 6,575                                    | \$ 2,284    | \$ 108,000  | \$ 311,276 |
| Ending balance of<br>allowance:   |                   |  |                          |                             |   |             |             |            |
| Individually evaluated<br>for impairment                                      | \$ 8,477          | \$ 301                                 | \$ 5                     | \$                          | \$  | \$ 50       | \$          | \$ 8,833   |
| Collectively evaluated<br>for impairment                                      | 117,802           | 50,350                                 | 10,291                   | 7,191                       | 6,575                                       | 2,234       | 108,000     | 302,443    |
| <b>Loans and leases,<br/>excluding covered<br/>loans</b>                      |                   |  |                          |                             |   |             |             |            |

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|   |              |              |              |            |            |            |               |
|---|--------------|--------------|--------------|------------|------------|------------|---------------|
| Ending balance of loans and leases:       |              |              |              |            |            |            |               |
| Loans and leases, excluding covered loans | \$ 8,837,544 | \$ 3,464,918 | \$ 4,814,435 | \$ 457,557 | \$ 716,816 | \$ 183,518 | \$ 18,474,788 |
| Individually evaluated for impairment     | 29,231       | 33,456       | 10,596       | 12,846     | 3,436      | 50         | 89,615        |
| Collectively evaluated for impairment     | 8,808,313    | 3,431,462    | 4,803,839    | 444,711    | 713,380    | 183,468    | 18,385,173    |

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(1) Includes lease financing loans.

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**Note 5. Loans, Allowance for Loan and Lease Losses, and Reserve for Off-Balance Sheet Credit Commitments (Continued)**

| (in thousands) (2)  | Commercial<br>(1) | Commercial<br>Real Estate<br>Mortgages | Residential<br>Mortgages | Real Estate<br>Construction | Home Equity<br>Loans and Lines<br>of Credit | Installment | Qualitative | Total         |
|---|-------------------|--|--------------------------|-----------------------------|---|-------------|-------------|---------------|
| <b>Three months ended<br/>June 30, 2013</b>                           |                   |  |                          |                             |   |             |             |               |
| <b>Allowance for loan and<br/>lease losses:</b>                       |                   |  |                          |                             |   |             |             |               |
| Beginning balance   | \$ 112,748        | \$ 52,016                              | \$ 7,253                 | \$ 9,962                    | \$ 4,843                                    | \$ 1,225    | \$ 94,281   | \$ 282,328    |
| Charge-offs   | (2,869)           |  | (1)                      | (100)                       | (35)  | (81)        |             | (3,086)       |
| Recoveries  | 5,724             | 1,034                                  | 38                       | 2,782                       | 410   | 603         |             | 10,591        |
| Net recoveries<br>(charge-offs)                                       | 2,855             | 1,034                                  | 37                       | 2,682                       | 375   | 522         |             | 7,505         |
| (Reversal of) provision<br>for credit losses                          | 1,016             | 289                                    | 714                      | (4,309)                     | 182   | (392)       | 2,500       |               |
| Transfers from reserve for<br>off-balance sheet credit<br>commitments |                   |  |                          |                             |   |             | 81          | 81            |
| Ending balance  | \$ 116,619        | \$ 53,339                              | \$ 8,004                 | \$ 8,335                    | \$ 5,400                                    | \$ 1,355    | \$ 96,862   | \$ 289,914    |
| <b>Six months ended<br/>June 30, 2013</b>                             |                   |  |                          |                             |   |             |             |               |
| <b>Allowance for loan and<br/>lease losses:</b>                       |                   |  |                          |                             |   |             |             |               |
| Beginning balance   | \$ 104,731        | \$ 48,901                              | \$ 10,558                | \$ 11,784                   | \$ 7,283                                    | \$ 1,858    | \$ 92,773   | \$ 277,888    |
| Charge-offs   | (4,231)           | (45)                                   | (106)                    | (100)                       | (275)                                       | (352)       |             | (5,109)       |
| Recoveries  | 9,259             | 1,082                                  | 75                       | 5,448                       | 538   | 1,020       |             | 17,422        |
| Net recoveries<br>(charge-offs)                                       | 5,028             | 1,037                                  | (31)                     | 5,348                       | 263   | 668         |             | 12,313        |
| (Reversal of) provision<br>for credit losses                          | 6,860             | 3,401                                  | (2,523)                  | (8,797)                     | (2,146)                                     | (1,171)     | 4,376       |               |
| Transfers to reserve for<br>off-balance sheet credit<br>commitments   |                   |  |                          |                             |   |             | (287)       | (287)         |
| Ending balance  | \$ 116,619        | \$ 53,339                              | \$ 8,004                 | \$ 8,335                    | \$ 5,400                                    | \$ 1,355    | \$ 96,862   | \$ 289,914    |
| Ending balance of<br>allowance:                                       |                   |  |                          |                             |   |             |             |               |
| Individually evaluated for<br>impairment                              | \$ 478            | \$ 2,252                               | \$ 230                   | \$                          | \$  | \$          | \$          | \$ 2,960      |
| Collectively evaluated for<br>impairment                              | 116,141           | 51,087                                 | 7,774                    | 8,335                       | 5,400                                       | 1,355       | 96,862      | 286,954       |
| <b>Loans and leases,<br/>excluding covered loans</b>                  |                   |  |                          |                             |   |             |             |               |
| Ending balance of loans<br>and leases:                                |                   |  |                          |                             |   |             |             |               |
| Loans and leases,<br>excluding covered loans                          | \$ 7,497,105      | \$ 2,978,975                           | \$ 4,153,051             | \$ 340,002                  | \$ 700,681                                  | \$ 149,438  | \$          | \$ 15,819,252 |
| Individually evaluated for<br>impairment                              | 34,915            | 41,932                                 | 7,979                    | 30,446                      | 3,257                                       |             |             | 118,529       |
| Collectively evaluated for<br>impairment                              | 7,462,190         | 2,937,043                              | 4,145,072                | 309,556                     | 697,424                                     | 149,438     |             | 15,700,723    |

(1) Includes lease financing loans.

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(2) Certain balances for the three and six months ended June 30, 2013 have been revised as a result of correcting the real estate construction loan balance to include loans that were previously reported as commercial real estate mortgages.

Off-balance sheet credit exposures include loan commitments and letters of credit. The following table provides a summary of activity in the reserve for off-balance sheet credit commitments for the three and six months ended June 30, 2014 and 2013:

| (in thousands)  | For the three months ended<br>June 30, |           | For the six months ended<br>June 30, |           |
|---|--|-----------|--------------------------------------|-----------|
|   | 2014                                   | 2013      | 2014                                 | 2013      |
| Balance, beginning of period                            | \$ 34,908                              | \$ 25,205 | \$ 33,944                            | \$ 24,837 |
| Transfers (to) from allowance for loan and lease losses | (10,121)                               | (81)      | (9,157)                              | 287       |
| Balance, end of period                                  | \$ 24,787                              | \$ 25,124 | \$ 24,787                            | \$ 25,124 |

The reserve for off-balance sheet credit commitments decreased \$10.1 million and \$9.2 million during the three and six months ended June 30, 2014, respectively. The decrease for both periods was primarily due to the conversion of an undrawn letter of credit that had a specific reserve to an on-balance sheet loan, and normal fluctuations in the amount of reserves required due to changes in the composition, amount, and quality of risk ratings of borrowers associated with the off-balance sheet commitments. Increases and decreases in the reserve for off-balance sheet credit commitments are reflected as an allocation of provision expense from or to the allowance for loan and lease losses.

Table of Contents**Note 5. Loans, Allowance for Loan and Lease Losses, and Reserve for Off-Balance Sheet Credit Commitments (Continued)***Impaired Loans and Leases*

The Company considers a loan to be impaired when it is probable that it will be unable to collect all amounts due according to the contractual terms of the loan agreement. Once a loan is determined to be impaired, the impairment is measured based on the present value of the expected future cash flows discounted at the loan's effective interest rate, except that if the loan is collateral dependent, the impairment is measured by using the fair value of the loan's collateral. As a final alternative, the observable market price of the debt may be used to assess impairment. Nonperforming loans greater than \$1 million are individually evaluated for impairment based upon the borrower's overall financial condition, resources, and payment record, and the prospects for support from any financially responsible guarantors. Loans under \$1 million will be measured for impairment using historical loss factors. When the measurement of the impaired loan is less than the recorded amount of the loan, an impairment is recognized by creating a valuation allowance with a corresponding charge to the allowance for loan and lease losses or by adjusting an existing valuation allowance for the impaired loan.

Information on impaired loans, excluding covered loans, at June 30, 2014, December 31, 2013 and June 30, 2013 is provided in the following tables:

| (in thousands)                        | Recorded<br>Investment | Unpaid<br>Contractual<br>Principal<br>Balance | Related<br>Allowance | For the three months ended<br>June 30, 2014 |                                  | For the six months ended<br>June 30, 2014 |                                  |
|---------------------------------------|------------------------|---|----------------------|---|----------------------------------|---|----------------------------------|
|                                       |                        |   |                      | Average<br>Recorded<br>Investment           | Interest<br>Income<br>Recognized | Average<br>Recorded<br>Investment         | Interest<br>Income<br>Recognized |
| <b>June 30, 2014</b>                  |                        |   |                      |   |                                  |   |                                  |
| With no related allowance recorded:   |                        |   |                      |   |                                  |   |                                  |
| Commercial                            | \$ 6,980               | \$ 7,713                                      | \$                   | \$ 9,118                                    | \$ 30                            | \$ 11,986                                 | \$ 167                           |
| Commercial real estate mortgages      | 28,233                 | 30,829  |                      | 32,398                                      | 246                              | 32,522                                    | 684                              |
| Residential mortgages:                |                        |   |                      |   |                                  |   |                                  |
| Fixed                                 | 4,796                  | 5,012   |                      | 4,842                                       | 10                               | 3,940                                     | 20                               |
| Variable                              | 1,799                  | 1,922   |                      | 2,408                                       | 14                               | 3,406                                     | 28                               |
| Total residential mortgages           | 6,595                  | 6,934   |                      | 7,250                                       | 24                               | 7,346                                     | 48                               |
| Real estate construction:             |                        |   |                      |   |                                  |   |                                  |
| Construction                          |                        |   |                      | 2,742                                       | 21                               | 3,656                                     | 76                               |
| Land                                  | 12,846                 | 26,520  |                      | 13,075                                      | 35                               | 13,254                                    | 69                               |
| Total real estate construction        | 12,846                 | 26,520  |                      | 15,817                                      | 56                               | 16,910                                    | 145                              |
| Home equity loans and lines of credit | 3,436                  | 4,505   |                      | 3,442                                       |                                  | 3,071                                     |                                  |
| Installment:                          |                        |   |                      |   |                                  |   |                                  |
| Consumer                              |                        |   |                      |   |                                  | 5   |                                  |
| Total installment                     |                        |   |                      |   |                                  | 5   |                                  |
| Total with no related allowance       | \$ 58,090              | \$ 76,501                                     | \$                   | \$ 68,025                                   | \$ 356                           | \$ 71,840                                 | \$ 1,044                         |
| With an allowance recorded:           |                        |   |                      |   |                                  |   |                                  |
| Commercial                            | \$ 22,251              | \$ 28,454                                     | \$ 8,477             | \$ 19,839                                   | \$                               | \$ 17,938                                 | \$                               |
| Commercial real estate mortgages      | 5,223                  | 5,586   | 301                  | 5,293                                       | 74                               | 5,323                                     | 118                              |
| Residential mortgages:                |                        |   |                      |   |                                  |   |                                  |
| Variable                              | 4,001                  | 3,993   | 5                    | 2,001                                       | 11                               | 1,892                                     | 11                               |

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|                                       |           |            |          |           |        |           |          |
|---------------------------------------|-----------|------------|----------|-----------|--------|-----------|----------|
| Total residential mortgages           | 4,001     | 3,993      | 5        | 2,001     | 11     | 1,892     | 11       |
| Installment:                          |           |            |          |           |        |           |          |
| Consumer                              | 50        | 50         | 50       | 25        | 1      | 17        | 1        |
| Total installment                     | 50        | 50         | 50       | 25        | 1      | 17        | 1        |
| Total with an allowance               | \$ 31,525 | \$ 38,083  | \$ 8,833 | \$ 27,158 | \$ 86  | \$ 25,170 | \$ 130   |
| Total impaired loans by type:         |           |            |          |           |        |           |          |
| Commercial                            | \$ 29,231 | \$ 36,167  | \$ 8,477 | \$ 28,957 | \$ 30  | \$ 29,924 | \$ 167   |
| Commercial real estate mortgages      | 33,456    | 36,415     | 301      | 37,691    | 320    | 37,845    | 802      |
| Residential mortgages                 | 10,596    | 10,927     | 5        | 9,251     | 35     | 9,238     | 59       |
| Real estate construction              | 12,846    | 26,520     |          | 15,817    | 56     | 16,910    | 145      |
| Home equity loans and lines of credit | 3,436     | 4,505      |          | 3,442     |        | 3,071     |          |
| Installment                           | 50        | 50         | 50       | 25        | 1      | 22        | 1        |
| Total impaired loans                  | \$ 89,615 | \$ 114,584 | \$ 8,833 | \$ 95,183 | \$ 442 | \$ 97,010 | \$ 1,174 |

Table of Contents**Note 5. Loans, Allowance for Loan and Lease Losses, and Reserve for Off-Balance Sheet Credit Commitments (Continued)**

| (in thousands)                        | Recorded<br>Investment | Unpaid<br>Contractual<br>Principal<br>Balance | Related<br>Allowance |
|---------------------------------------|------------------------|---|----------------------|
| <b>Year ended December 31, 2013</b>   |                        |   |                      |
| With no related allowance recorded:   |                        |   |                      |
| Commercial                            | \$ 17,721              | \$ 18,041                                     | \$                   |
| Commercial real estate mortgages      | 32,770                 | 37,555  |                      |
| Residential mortgages:                |                        |   |                      |
| Fixed                                 | 2,135                  | 2,295   |                      |
| Variable                              | 5,402                  | 5,783   |                      |
| Total residential mortgages           | 7,537                  | 8,078   |                      |
| Real estate construction:             |                        |   |                      |
| Construction                          | 5,485                  | 6,766   |                      |
| Land                                  | 13,612                 | 26,928  |                      |
| Total real estate construction        | 19,097                 | 33,694  |                      |
| Home equity loans and lines of credit | 2,329                  | 3,375   |                      |
| Installment:                          |                        |   |                      |
| Consumer                              | 16                     | 24  |                      |
| Total installment                     | 16                     | 24  |                      |
| Total with no related allowance       | \$ 79,470              | \$ 100,767                                    | \$                   |
| With an allowance recorded:           |                        |   |                      |
| Commercial                            | \$ 14,136              | \$ 18,156                                     | \$ 1,961             |
| Commercial real estate mortgages      | 5,384                  | 5,764   | 586                  |
| Residential mortgages:                |                        |   |                      |
| Variable                              | 1,674                  | 1,687   | 478                  |
| Total residential mortgages           | 1,674                  | 1,687   | 478                  |
| Total with an allowance               | \$ 21,194              | \$ 25,607                                     | \$ 3,025             |
| Total impaired loans by type:         |                        |   |                      |
| Commercial                            | \$ 31,857              | \$ 36,197                                     | \$ 1,961             |
| Commercial real estate mortgages      | 38,154                 | 43,319  | 586                  |
| Residential mortgages                 | 9,211                  | 9,765   | 478                  |
| Real estate construction              | 19,097                 | 33,694  |                      |
| Home equity loans and lines of credit | 2,329                  | 3,375   |                      |
| Installment                           | 16                     | 24  |                      |
| Total impaired loans                  | \$ 100,664             | \$ 126,374                                    | \$ 3,025             |



Table of Contents**Note 5. Loans, Allowance for Loan and Lease Losses, and Reserve for Off-Balance Sheet Credit Commitments (Continued)**

| (in thousands)                        | Recorded<br>Investment | Unpaid<br>Contractual<br>Principal<br>Balance | Related<br>Allowance | For the three months ended<br>June 30, 2013 |                                  | For the six months ended<br>June 30, 2013 |                                  |
|---------------------------------------|------------------------|---|----------------------|---|----------------------------------|---|----------------------------------|
|                                       |                        |   |                      | Average<br>Recorded<br>Investment           | Interest<br>Income<br>Recognized | Average<br>Recorded<br>Investment         | Interest<br>Income<br>Recognized |
| <b>June 30, 2013</b>                  |                        |   |                      |   |                                  |   |                                  |
| With no related allowance recorded:   |                        |   |                      |   |                                  |   |                                  |
| Commercial                            | \$ 27,276              | \$ 28,029                                     | \$                   | \$ 23,171                                   | \$ 428                           | \$ 21,701                                 | \$ 847                           |
| Commercial real estate mortgages      | 26,821                 | 31,116  |                      | 28,112                                      | 427                              | 33,035                                    | 662                              |
| Residential mortgages:                |                        |   |                      |   |                                  |   |                                  |
| Fixed                                 | 2,008                  | 2,356   |                      | 2,963                                       | 24                               | 3,136                                     | 42                               |
| Variable                              | 4,277                  | 4,619   |                      | 4,161                                       | 55                               | 4,396                                     | 69                               |
| Total residential mortgages           | 6,285                  | 6,975   |                      | 7,124                                       | 79                               | 7,532                                     | 111                              |
| Real estate construction:             |                        |   |                      |   |                                  |   |                                  |
| Construction                          | 16,265                 | 21,064  |                      | 17,799                                      | 228                              | 18,453                                    | 558                              |
| Land                                  | 14,181                 | 27,156  |                      | 13,172                                      | 253                              | 17,364                                    | 287                              |
| Total real estate construction        | 30,446                 | 48,220  |                      | 30,971                                      | 481                              | 35,817                                    | 845                              |
| Home equity loans and lines of credit | 3,257                  | 4,310   |                      | 2,698                                       | 34                               | 2,986                                     | 34                               |
| Installment:                          |                        |   |                      |   |                                  |   |                                  |
| Consumer                              |                        |   |                      |   |                                  | 150                                       |                                  |
| Total installment                     |                        |   |                      |   |                                  | 150                                       |                                  |
| Total with no related allowance       | \$ 94,085              | \$ 118,650                                    | \$                   | \$ 92,076                                   | \$ 1,449                         | \$ 101,221                                | \$ 2,499                         |
| With an allowance recorded:           |                        |   |                      |   |                                  |   |                                  |
| Commercial                            | \$ 7,639               | \$ 9,170                                      | \$ 478               | \$ 7,606                                    | \$ 311                           | \$ 7,576                                  | \$ 357                           |
| Commercial real estate mortgages      | 15,111                 | 15,963  | 2,252                | 14,228                                      | 148                              | 12,886                                    | 316                              |
| Residential mortgages:                |                        |   |                      |   |                                  |   |                                  |
| Fixed                                 |                        |   |                      |   |                                  | 154                                       |                                  |
| Variable                              | 1,694                  | 1,688   | 230                  | 847   | 41                               | 565                                       | 41                               |
| Total residential mortgages           | 1,694                  | 1,688   | 230                  | 847   | 41                               | 719                                       | 41                               |
| Real estate construction:             |                        |   |                      |   |                                  |   |                                  |
| Land                                  |                        |   |                      | 6,425                                       |                                  | 4,283                                     | 213                              |
| Total real estate construction        |                        |   |                      | 6,425                                       |                                  | 4,283                                     | 213                              |
| Home equity loans and lines of credit |                        |   |                      |   |                                  | 300                                       |                                  |
| Total with an allowance               | \$ 24,444              | \$ 26,821                                     | \$ 2,960             | \$ 29,106                                   | \$ 500                           | \$ 25,764                                 | \$ 927                           |
| Total impaired loans by type:         |                        |   |                      |   |                                  |   |                                  |
| Commercial                            | \$ 34,915              | \$ 37,199                                     | \$ 478               | \$ 30,777                                   | \$ 739                           | \$ 29,277                                 | \$ 1,204                         |
| Commercial real estate mortgages      | 41,932                 | 47,079  | 2,252                | 42,340                                      | 575                              | 45,921                                    | 978                              |
| Residential mortgages                 | 7,979                  | 8,663   | 230                  | 7,971                                       | 120                              | 8,251                                     | 152                              |
| Real estate construction              | 30,446                 | 48,220  |                      | 37,396                                      | 481                              | 40,100                                    | 1,058                            |
| Home equity loans and lines of credit | 3,257                  | 4,310   |                      | 2,698                                       | 34                               | 3,286                                     | 34                               |
| Installment                           |                        |   |                      |   |                                  | 150                                       |                                  |
| Total impaired loans                  | \$ 118,529             | \$ 145,471                                    | \$ 2,960             | \$ 121,182                                  | \$ 1,949                         | \$ 126,985                                | \$ 3,426                         |

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Impaired loans at June 30, 2014 and December 31, 2013 included \$34.7 million and \$42.1 million, respectively, of loans that are on accrual status. With the exception of restructured loans on accrual status and a limited number of loans on cash basis nonaccrual for which the full collection of principal and interest is expected, interest income is not recognized on impaired loans until the principal balance of these loans is paid off.

Table of Contents**Note 5. Loans, Allowance for Loan and Lease Losses, and Reserve for Off-Balance Sheet Credit Commitments (Continued)***Troubled Debt Restructured Loans*

The following table provides a summary of loans modified in a troubled debt restructuring during the three months ended June 30, 2014 and 2013:

| (in thousands)                          | Number of Contracts | Pre-Modification Outstanding Principal | Period-End Outstanding Principal | Financial Effects (1) |
|---|---------------------|--|----------------------------------|-----------------------|
| <b>Three months ended June 30, 2014</b> |                     |  |                                  |                       |
| Residential mortgages:                  |                     |  |                                  |                       |
| Variable                                | 1                   | \$ 4,000                               | \$ 3,993                         | \$ 5                  |
| Installment:                            |                     |  |                                  |                       |
| Consumer                                | 1                   | 50                                     | 50                               | 50                    |
| Total troubled debt restructured loans  | 2                   | \$ 4,050                               | \$ 4,043                         | \$ 55                 |
| <b>Three months ended June 30, 2013</b> |                     |  |                                  |                       |
| Commercial                              | 6                   | \$ 6,956                               | \$ 6,926                         | \$                    |
| Commercial real estate mortgages        | 1                   | 547                                    | 547                              |                       |
| Total troubled debt restructured loans  | 7                   | \$ 7,503                               | \$ 7,473                         | \$                    |

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

The following table provides a summary of loans modified in a troubled debt restructuring during the six months ended June 30, 2014 and 2013:

| (in thousands)                         | Number of Contracts | Pre-Modification Outstanding Principal | Period-End Outstanding Principal | Financial Effects (1) |
|--|---------------------|--|----------------------------------|-----------------------|
| <b>Six months ended June 30, 2014</b>  |                     |  |                                  |                       |
| Commercial                             | 2                   | \$ 4,098                               | \$ 3,967                         | \$                    |
| Residential mortgages:                 |                     |  |                                  |                       |
| Variable                               | 2                   | 4,676                                  | 4,669                            | 5                     |
| Installment:                           |                     |  |                                  |                       |
| Consumer                               | 1                   | 50                                     | 50                               | 50                    |
| Total troubled debt restructured loans | 5                   | \$ 8,824                               | \$ 8,686                         | \$ 55                 |
| <b>Six months ended June 30, 2013</b>  |                     |  |                                  |                       |
| Commercial                             | 10                  | \$ 8,683                               | \$ 8,336                         | \$                    |
| Commercial real estate mortgages       | 1                   | 547                                    | 547                              |                       |
| Home equity loans and lines of credit  | 1                   | 345                                    |                                  |                       |
| Total troubled debt restructured loans | 12                  | \$ 9,575                               | \$ 8,883                         | \$                    |

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

A restructuring constitutes a troubled debt restructuring when a lender, for reasons related to a borrower's financial difficulties, grants a concession to the borrower that it would not otherwise consider. Loans with pre-modification outstanding balances totaling \$4.1 million and \$8.8 million were modified in troubled debt restructurings during the three and six months ended June 30, 2014, respectively. Loans with pre-modification outstanding balances totaling \$7.5 million and \$9.6 million were modified in troubled debt restructurings during the three and six months ended June 30, 2013, respectively. The concessions granted in the restructurings completed in 2014 consisted of maturity extensions and rate modifications.

Table of Contents**Note 5. Loans, Allowance for Loan and Lease Losses, and Reserve for Off-Balance Sheet Credit Commitments (Continued)**

The unpaid principal balance of troubled debt restructured ( TDR ) loans was \$45.4 million, before specific reserves of \$1.6 million, at June 30, 2014 and \$52.2 million, before specific reserves of \$0.8 million, at December 31, 2013. The net decrease in TDR loans from the prior year-end was primarily attributable to payoffs and payments received on existing TDR loans totaling \$16.2 million and to the removal of \$0.5 million of loans that were restructured in an A/B note structure in prior year that are no longer reported as TDRs. These decreases were partially offset by additions totaling \$8.8 million and advances on existing TDR loans totaling \$1.5 million. Loans modified in troubled debt restructurings are impaired loans at the time of restructuring and subject to the same measurement criteria as all other impaired loans.

The Company had no TDR loans that subsequently defaulted during the three and six months ended June 30, 2014. The following table provides a summary of TDR loans that subsequently defaulted during the three and six months ended June 30, 2013, that had been modified as a troubled debt restructuring during the 12 months prior to their default. A TDR loan is considered to be in default when payments are 90 days or more past due.

| (in thousands)                          | For three months ended June 30, 2013 |                                  |                             | For six months ended June 30, 2013 |                                  |                             |
|---|--------------------------------------|----------------------------------|-----------------------------|------------------------------------|----------------------------------|-----------------------------|
|   | Number of Contracts                  | Period-End Outstanding Principal | Period-End Specific Reserve | Number of Contracts                | Period-End Outstanding Principal | Period-End Specific Reserve |
| Commercial                              | 2                                    | \$ 427                           | \$                          | 4                                  | \$ 1,487                         | \$                          |
| Real estate construction:               |                                      |                                  |                             |                                    |                                  |                             |
| Land                                    | 1                                    | 7,491                            |                             | 1                                  | 7,491                            |                             |
| Home equity loans and lines of credit   |                                      |                                  |                             | 1                                  | 141                              |                             |
| Total loans that subsequently defaulted | 3                                    | \$ 7,918                         | \$                          | 6                                  | \$ 9,119                         | \$                          |

All TDR loans were performing in accordance with their restructured terms at June 30, 2014. As of June 30, 2014, commitments to lend additional funds on restructured loans totaled \$0.2 million.

*Past Due and Nonaccrual Loans and Leases*

Loans are considered past due following the date when either interest or principal is contractually due and unpaid. The following tables provide a summary of past due and nonaccrual loans, excluding covered loans, at June 30, 2014 and December 31, 2013 based upon the length of time the loans have been past due:

| (in thousands)       | 30-59 Days Past Due | 60-89 Days Past Due | Greater Than 90 Days and Accruing | Nonaccrual | Total Past Due and Nonaccrual Loans | Current      | Total Loans and Leases |
|----------------------|---------------------|---------------------|-----------------------------------|------------|-------------------------------------|--------------|------------------------|
| <b>June 30, 2014</b> |                     |                     |                                   |            |                                     |              |                        |
| Commercial           | \$ 6,924            | \$ 2,702            |                                   | \$ 27,314  | \$ 36,940                           | \$ 8,193,172 | \$ 8,230,112           |

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|                                       |          |          |          |           |           |               |
|---------------------------------------|----------|----------|----------|-----------|-----------|---------------|
| Commercial real estate mortgages      | 1,101    | 1,418    | 9,216    | 11,735    | 3,453,183 | 3,464,918     |
| Residential mortgages:                |          |          |          |           |           |               |
| Fixed                                 | 819      | 379      | 6,748    | 7,946     | 1,419,517 | 1,427,463     |
| Variable                              | 1,176    |          | 2,283    | 3,459     | 3,383,513 | 3,386,972     |
| Total residential mortgages           | 1,995    | 379      | 9,031    | 11,405    | 4,803,030 | 4,814,435     |
| Real estate construction:             |          |          |          |           |           |               |
| Construction                          |          |          |          |           | 432,934   | 432,934       |
| Land                                  |          |          | 12,834   | 12,834    | 11,789    | 24,623        |
| Total real estate construction        |          |          | 12,834   | 12,834    | 444,723   | 457,557       |
| Home equity loans and lines of credit | 388      |          | 6,090    | 6,478     | 710,338   | 716,816       |
| Installment:                          |          |          |          |           |           |               |
| Commercial                            | 1        | 4        |          | 5         | 310       | 315           |
| Consumer                              | 533      |          | 125      | 658       | 182,545   | 183,203       |
| Total installment                     | 534      | 4        | 125      | 663       | 182,855   | 183,518       |
| Lease financing                       |          |          | 172      | 172       | 607,260   | 607,432       |
| Total                                 | \$ 8,947 | \$ 4,697 | \$ 1,801 | \$ 64,782 | \$ 80,227 | \$ 18,394,561 |
|                                       |          |          |          |           |           | \$ 18,474,788 |

Table of Contents**Note 5. Loans, Allowance for Loan and Lease Losses, and Reserve for Off-Balance Sheet Credit Commitments (Continued)**

| (in thousands) (1)                       | 30-59 Days<br>Past Due | 60-89 Days<br>Past Due | Greater<br>Than 90<br>Days and<br>Accruing | Nonaccrual | Total Past<br>Due and<br>Nonaccrual<br>Loans | Current       | Total Loans and<br>Leases |
|--|------------------------|------------------------|--|------------|--|---------------|---------------------------|
| <b>December 31, 2013</b>                 |                        |                        |  |            |  |               |                           |
| Commercial                               | \$ 6,582               | \$ 362                 | \$   | \$ 14,248  | \$ 21,192                                    | \$ 7,541,108  | \$ 7,562,300              |
| Commercial real estate<br>mortgages      | 1,197                  | 1,633                  |  | 18,449     | 21,279                                       | 3,201,722     | 3,223,001                 |
| Residential mortgages:                   |                        |                        |  |            |  |               |                           |
| Fixed                                    |                        |                        | 379  | 3,789      | 4,168  | 1,436,283     | 1,440,451                 |
| Variable                                 |                        |                        |  | 7,872      | 7,872  | 3,105,988     | 3,113,860                 |
| Total residential mortgages              |                        |                        | 379  | 11,661     | 12,040                                       | 4,542,271     | 4,554,311                 |
| Real estate construction:                |                        |                        |  |            |  |               |                           |
| Construction                             |                        |                        |  | 5,467      | 5,467  | 332,131       | 337,598                   |
| Land                                     |                        | 797                    |  | 13,600     | 14,397                                       | 15,009        | 29,406                    |
| Total real estate<br>construction        |                        | 797                    |  | 19,067     | 19,864                                       | 347,140       | 367,004                   |
| Home equity loans and<br>lines of credit |                        |                        | 74   | 5,144      | 5,218  | 704,126       | 709,344                   |
| Installment:                             |                        |                        |  |            |  |               |                           |
| Commercial                               | 1                      |                        |  |            | 1  | 361           | 362                       |
| Consumer                                 | 10                     | 7                      |  | 32         | 49   | 151,544       | 151,593                   |
| Total installment                        | 11                     | 7                      |  | 32         | 50   | 151,905       | 151,955                   |
| Lease financing                          | 401                    | 126                    |  | 50         | 577  | 601,946       | 602,523                   |
| Total                                    | \$ 8,191               | \$ 2,925               | \$ 453                                     | \$ 68,651  | \$ 80,220                                    | \$ 17,090,218 | \$ 17,170,438             |

(1) Commercial loans as of December 31, 2013 have been corrected to include \$158.2 million of loans that were previously reported as lease financing.

*Credit Quality Monitoring*

The Company closely monitors and assesses credit quality and credit risk in the loan and lease portfolio on an ongoing basis. Loan risk classifications are continuously reviewed and updated. The following tables provide a summary of the loan and lease portfolio, excluding covered loans, by loan type and credit quality classification as of June 30, 2014 and December 31, 2013. Nonclassified loans generally include those loans that are expected to be repaid in accordance with contractual loan terms. Classified loans are those loans that are classified as substandard or doubtful consistent with regulatory guidelines.

| (in thousands) (1)                  | June 30, 2014 |            |              | December 31, 2013 |            |              |
|-------------------------------------|---------------|------------|--------------|-------------------|------------|--------------|
|                                     | Nonclassified | Classified | Total        | Nonclassified     | Classified | Total        |
| Commercial                          | \$ 8,148,482  | \$ 81,630  | \$ 8,230,112 | \$ 7,416,487      | \$ 145,813 | \$ 7,562,300 |
| Commercial real<br>estate mortgages | 3,416,709     | 48,209     | 3,464,918    | 3,139,707         | 83,294     | 3,223,001    |
| Residential<br>mortgages:           |               |            |              |                   |            |              |

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|                                       |               |            |               |               |            |               |
|---------------------------------------|---------------|------------|---------------|---------------|------------|---------------|
| Fixed                                 | 1,407,809     | 19,654     | 1,427,463     | 1,425,087     | 15,364     | 1,440,451     |
| Variable                              | 3,357,979     | 28,993     | 3,386,972     | 3,087,636     | 26,224     | 3,113,860     |
| Total residential mortgages           | 4,765,788     | 48,647     | 4,814,435     | 4,512,723     | 41,588     | 4,554,311     |
| Real estate construction:             |               |            |               |               |            |               |
| Construction                          | 432,934       |            | 432,934       | 332,131       | 5,467      | 337,598       |
| Land                                  | 11,788        | 12,835     | 24,623        | 15,522        | 13,884     | 29,406        |
| Total real estate construction        | 444,722       | 12,835     | 457,557       | 347,653       | 19,351     | 367,004       |
| Home equity loans and lines of credit | 687,909       | 28,907     | 716,816       | 687,732       | 21,612     | 709,344       |
| Installment:                          |               |            |               |               |            |               |
| Commercial                            | 315           |            | 315           | 362           |            | 362           |
| Consumer                              | 182,090       | 1,113      | 183,203       | 151,468       | 125        | 151,593       |
| Total installment                     | 182,405       | 1,113      | 183,518       | 151,830       | 125        | 151,955       |
| Lease financing                       | 602,693       | 4,739      | 607,432       | 598,821       | 3,702      | 602,523       |
| Total                                 | \$ 18,248,708 | \$ 226,080 | \$ 18,474,788 | \$ 16,854,953 | \$ 315,485 | \$ 17,170,438 |

(1) Commercial loans as of December 31, 2013 have been corrected to include \$158.2 million of loans that were previously reported as lease financing.



Table of Contents**Note 5. Loans, Allowance for Loan and Lease Losses, and Reserve for Off-Balance Sheet Credit Commitments (Continued)***Credit Quality on Covered Loans*

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

| (in thousands)                              | For the three months ended<br>June 30, |           |           | For the six months ended<br>June 30, |           |           |
|---|--|-----------|-----------|--------------------------------------|-----------|-----------|
|   | 2014                                   | 2013      | 2013      | 2014                                 | 2013      | 2013      |
| Balance, beginning of period                | \$ 18,439                              | \$ 42,354 | \$ 42,354 | \$ 15,922                            | \$ 44,781 | \$ 44,781 |
| (Reversal of) provision for losses          | (1,461)                                | (11,927)  | (11,927)  | 3,194                                | (2,035)   | (2,035)   |
| Reduction in allowance due to loan removals | (7,875)                                | (6,013)   | (6,013)   | (10,013)                             | (18,332)  | (18,332)  |
| Balance, end of period                      | \$ 9,103                               | \$ 24,414 | \$ 24,414 | \$ 9,103                             | \$ 24,414 | \$ 24,414 |

The allowance for losses on covered loans was \$9.1 million, \$15.9 million and \$24.4 million as of June 30, 2014, December 31, 2013 and June 30, 2013, respectively. As a result of improvements in the portfolio's credit quality and general market conditions, the Company recorded a \$1.5 million reversal of provision for losses on covered loans during the three months ended June 30, 2014. Provision expense was \$3.2 million for the six months ended June 30, 2014. The Company recorded an \$11.9 million and \$2.0 million reversal of provision during the three and six months ended June 30, 2013, respectively. The Company updates its cash flow projections for covered loans accounted for under ASC 310-30 on a quarterly basis, and may recognize provision expense or reversal of provision for loan losses as a result of that analysis. The provision expense or reversal of provision for losses on covered loans is the result of changes in expected cash flows, both amount and timing, due to actual loan performance and the Company's revised loan loss and prepayment forecasts. The revisions of these forecasts were based on the results of management's review of market conditions, the credit quality of outstanding covered loans and the analysis of loan performance data since the acquisition of covered loans. The allowance for losses on covered loans is reversed for any loan removals, which occur when a loan has been fully paid off, fully charged off, sold or transferred to OREO.

Covered loans accounted for under ASC 310-30 are generally considered accruing and performing loans as the loans accrete interest income over the estimated life of the loan when cash flows are reasonably estimable. Accordingly, acquired impaired loans that are contractually past due are still considered to be accruing and performing loans. If the timing and amount of future cash flows is not reasonably estimable, the loans may be classified as nonaccrual loans and interest income is not recognized until the timing and amount of future cash flows can be reasonably estimated. There were no covered loans that were on nonaccrual status as of June 30, 2014 and December 31, 2013.

At June 30, 2014, covered loans that were 30 to 89 days delinquent totaled \$11.6 million and covered loans that were 90 days or more past due on accrual status totaled \$31.0 million. At December 31, 2013, covered loans that were 30 to 89 days delinquent totaled \$15.5 million and covered loans that were 90 days or more past due on accrual status totaled \$45.7 million.

**Note 6. Other Real Estate Owned**

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The following table provides a summary of OREO activity for the three months ended June 30, 2014 and 2013:

| (in thousands)               | For the three months ended<br>June 30, 2014 |                 |           | For the three months ended<br>June 30, 2013 |                 |           |
|------------------------------|---|-----------------|-----------|---|-----------------|-----------|
|                              | Non-Covered<br>OREO                         | Covered<br>OREO | Total     | Non-Covered<br>OREO                         | Covered<br>OREO | Total     |
| Balance, beginning of period | \$ 9,412                                    | \$ 24,855       | \$ 34,267 | \$ 19,786                                   | \$ 43,751       | \$ 63,537 |
| Additions                    | 110   | 1,987           | 2,097     | 341   | 4,612           | 4,953     |
| Sales                        | (5,253)                                     | (7,964)         | (13,217)  | (390)                                       | (4,378)         | (4,768)   |
| Valuation adjustments        |   | (934)           | (934)     | (61)  | (2,184)         | (2,245)   |
| Balance, end of period       | \$ 4,269                                    | \$ 17,944       | \$ 22,213 | \$ 19,676                                   | \$ 41,801       | \$ 61,477 |

Table of Contents**Note 6. Other Real Estate Owned (continued)**

The following table provides a summary of OREO activity for the six months ended June 30, 2014 and 2013:

| (in thousands)               | For the six months ended<br>June 30, 2014 |                 |           | For the six months ended<br>June 30, 2013 |                 |           |
|------------------------------|---|-----------------|-----------|---|-----------------|-----------|
|                              | Non-Covered<br>OREO                       | Covered<br>OREO | Total     | Non-Covered<br>OREO                       | Covered<br>OREO | Total     |
| Balance, beginning of period | \$ 12,611                                 | \$ 25,481       | \$ 38,092 | \$ 21,027                                 | \$ 58,276       | \$ 79,303 |
| Additions                    | 111                                       | 4,020           | 4,131     | 723                                       | 13,906          | 14,629    |
| Sales                        | (8,439)                                   | (10,468)        | (18,907)  | (1,781)                                   | (25,162)        | (26,943)  |
| Valuation adjustments        | (14)                                      | (1,089)         | (1,103)   | (293)                                     | (5,219)         | (5,512)   |
| Balance, end of period       | \$ 4,269                                  | \$ 17,944       | \$ 22,213 | \$ 19,676                                 | \$ 41,801       | \$ 61,477 |

At June 30, 2014, OREO was \$22.2 million and included \$17.9 million of covered OREO. At December 31, 2013, OREO was \$38.1 million and included \$25.5 million of covered OREO. The balance of OREO at June 30, 2014 and December 31, 2013 is net of valuation allowances of \$11.1 million and \$17.4 million, respectively.

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

Table of Contents**Note 7. Borrowed Funds**

Short-term borrowings consist of funds with remaining maturities of one year or less and long-term debt consists of borrowings with remaining maturities greater than one year. The components of short-term borrowings and long-term debt as of June 30, 2014 and December 31, 2013 are provided below:

| (in thousands) (1)  | June 30,<br>2014  | December 31,<br>2013 |
|---|-------------------|----------------------|
| <b>Short-term borrowings</b>  |                   |                      |
| Current portion of subordinated debt:   |                   |                      |
| City National Bank - 9.00% Subordinated Notes Due July 2019 (2)                 | \$ 50,000         | \$                   |
| City National Bank - Fixed and Floating Subordinated Notes due August 2019 (3)  | 55,000            |                      |
| Federal funds purchased   | 50,000            |                      |
| Current portion of nonrecourse debt (4)   | 5,337             | 3,889                |
| <b>Total short-term borrowings</b>  | <b>\$ 160,337</b> | <b>\$ 3,889</b>      |
| <b>Long-term debt</b>   |                   |                      |
| Senior notes:   |                   |                      |
| City National Corporation - 5.25% Senior Notes Due September 2020               | \$ 299,502        | \$ 299,463           |
| Subordinated debt:  |                   |                      |
| City National Bank - 9.00% Subordinated Notes Due July 2019 (2)                 |                   | 50,000               |
| City National Bank - 9.00% Subordinated Notes Due August 2019                   | 75,000            | 75,000               |
| City National Bank - Fixed and Floating Subordinated Notes due August 2019 (3)  |                   | 55,000               |
| City National Bank - 5.375% Subordinated Notes Due July 2022                    | 149,994           | 149,994              |
| Junior subordinated debt:   |                   |                      |
| Floating Rate Business Bancorp Capital Trust I Securities due November 2034 (5) | 5,155             | 5,155                |
| Nonrecourse debt (4)  | 88,246            | 91,388               |
| Other long-term debt (6)  | 9,871             | 9,968                |
| <b>Total long-term debt</b>   | <b>\$ 627,768</b> | <b>\$ 735,968</b>    |

(1) The carrying value of certain borrowed funds is net of discount which is being amortized into interest expense, as well as the impact of fair value hedge accounting, if applicable.

(2) These notes bear a fixed interest rate of 9 percent for the initial five years from the date of issuance (July 15, 2009) and thereafter the rate is reset at the Bank's option to either LIBOR plus 6 percent or to prime plus 5 percent. The Bank elected to redeem the notes in accordance with their terms and procedures on July 15, 2014.

(3) These notes bear a fixed interest rate of 9 percent for the initial five years from the date of issuance (August 12, 2009) and thereafter bear an interest rate equal to the three-month LIBOR rate plus 6 percent. The rate is reset quarterly and is subject to an interest rate cap of 10 percent throughout the term of the notes. The Bank has notified investors of its election to redeem the notes in accordance with their terms and procedures on August 12, 2014.

(4) Nonrecourse debt bears interest at an average rate of 3.83 percent as of June 30, 2014 and has maturity dates ranging from August 2014 to February 2023.

(5) These floating rate securities pay interest of three-month LIBOR plus 1.965 percent which is reset quarterly. As of June 30, 2014, the interest rate was approximately 2.19 percent.

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- (6) Other long-term debt includes a note payable that bears a fixed interest rate of 5.64 percent and is scheduled to mature on June 2017.

The Company holds debt affiliated with First American Equipment Finance ( FAEF ), its wholly-owned equipment finance subsidiary. FAEF assigns the future rentals of certain lease financing loans to financial institutions on a nonrecourse basis at fixed interest rates. In return for future minimum lease rentals assigned, FAEF receives a discounted cash payment. Proceeds from discounting are reflected in the table above as nonrecourse debt.

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**Note 8. Shareholders Equity**

On November 7, 2013, the Corporation issued 4 million depository shares, each representing a 1/40th interest in a share of 6.75 percent Series D fixed-to-floating rate non-cumulative perpetual preferred stock with a liquidation preference of \$1,000 per share (equivalent to \$25.00 per depository share). Net proceeds, after issuance cost, were approximately \$97.7 million. Dividends on the preferred stock are payable quarterly, in arrears, if declared by the Corporation's Board of Directors at an annual rate of 6.75 percent. Effective for the February 7, 2024 dividend payment, the annual rate will adjust to three-month LIBOR plus 4.052 percent. The preferred stock has no maturity date and may be redeemed in whole or in part at the option of the Corporation on any dividend payment date after 10 years from the date of issuance, or in whole but not in part within 90 days following a determination by the Corporation that the Corporation will not be entitled to treat the full liquidation preference amount then outstanding as tier 1 capital for purposes of the capital adequacy guidelines of the Federal Reserve (or its equivalent).

At June 30, 2014 and December 31, 2013, AOCI was comprised of net unrealized gains on securities available-for-sale of \$2.1 million and net unrealized losses on securities available-for-sale of \$15.6 million, respectively.

The following table presents the tax effects allocated to each component of other comprehensive income (loss) for the three and six month periods ended June 30, 2014 and 2013:

| (in thousands)   | For the three months ended<br>June 30, 2014 |                          |            | For the three months ended<br>June 30, 2013 |                          |             |
|--|---|--------------------------|------------|---|--------------------------|-------------|
|  | Pre-tax                                     | Tax expense<br>(benefit) | Net-of-tax | Pre-tax                                     | Tax expense<br>(benefit) | Net-of-tax  |
| Securities available-for-sale:                                       |   |                          |            |   |                          |             |
| Net unrealized gains (losses) arising during the period              | \$ 16,820                                   | \$ 7,056                 | \$ 9,764   | \$ (111,213)                                | \$ (46,520)              | \$ (64,693) |
| Reclassification adjustment for net gains included in net income (1) | (5,359)                                     | (2,242)                  | (3,117)    | (4,785)                                     | (2,002)                  | (2,783)     |
| Non-credit related impairment loss                                   | (317)                                       | (133)                    | (184)      | (240)                                       | (100)                    | (140)       |
| Total securities available-for-sale                                  | 11,144                                      | 4,681                    | 6,463      | (116,238)                                   | (48,622)                 | (67,616)    |
| Net change on cash flow hedges                                       |   |                          |            | (21)  |                          | (21)        |
| Total other comprehensive income (loss)                              | \$ 11,144                                   | \$ 4,681                 | \$ 6,463   | \$ (116,259)                                | \$ (48,622)              | \$ (67,637) |

| (in thousands)   | For the six months ended<br>June 30, 2014 |                          |            | For the six months ended<br>June 30, 2013 |                          |             |
|--|---|--------------------------|------------|---|--------------------------|-------------|
|  | Pre-tax                                   | Tax expense<br>(benefit) | Net-of-tax | Pre-tax                                   | Tax expense<br>(benefit) | Net-of-tax  |
| Securities available-for-sale:                                       |   |                          |            |   |                          |             |
| Net unrealized gains (losses) arising during the period              | \$ 38,348                                 | \$ 16,031                | \$ 22,317  | \$ (131,515)                              | \$ (55,013)              | \$ (76,502) |
| Reclassification adjustment for net gains included in net income (1) | (7,551)                                   | (3,159)                  | (4,392)    | (5,672)                                   | (2,373)                  | (3,299)     |

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|   |           |           |           |              |             |             |
|---|-----------|-----------|-----------|--------------|-------------|-------------|
| Non-credit related impairment loss      | (317)     | (133)     | (184)     | (240)        | (100)       | (140)       |
| Total securities available-for-sale     | 30,480    | 12,739    | 17,741    | (137,427)    | (57,486)    | (79,941)    |
| Net change on cash flow hedges          |           |           |           | (56)         |             | (56)        |
| Total other comprehensive income (loss) | \$ 30,480 | \$ 12,739 | \$ 17,741 | \$ (137,483) | \$ (57,486) | \$ (79,997) |

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(1) Recognized in Gain on sale of securities in the consolidated statements of income.

Table of Contents**Note 8. Shareholders Equity (Continued)**

The following table summarizes the Company's share repurchases for the three months ended June 30, 2014. All repurchases relate to shares withheld or previously owned shares used to pay taxes due upon vesting of restricted stock. There were no issuer repurchases of the Corporation's common stock as part of its repurchase plan for the three months ended June 30, 2014.

| Period                          | Total Number<br>of Shares<br>(or Units)<br>Purchased | Average<br>Price Paid<br>per Share<br>(or Unit) |
|---------------------------------|--|---|
| April 1, 2014 to April 30, 2014 | 127  | \$ 75.45  |
| May 1, 2014 to May 31, 2014     |  |   |
| June 1, 2014 to June 30, 2014   | 970  | 76.33   |
| Total share repurchases         | 1,097  | 76.23   |

**Note 9. Earnings per Common Share**

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

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

| (in thousands, except per share amounts)             | For the three months ended<br>June 30, |           | For the six months ended<br>June 30, |            |
|--|--|-----------|--------------------------------------|------------|
|  | 2014                                   | 2013      | 2014                                 | 2013       |
| <b>Basic EPS:</b>                                    |  |           |                                      |            |
| Net income attributable to City National Corporation | \$ 66,701                              | \$ 59,741 | \$ 121,212                           | \$ 111,264 |
| Less: Dividends on preferred stock                   | 4,094                                  | 2,406     | 8,188                                | 4,812      |
| Net income available to common shareholders          | \$ 62,607                              | \$ 57,335 | \$ 113,024                           | \$ 106,452 |
| Less: Earnings allocated to participating securities | 626                                    | 656       | 1,173                                | 1,287      |
| Earnings allocated to common shareholders            | \$ 61,981                              | \$ 56,679 | \$ 111,851                           | \$ 105,165 |
| Weighted average common shares outstanding           | 54,957                                 | 54,105    | 54,824                               | 53,919     |
| Basic earnings per common share                      | \$ 1.13                                | \$ 1.05   | \$ 2.04                              | \$ 1.95    |
| <b>Diluted EPS:</b>                                  |  |           |                                      |            |
| Earnings allocated to common shareholders (1)        | \$ 61,986                              | \$ 56,682 | \$ 111,861                           | \$ 105,173 |
| Weighted average common shares outstanding           | 54,957                                 | 54,105    | 54,824                               | 53,919     |
| Dilutive effect of equity awards                     | 675                                    | 372       | 717                                  | 361        |
| Weighted average diluted common shares outstanding   | 55,632                                 | 54,477    | 55,541                               | 54,280     |



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|                                   |    |      |    |      |    |      |    |      |
|-----------------------------------|----|------|----|------|----|------|----|------|
| Diluted earnings per common share | \$ | 1.11 | \$ | 1.04 | \$ | 2.01 | \$ | 1.94 |
|-----------------------------------|----|------|----|------|----|------|----|------|

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

The average price of the Company's common stock for the period is used to determine the dilutive effect of outstanding stock options. Antidilutive stock options are not included in the calculation of diluted EPS. There were 1.1 million and 2.4 million average outstanding stock options that were antidilutive for the three months ended June 30, 2014 and 2013, respectively. There were 0.7 million and 2.3 million average outstanding stock options that were antidilutive for the six months ended June 30, 2014 and 2013, respectively.

Table of Contents**Note 10. Share-Based Compensation**

On June 30, 2014, the Company had one share-based compensation plan, the Amended and Restated City National Corporation 2008 Omnibus Plan (the Plan), which was originally approved by the Company's shareholders on April 23, 2008. No new awards have been or will be granted under predecessor plans since the adoption of the Plan. The Plan permits the grant of stock options, restricted stock, restricted stock units, cash-settled restricted stock units, performance shares, performance share units, performance units and stock appreciation rights, or any combination thereof, to the Company's eligible employees and non-employee directors. No grants of performance shares, performance share units or stock appreciation rights had been made as of June 30, 2014. At June 30, 2014, there were approximately 2.8 million shares available for future grants. Refer to the Company's Annual Report on Form 10-K for the year ended December 31, 2013 for further discussion of the Company's share-based compensation plan.

The compensation cost recognized for all share-based awards was \$5.2 million and \$10.6 million for the three and six months ended June 30, 2014, respectively, compared with \$5.4 million and \$10.5 million for the three and six months ended June 30, 2013, respectively. The total income tax benefit recognized in the consolidated statements of income for share-based compensation arrangements was \$2.2 million and \$4.5 million for the three and six months ended June 30, 2014, respectively, compared with \$2.3 million and \$4.4 million for the three and six months ended June 30, 2013, respectively. The Company received \$16.4 million and \$17.8 million in cash for the exercise of stock options during the six months ended June 30, 2014 and 2013, respectively. The actual tax benefit realized for the tax deductions from stock option exercises was \$2.2 million and \$3.5 million for the six months ended June 30, 2014 and 2013, respectively.

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

|                             | For the three months ended<br>June 30, |      | For the six months ended<br>June 30, |        |
|-----------------------------|--|------|--------------------------------------|--------|
|                             | 2014                                   | 2013 | 2014                                 | 2013   |
| Weighted-average volatility | 27.15%                                 |      | 27.35%                               | 28.12% |
| Dividend yield              | 1.78%                                  |      | 1.79%                                | 2.15%  |
| Expected term (in years)    | 5.46                                   |      | 6.06                                 | 6.15   |
| Risk-free interest rate     | 1.92%                                  |      | 1.99%                                | 1.24%  |

Using the Black-Scholes methodology, the weighted-average grant-date fair values of options granted during the six months ended June 30, 2014 and 2013 were \$17.93 and \$12.57, respectively. The total intrinsic value of options exercised during the six months ended June 30, 2014 and 2013 was \$5.2 million and \$8.5 million, respectively.

A summary of option activity and related information for the six months ended June 30, 2014 is presented below:

| Options | Number of<br>Shares<br>(in thousands) | Weighted<br>Average<br>Exercise<br>Price<br>(per share) | Aggregate<br>Intrinsic<br>Value<br>(in thousands) (1) | Weighted<br>Average<br>Remaining<br>Contractual<br>Term |
|---------|---------------------------------------|---|---|---|
|---------|---------------------------------------|---|---|---|

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|                                |       |    |       |    |        |
|--------------------------------|-------|----|-------|----|--------|
| Outstanding at January 1, 2014 | 4,075 | \$ | 55.50 |    |        |
| Granted                        | 452   |    | 73.64 |    |        |
| Exercised                      | (289) |    | 56.61 |    |        |
| Forfeited or expired           | (30)  |    | 58.36 |    |        |
| Outstanding at June 30, 2014   | 4,208 | \$ | 57.35 | \$ | 77,718 |
| Exercisable at June 30, 2014   | 2,870 | \$ | 56.05 | \$ | 56,782 |
|                                |       |    |       |    | 4.43   |

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

Table of Contents**Note 10. Share-Based Compensation (Continued)**

A summary of changes in unvested options and related information for the six months ended June 30, 2014 is presented below:

| <b>Unvested Options</b>     | <b>Number of<br/>Shares<br/>(in thousands)</b> | <b>Weighted Average<br/>Grant Date<br/>Fair Value<br/>(per share)</b> |
|-----------------------------|--|---|
| Unvested at January 1, 2014 | 1,425  | \$ 13.64  |
| Granted                     | 452  | 17.93   |
| Vested                      | (519)  | 14.57   |
| Forfeited                   | (19)   | 12.78   |
| Unvested at June 30, 2014   | 1,339  | \$ 14.75  |

The number of options vested during the six months ended June 30, 2014 and 2013 was 518,620 and 646,736, respectively. The total fair value of options vested during the six months ended June 30, 2014 and 2013 was \$7.6 million and \$7.8 million, respectively. As of June 30, 2014, there was \$15.2 million of unrecognized compensation cost related to unvested stock options granted under the Company's plans. That cost is expected to be recognized over a weighted-average period of 2.7 years.

A summary of changes in restricted stock and related information for the six months ended June 30, 2014 is presented below:

| <b>Restricted Stock (1)</b> | <b>Number of<br/>Shares<br/>(in thousands)</b> | <b>Weighted Average<br/>Grant Date<br/>Fair Value<br/>(per share)</b> |
|-----------------------------|--|---|
| Unvested at January 1, 2014 | 608  | \$ 53.03  |
| Granted                     | 119  | 73.63   |
| Vested                      | (169)  | 44.00   |
| Forfeited                   | (6)  | 54.12   |
| Unvested at June 30, 2014   | 552  | \$ 60.22  |

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(1) Includes restricted stock units.

Restricted stock is valued at the closing price of the Company's stock on the date of award. The weighted-average grant-date fair value of restricted stock granted during the six months ended June 30, 2014 and 2013 was \$73.63 and \$55.73, respectively. The number of restricted shares vested during the six months ended June 30, 2014 and 2013 was 169,028 and 186,109, respectively. The total fair value of restricted stock vested during the six months ended June 30, 2014 and 2013 was \$7.4 million and \$8.5 million, respectively. As of June 30, 2014, the unrecognized compensation cost related to restricted stock granted under the Company's plans was \$19.2 million. That cost is expected to be recognized over a weighted-average period of 3.0 years.



Table of Contents**Note 10. Share-Based Compensation (Continued)**

Cash-settled restricted stock units are initially valued at the closing price of the Company's stock on the date of award. They are subsequently remeasured to the closing price of the Company's stock at each reporting date until settlement. A summary of changes in cash-settled restricted stock units for the six months ended June 30, 2014 is presented below:

| Cash-Settled Restricted Stock Units | Number of<br>Shares<br>(in thousands) |
|-------------------------------------|---------------------------------------|
| Unvested at January 1, 2014         | 190                                   |
| Granted                             | 15                                    |
| Vested                              | (23)                                  |
| Forfeited                           | (3)                                   |
| Unvested at June 30, 2014           | 179                                   |

**Note 11. Derivative Instruments**

The Company uses interest-rate swaps to mitigate interest-rate risk associated with changes to (1) the fair value of certain fixed-rate deposits and borrowings (fair value hedges) and (2) certain cash flows related to future interest payments on variable rate loans (cash flow hedges). Interest-rate swap agreements involve the exchange of fixed and variable rate interest payments between counterparties based upon a notional principal amount and maturity date. The Company recognizes derivatives as assets or liabilities on the consolidated balance sheets at their fair value. The treatment of changes in the fair value of derivatives depends on the character of the transaction. The Company also offers various derivative products to clients and enters into derivative transactions in due course. These transactions are not linked to specific Company assets or liabilities in the consolidated balance sheets or to forecasted transactions in a hedge relationship and, therefore, do not qualify for hedge accounting.

The following table summarizes the fair value and balance sheet classification of derivative instruments as of June 30, 2014 and December 31, 2013. The notional amount of the contract is not recorded on the consolidated balance sheets, but is used as the basis for determining the amount of interest payments to be exchanged between the counterparties. If a counterparty fails to perform, the Company's counterparty credit risk is equal to the amount reported as a derivative asset.

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

| (in millions) (1)  | Notional<br>Amount | June 30, 2014<br>Derivative<br>Assets | Derivative<br>Liabilities | Notional<br>Amount | December 31, 2013<br>Derivative<br>Assets | Derivative<br>Liabilities |
|--|--------------------|---------------------------------------|---------------------------|--------------------|---|---------------------------|
| <b>Derivatives not designated as hedging instruments</b> |                    |                                       |                           |                    |   |                           |
| Interest rate contracts:                                 |                    |                                       |                           |                    |   |                           |
| Swaps  | \$ 2,907.3         | \$ 42.5                               | \$ 42.4                   | \$ 2,769.4         | \$ 42.7                                   | \$ 41.7                   |

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|   |            |         |         |            |         |         |
|---|------------|---------|---------|------------|---------|---------|
| Interest-rate caps, floors and collars                  | 396.4      | 0.8     | 0.8     | 251.6      | 0.5     | 0.5     |
| Options purchased                                       | 0.2        | 0.2     | 0.2     | 1.5        | 0.6     | 0.6     |
| Options written   | 0.2        |         |         | 1.5        |         |         |
| Total interest-rate contracts                           | \$ 3,304.1 | \$ 43.5 | \$ 43.4 | \$ 3,024.0 | \$ 43.8 | \$ 42.8 |
| Option contracts  | \$ 2.0     | \$ 0.2  | \$      | \$ 1.9     | \$ 0.4  | \$      |
| Foreign exchange contracts:                             |            |         |         |            |         |         |
| Spot and forward contracts                              | \$ 473.1   | \$ 3.3  | \$ 2.6  | \$ 461.4   | \$ 3.5  | \$ 3.3  |
| Options purchased                                       | 5.3        |         |         | 6.3        |         |         |
| Options written   | 5.3        | 0.2     | 0.2     | 6.3        | 0.2     | 0.2     |
| Total foreign exchange contracts                        | \$ 483.7   | \$ 3.5  | \$ 2.8  | \$ 474.0   | \$ 3.7  | \$ 3.5  |
| Equity warrants   | \$         | \$ 0.6  | \$      | \$         | \$      | \$      |
| Total derivatives not designated as hedging instruments | \$ 3,789.8 | \$ 47.8 | \$ 46.2 | \$ 3,499.9 | \$ 47.9 | \$ 46.3 |

(1) The Company offsets mark-to-market adjustments, interest receivable, interest payable and cash collateral received on interest-rate swaps that are executed with the same counterparty under a master netting agreement, and reports the net balance in other assets or other liabilities in the consolidated balance sheets. For purposes of this disclosure, mark-to-market adjustments, interest receivable and interest payable are presented on a gross basis and cash collateral is excluded from fair value amounts.

Table of Contents**Note 11. Derivative Instruments (Continued)***Derivatives Designated as Hedging Instruments*

The Company had no hedging instruments as of June 30, 2014 and December 31, 2013.

The periodic net settlement of interest-rate swaps is recorded as an adjustment to interest income or interest expense. There was no net interest income recognized on interest rate swaps for the three and six months ended June 30, 2014. Interest rate swaps increased net interest income by \$1.1 million for the six months ended June 30, 2013.

Changes in fair value of the effective portion of cash flow hedges are reported in AOCI. When the cash flows associated with the hedged item are realized, the gain or loss included in AOCI is recognized in Interest income on loans and leases, the same location in the consolidated statements of income as the income on the hedged item. There were no cash flow hedges outstanding during the six-month periods ended June 30, 2014 and 2013. The \$0.1 million of gains on cash flow hedges reclassified from AOCI to interest income for the six months ended June 30, 2013 represents the amortization of deferred gains on cash flow hedges that were terminated in 2010 prior to their respective maturity dates for which the hedge transactions had yet to occur. The balance of deferred gain on terminated swaps was fully amortized in 2013.

*Derivatives Not Designated as Hedging Instruments*

Derivative contracts not designated as hedges are composed primarily of interest-rate contracts with certain commercial clients that are offset by paired trades with unrelated bank counterparties. The Company also enters into foreign-exchange contracts with its clients and counterparty banks primarily for the purpose of offsetting or economically hedging the clients' transaction and economic exposures arising out of commercial transactions. The Company also obtains equity warrants in association with certain lending transactions. Derivative contracts not designated as hedges are carried at fair value each reporting period with changes in fair value recorded as a part of Noninterest income in the consolidated statements of income. The table below provides the amount of gains and losses on these derivative contracts for the three and six months ended June 30, 2014 and 2013:

| (in millions)<br>Derivatives Not Designated as<br>Hedging Instruments | Location in Consolidated<br>Statements of Income | For the three months ended<br>June 30, |        | For the six months ended<br>June 30, |         |
|---|--|--|--------|--------------------------------------|---------|
|   |  | 2014                                   | 2013   | 2014                                 | 2013    |
| Interest-rate contracts   | Other noninterest income                         | \$ (0.5)                               | \$ 1.5 | \$ (1.0)                             | \$ 1.2  |
| Option contracts  | Other noninterest income                         | (0.1)                                  | 0.1    |                                      | 0.4     |
| Foreign exchange contracts  | International services income                    | 8.2                                    | 7.3    | 15.4                                 | 13.2    |
| Equity warrants   | Other noninterest income                         | 0.1                                    |        | 0.1                                  |         |
| Total income  |  | \$ 7.7                                 | \$ 8.9 | \$ 14.5                              | \$ 14.8 |

In the course of negotiating credit facilities, the Company may obtain rights to acquire stock in the form of equity warrants in primarily private, venture-backed technology companies. The warrants grant the Company an option to purchase a specific number of shares of stock in the



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underlying company at a specific price within a specific time period. The warrant agreements typically contain a net share settlement provision (cashless exercise) which gives the Company the option to receive at exercise a number of shares equal to the intrinsic value of the warrant divided by the share price. Equity warrants are accounted for as derivatives under ASC Topic 815, *Derivatives and Hedging*, and are recorded as derivative assets at their estimated fair value on the grant date. The warrant portfolio is reviewed quarterly for changes in fair value. Subsequent changes in the fair value of warrants are recognized in Other noninterest income. If a warrant is exercised or paid out for cash, the gain is recorded in Other noninterest income.

Table of Contents**Note 11. Derivative Instruments (Continued)***Credit Risk Exposure and Collateral*

The Company's swap agreements require the deposit of cash or marketable debt securities as collateral based on certain risk thresholds. These requirements apply individually to the Corporation and to the Bank. Additionally, certain of the Company's swap contracts contain security agreements that include credit-risk-related contingent features. Under these agreements, the collateral requirements are based on the Company's credit rating from the major credit rating agencies. The amount of collateral required may vary by counterparty based on a range of credit ratings that correspond with exposure thresholds established in the derivative agreements. If the credit ratings on the Company's debt were to fall below the level associated with a particular exposure threshold and the derivatives with a counterparty are in a net liability position that exceeds that threshold, the counterparty could request immediate payment or delivery of collateral for the difference between the net liability amount and the exposure threshold. The aggregate fair value of all derivative instruments with credit-risk-related contingent features that were in a net liability position on June 30, 2014 was \$14.2 million. The Company delivered collateral in the form of securities valued at \$4.1 million and cash totaling \$17.7 million on swap agreements that had credit-risk contingent features that were in a net liability position at June 30, 2014.

The Company's interest-rate swaps had \$0.2 million and \$2.4 million of credit risk exposure at June 30, 2014 and December 31, 2013, respectively. The credit exposure represents the cost to replace, on a present value basis and at current market rates, all contracts by trading counterparty having an aggregate positive market value, net of margin collateral received. The Company enters into master netting agreements with swap counterparties to mitigate credit risk. Under these agreements, the net amount due from or payable to each counterparty is settled on the contract payment date. No collateral had been received from swap counterparties at June 30, 2014 and December 31, 2013. The Company delivered collateral valued at \$7.6 million on swap agreements that did not have credit-risk contingent features at June 30, 2014.

See Note 12, *Balance Sheet Offsetting*, of the Notes to the Unaudited Consolidated Financial Statements for additional information about the Company's derivative instruments subject to master netting agreements.

**Note 12. Balance Sheet Offsetting**

Assets and liabilities relating to certain financial instruments, including derivatives, securities purchased under resale agreements ( reverse repurchase agreements ) and securities sold under repurchase agreements ( repurchase agreements ), may be eligible for offset in the consolidated balance sheet as permitted under accounting guidance. The Company is party to transactions involving derivative instruments that are subject to enforceable master netting arrangements or similar agreements. Under these agreements, the Company may have the right to net settle multiple contracts with the same counterparty. Certain derivative transactions may require the Company to receive or pledge marketable debt securities as collateral based on certain risk thresholds. The Company also enters into reverse repurchase agreements to invest available liquidity and collateral swap agreements. Under reverse repurchase agreements the Company has the right to claim securities collateral if the counterparty fails to perform. Collateral swap agreements involve the exchange of securities collateral under simultaneous repurchase and reverse repurchase agreements with the same bank counterparty. These agreements have the same principal amounts, inception dates and maturity dates and have been offset against each other in the balance sheet as permitted under the netting provisions of ASC Topic 210-20-45. Securities swaps totaled \$500.0 million at June 30, 2014. At June 30, 2014, the Company had delivered collateral of approximately \$536.5 million on the repurchase agreement and accepted collateral of approximately \$525.9 million on the reverse repurchase agreement. The collateral consisted of agency mortgage-backed securities. Securities that have been pledged by counterparties as collateral are not recorded in the Company's consolidated balance sheet unless the counterparty defaults. Securities that have been pledged by the Company to counterparties continue to be reported in the Company's consolidated balance sheet unless the Company defaults.

The Company also offers various derivative products to clients and enters into derivative transactions in due course. These derivative contracts are offset by paired trades with unrelated bank counterparties. Certain derivative transactions with clients are not subject to master netting arrangements and have been excluded from the balance sheet offsetting table below.

Table of Contents**Note 12. Balance Sheet Offsetting (Continued)**

The following table provides information about financial instruments that are eligible for offset at June 30, 2014 and December 31, 2013:

| (in thousands)                                    | Gross Amount Recognized | Gross Amount Offset | Net Amount Presented in the Balance Sheet | Gross Amounts Not Offset in the Balance Sheet | Securities Collateral | Cash Collateral | Net Amount |
|---|-------------------------|---------------------|---|---|-----------------------|-----------------|------------|
| <b>June 30, 2014</b>                              |                         |                     |   |   |                       |                 |            |
| Financial assets:                                 |                         |                     |   |   |                       |                 |            |
| Reverse repurchase agreements                     | \$ 700,149              | \$ (500,041)        | \$ 200,108                                | \$ (200,000)                                  |                       |                 | \$ 108     |
| Derivatives not designated as hedging instruments | 8,080                   | (4,500)             | 3,580                                     |   |                       |                 | 3,580      |
| Total financial assets                            | \$ 708,229              | \$ (504,541)        | \$ 203,688                                | \$ (200,000)                                  |                       |                 | \$ 3,688   |
| Financial liabilities:                            |                         |                     |   |   |                       |                 |            |
| Repurchase agreements                             | \$ 500,041              | \$ (500,041)        |   |   |                       |                 | \$         |
| Derivatives not designated as hedging instruments | 41,791                  | (4,500)             | 37,291                                    | (11,721)                                      |                       | (17,729)        | 7,841      |
| Total financial liabilities                       | \$ 541,832              | \$ (504,541)        | \$ 37,291                                 | \$ (11,721)                                   |                       | \$ (17,729)     | \$ 7,841   |
| <b>December 31, 2013</b>                          |                         |                     |   |   |                       |                 |            |
| Financial assets:                                 |                         |                     |   |   |                       |                 |            |
| Reverse repurchase agreements                     | \$ 200,000              |                     | \$ 200,000                                | \$ (200,000)                                  |                       |                 | \$         |
| Derivatives not designated as hedging instruments | 18,749                  | (13,323)            | 5,426                                     |   |                       |                 | 5,426      |
| Total financial assets                            | \$ 218,749              | \$ (13,323)         | \$ 205,426                                | \$ (200,000)                                  |                       |                 | \$ 5,426   |
| Financial liabilities:                            |                         |                     |   |   |                       |                 |            |
| Derivatives not designated as hedging instruments | \$ 32,193               | \$ (13,323)         | \$ 18,870                                 | \$ (12,376)                                   |                       | \$ (7,761)      | \$ (1,267) |
| Total financial liabilities                       | \$ 32,193               | \$ (13,323)         | \$ 18,870                                 | \$ (12,376)                                   |                       | \$ (7,761)      | \$ (1,267) |

**Note 13. Income Taxes**

The Company recognized income tax expense of \$29.8 million and \$56.1 million for the three and six months ended June 30, 2014, respectively. The Company recognized income tax expense of \$25.4 million and \$46.7 million for the same periods in 2013.

The Company recognizes accrued interest and penalties relating to uncertain tax positions as an income tax provision expense. The Company recognized a benefit on interest and penalties of \$0.3 million and \$0.5 million for the six months ended June 30, 2014 and 2013, respectively. The Company had approximately \$2.7 million and \$3.0 million of accrued interest and penalties as of June 30, 2014 and December 31, 2013, respectively.

The Company and its subsidiaries file federal and various state income tax returns. The Company is currently being audited by the Internal Revenue Service for the tax year 2013 and 2014. The Company is also under audit with the California Franchise Tax Board for the tax years 2005 to 2007. The financial statement impact resulting from completion of these audits is not expected to be material.

From time to time, there may be differences in opinion with respect to the tax treatment of certain transactions. If a tax position which was previously recognized on the consolidated financial statements is no longer more likely than not to be sustained upon a challenge from the taxing authorities, the tax benefit from the tax position will be derecognized. The Company did not have any material tax positions for which previously recognized benefits were derecognized during the six month period ended June 30, 2014.

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**Note 14. Employee Benefit Plans**

*Defined Contribution Plan*

The Company has a profit-sharing retirement plan with an Internal Revenue Code Section 401(k) feature covering eligible employees. Employer contributions are made annually into a trust fund and are allocated to participants based on their salaries. The profit sharing contribution requirement is based on a percentage of annual operating income subject to a percentage of salary cap. Eligible employees may contribute up to 50 percent of their salary to the 401(k) plan, but not more than the maximum allowed under Internal Revenue Service ( IRS ) regulations. The Company matches 50 percent of the first 6 percent of covered compensation. The Company recorded total profit sharing and matching contribution expense of \$5.4 million and \$10.7 million for the three and six months ended June 30, 2014, respectively. Profit sharing and matching contribution expense was \$5.2 million and \$10.0 million for the same periods in 2013, respectively.

*Deferred Compensation Plan*

The Company offers a deferred compensation plan for eligible employees and non-employee directors. Participants under the employee plan may make an annual irrevocable election to defer a portion of base salary and up to 100 percent of commission and incentive compensation while employed with the Company. Participants under the non-employee director plan also may make an annual irrevocable election to defer all or part of annual retainers, annual awards, committee chair retainers and meeting fees (collectively, directors fees ) until board service with the Company ceases. The deferred compensation plans are nonqualified plans under IRS regulations. Deferrals are made on a pretax basis and are allocated among the investment crediting options available under the plans as directed by the plan participants. The Company informally funds plan benefits through the purchase of life insurance policies which are recorded in Other assets on the consolidated balance sheets. Participant deferrals are recorded in Other liabilities on the consolidated balance sheets. Employee salaries and non-employee directors fees deferred under the plan are charged to Salaries and employee benefits and Other operating expense, respectively, on the consolidated statements of income. Earnings on plan assets, net of benefits payable to plan participants, are reported in Salaries and employee benefits on the consolidated statements of income, and were \$0.4 million and \$0.5 million for the three and six months ended June 30, 2014, respectively. Earnings on plan assets, net of benefits payable to plan participants, were \$0.3 million and \$0.5 million for the same periods in 2013, respectively.

**Note 15. Contingencies**

In the normal course of business, the Company issues financial guarantees in the form of letters of credit. Standby letters of credit are commitments issued by the Company to guarantee the obligations of its customer to beneficiaries. Commercial letters of credit are issued on behalf of customers to ensure payment in connection with trade transactions. Exposure to credit loss in the event of nonperformance by the other party to the letters of credit is represented by the contractual notional amount. At June 30, 2014, the Company had \$679.0 million in letters of credit, of which \$574.3 million relate to standby letters of credit and \$104.7 million relate to commercial letters of credit. The Company had \$733.5 million outstanding in letters of credit at December 31, 2013, of which \$617.3 million relate to standby letters of credit and \$116.2 million relate to commercial letters of credit.

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

amounts under the terms of this indemnity.

**Note 16. Variable Interest Entities**

The Company holds ownership interests in certain special-purpose entities formed to provide affordable housing. The Company evaluates its interest in these entities to determine whether they meet the definition of a VIE and whether the Company is required to consolidate these entities. The Company is not the primary beneficiary of the affordable housing VIEs in which it holds interests and is therefore not required to consolidate these entities. The investment in these entities is initially recorded at cost, which approximates the maximum exposure to loss as a result of the Company's involvement with these unconsolidated entities. Subsequently, the carrying value is amortized over the stream of available tax credits and benefits. The Company expects to recover its investments over time, primarily through realization of federal low-income housing tax credits. The balance of the investments in these entities was \$200.6 million and \$188.2 million at June 30, 2014 and December 31, 2013, respectively, and is included in Affordable housing investments in the consolidated balance sheets. Unfunded commitments for affordable housing investments were \$77.1 million at June 30, 2014. These unfunded commitments are recorded in Other liabilities in the consolidated balance sheets.

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**Note 16. Variable Interest Entities (Continued)**

Of the affordable housing investments held as of June 30, 2014, the Company had a significant variable interest in four affordable housing partnerships. These interests were acquired at various times from 1998 to 2001. The Company's maximum exposure to loss as a result of its involvement with these entities is limited to the \$1.0 million aggregate carrying value of these investments at June 30, 2014. There were no unfunded commitments for these affordable housing investments at June 30, 2014.

The Company also has ownership interests in several private equity and alternative investment funds that are VIEs. The Company is not a primary beneficiary and, therefore, is not required to consolidate these VIEs. The investment in these entities is carried at cost and net of impairments, which approximates the maximum exposure to loss as a result of the Company's involvement with these entities. The Company expects to recover its investments over time, primarily through the allocation of fund income, gains or losses on the sale of fund assets, dividends or interest income. The balance in these entities was \$29.7 million and \$34.0 million at June 30, 2014 and December 31, 2013, respectively, and is included in Other assets in the consolidated balance sheets. Income associated with these investments is reported in Other noninterest income in the consolidated statements of income.

**Note 17. Noncontrolling Interest**

In accordance with ASC Topic 810, *Consolidation*, and EITF Topic D-98, *Classification and Measurement of Redeemable Securities* (Topic D-98), the Company reports noncontrolling interest in its majority-owned affiliates as Redeemable noncontrolling interest in the mezzanine section between liabilities and equity in the consolidated financial statements. Topic D-98 specifies that securities that are redeemable at the option of the holder or outside the control of the issuer are not considered permanent equity and should be classified in the mezzanine section.

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

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

As of June 30, 2014, affiliate noncontrolling owners held equity interests with an estimated fair value of \$46.5 million. This estimate reflects the maximum obligation to purchase equity interests in the affiliates. The events which would require the Company to purchase the equity interests may occur in the near term or over a longer period of time. The terms of the put provisions vary by agreement, but the value of the put is at the approximate fair value of the interests. The parent company carries key man life insurance policies to fund a portion of these conditional purchase obligations in the event of the death of certain key holders.



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The following is a summary of activity for redeemable noncontrolling interest for the six months ended June 30, 2014 and 2013:

| (in thousands)                                      | For the six months ended |          |    |         |
|---|--------------------------|----------|----|---------|
|   |                          | June 30, |    |         |
|   |                          | 2014     |    | 2013    |
| Balance, beginning of period                        | \$                       | 39,768   | \$ | 41,112  |
| Net income  |                          | 1,209    |    | 1,048   |
| Distributions to redeemable noncontrolling interest |                          | (1,854)  |    | (940)   |
| Additions and redemptions, net                      |                          | (75)     |    | (1,693) |
| Adjustments to fair value                           |                          | 7,501    |    | 416     |
| Balance, end of period                              | \$                       | 46,549   | \$ | 39,943  |

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**Note 18. Segment Results**

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

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

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

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

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

Effective with second quarter 2013 reporting, the methodology for allocating the provision for income taxes to the segments was revised to base the allocation on the Company's effective tax rate. The allocation was previously based on the statutory tax rate. Prior period segment results have been revised to reflect this change in methodology.

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

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

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

Selected financial information for each segment is presented in the following tables. Commercial and Private Banking includes all revenue and costs from products and services utilized by clients of Commercial and Private Banking, including both revenue and costs for Wealth Management products and services. The revenues and costs associated with Wealth Management products and services that are allocated to Commercial and Private Banking for management reporting purposes are eliminated in the Other segment. The current period reflects any changes made in the process or methodology for allocations to the reportable segments. Prior period segment results have been revised to conform to current period presentation.

| (in thousands)   | For the three months ended June 30, 2014 |                   |            | Consolidated Company |
|--|--|-------------------|------------|----------------------|
|  | Commercial and Private Banking           | Wealth Management | Other      |                      |
| <b>Earnings Summary:</b>   |  |                   |            |                      |
| Net interest income  | \$ 208,413                               | \$ 474            | \$ 10,215  | \$ 219,102           |
| (Reversal of) provision for credit losses on loans and leases, excluding covered loans | (1,000)                                  |                   |            | (1,000)              |
| (Reversal of) provision for losses on covered loans                                    | (1,461)                                  |                   |            | (1,461)              |
| Noninterest income   | 40,926                                   | 69,471            | (9,298)    | 101,099              |
| Depreciation and amortization  | 2,774                                    | 1,766             | 4,799      | 9,339                |
| Noninterest expense  | 179,904                                  | 57,159            | (20,780)   | 216,283              |
| Income before income taxes   | 69,122                                   | 11,020            | 16,898     | 97,040               |
| Provision for income taxes   | 21,360                                   | 3,248             | 5,221      | 29,829               |
| Net income   | 47,762                                   | 7,772             | 11,677     | 67,211               |
| Less: Net income attributable to noncontrolling interest                               |  | 510               |            | 510                  |
| Net income attributable to City National Corporation                                   | \$ 47,762                                | \$ 7,262          | \$ 11,677  | \$ 66,701            |
| <b>Selected Average Balances:</b>  |  |                   |            |                      |
| Loans and leases, excluding covered loans  | \$ 17,901,508                            | \$                | \$ 57,683  | \$ 17,959,191        |
| Covered loans  | 643,690                                  |                   |            | 643,690              |
| Total assets   | 18,705,693                               | 693,473           | 10,579,781 | 29,978,947           |
| Deposits   | 25,584,025                               | 73,784            | 254,272    | 25,912,081           |
| Goodwill   | 393,177                                  | 249,445           |            | 642,622              |
| Customer-relationship intangibles, net   | 2,692                                    | 35,778            |            | 38,470               |

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

| (in thousands)   | For the three months ended June 30, 2013 |                   |           | Consolidated Company |
|--|--|-------------------|-----------|----------------------|
|  | Commercial and Private Banking           | Wealth Management | Other     |                      |
| <b>Earnings Summary:</b>                                 |  |                   |           |                      |
| Net interest income                                      | \$ 185,040                               | \$ 247            | \$ 17,632 | \$ 202,919           |
| (Reversal of) provision for losses on covered loans      | (11,927)                                 |                   |           | (11,927)             |
| Noninterest income                                       | 30,555                                   | 58,472            | (6,818)   | 82,209               |
| Depreciation and amortization                            | 3,624                                    | 1,876             | 4,680     | 10,180               |
| Noninterest expense                                      | 171,254                                  | 48,720            | (18,725)  | 201,249              |
| Income before income taxes                               | 52,644                                   | 8,123             | 24,859    | 85,626               |
| Provision for income taxes                               | 15,715                                   | 2,287             | 7,420     | 25,422               |
| Net income   | 36,929                                   | 5,836             | 17,439    | 60,204               |
| Less: Net income attributable to noncontrolling interest |  | 463               |           | 463                  |
| Net income attributable to City National Corporation     | \$ 36,929                                | \$ 5,373          | \$ 17,439 | \$ 59,741            |

|   |               |         |            |               |
|---|---------------|---------|------------|---------------|
| <b>Selected Average Balances:</b>         |               |         |            |               |
| Loans and leases, excluding covered loans | \$ 15,379,372 | \$      | \$ 54,730  | \$ 15,434,102 |
| Covered loans                             | 909,728       |         |            | 909,728       |
| Total assets                              | 16,503,312    | 652,737 | 10,313,532 | 27,469,581    |
| Deposits                                  | 22,409,159    | 120,702 | 588,957    | 23,118,818    |
| Goodwill                                  | 393,177       | 249,445 |            | 642,622       |
| Customer-relationship intangibles, net    | 5,176         | 40,199  |            | 45,375        |

| (in thousands)   | For the six months ended June 30, 2014 |                   |           | Consolidated Company |
|--|--|-------------------|-----------|----------------------|
|  | Commercial and Private Banking         | Wealth Management | Other     |                      |
| <b>Earnings Summary:</b>   |  |                   |           |                      |
| Net interest income  | \$ 398,206                             | \$ 800            | \$ 19,894 | \$ 418,900           |
| (Reversal of) provision for credit losses on loans and leases, excluding covered loans | (1,000)                                |                   |           | (1,000)              |
| Provision for losses on covered loans  | 3,194                                  |                   |           | 3,194                |
| Noninterest income   | 89,140                                 | 133,564           | (20,357)  | 202,347              |
| Depreciation and amortization  | 5,595                                  | 3,513             | 9,546     | 18,654               |
| Noninterest expense  | 351,972                                | 109,892           | (40,003)  | 421,861              |
| Income before income taxes   | 127,585                                | 20,959            | 29,994    | 178,538              |
| Provision for income taxes   | 40,375                                 | 6,250             | 9,492     | 56,117               |
| Net income   | 87,210                                 | 14,709            | 20,502    | 122,421              |
| Less: Net income attributable to noncontrolling interest                               |  | 1,209             |           | 1,209                |
| Net income attributable to City National Corporation                                   | \$ 87,210                              | \$ 13,500         | \$ 20,502 | \$ 121,212           |

|   |               |         |            |               |
|---|---------------|---------|------------|---------------|
| <b>Selected Average Balances:</b>         |               |         |            |               |
| Loans and leases, excluding covered loans | \$ 17,594,167 | \$      | \$ 56,353  | \$ 17,650,520 |
| Covered loans                             | 669,781       |         |            | 669,781       |
| Total assets                              | 18,473,951    | 675,663 | 10,554,566 | 29,704,180    |

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|  |            |         |         |            |
|--|------------|---------|---------|------------|
| Deposits                               | 25,319,356 | 80,738  | 243,238 | 25,643,332 |
| Goodwill                               | 393,177    | 249,445 |         | 642,622    |
| Customer-relationship intangibles, net | 2,912      | 36,346  |         | 39,258     |

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

| (in thousands)   | For the six months ended June 30, 2013 |                   |            | Consolidated Company |
|--|--|-------------------|------------|----------------------|
|  | Commercial and Private Banking         | Wealth Management | Other      |                      |
| <b>Earnings Summary:</b>                                 |  |                   |            |                      |
| Net interest income                                      | \$ 369,017                             | \$ 565            | \$ 34,410  | \$ 403,992           |
| (Reversal of) provision for losses on covered loans      | (2,035)                                |                   |            | (2,035)              |
| Noninterest income                                       | 80,818                                 | 113,925           | (19,006)   | 175,737              |
| Depreciation and amortization                            | 7,243                                  | 3,776             | 9,265      | 20,284               |
| Noninterest expense                                      | 342,201                                | 95,749            | (35,465)   | 402,485              |
| Income before income taxes                               | 102,426                                | 14,965            | 41,604     | 158,995              |
| Provision for income taxes                               | 30,273                                 | 4,113             | 12,297     | 46,683               |
| Net income   | 72,153                                 | 10,852            | 29,307     | 112,312              |
| Less: Net income attributable to noncontrolling interest |  | 1,048             |            | 1,048                |
| Net income attributable to City National Corporation     | \$ 72,153                              | \$ 9,804          | \$ 29,307  | \$ 111,264           |
| <b>Selected Average Balances:</b>                        |  |                   |            |                      |
| Loans and leases, excluding covered loans                | \$ 15,068,756                          | \$                | \$ 54,691  | \$ 15,123,447        |
| Covered loans  | 949,370                                |                   |            | 949,370              |
| Total assets   | 16,244,521                             | 648,561           | 10,695,626 | 27,588,708           |
| Deposits   | 22,126,242                             | 113,563           | 527,035    | 22,766,840           |
| Goodwill   | 393,177                                | 249,445           |            | 642,622              |
| Customer-relationship intangibles, net                   | 5,543                                  | 40,794            |            | 46,337               |

**Note 19. Subsequent Events**

On June 25, 2014, City National Bank announced that it had entered into an agreement to sell its retirement services recordkeeping business to OneAmerica Retirement Services, LLC. The sale is expected to close in the third quarter of 2014. The transaction, after sale expenses, is not expected to have a significant impact on the Bank's financial results.

As of June 30, 2014, the Bank had notified the holders of the \$50 million 9.00% Subordinated Notes due July 2019 and \$55 million Fixed and Floating Subordinated Notes due August 2019 of its election to redeem in full the outstanding obligations of these issues in accordance with the terms and provisions of the notes. Redemption of the \$50 million Subordinated Notes, including all accrued and unpaid interest, was completed on July 15, 2014. Redemption of the \$55 million Fixed and Floating Subordinated Notes will be completed on August 12, 2014.

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

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

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

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

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

For a more complete discussion of these risks and uncertainties, see the Company's Annual Report on Form 10-K for the year ended December 31, 2013 and particularly, Item 1A, titled "Risk Factors."





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## CITY NATIONAL CORPORATION

## FINANCIAL HIGHLIGHTS

| (in thousands, except per share amounts) (1)         | At or for the three months ended |                                  |                                 | Percent change<br>June 30, 2014 from |                  |
|--|----------------------------------|----------------------------------|---------------------------------|--------------------------------------|------------------|
|  | June 30,<br>2014<br>(Unaudited)  | March 31,<br>2014<br>(Unaudited) | June 30,<br>2013<br>(Unaudited) | March 31,<br>2014                    | June 30,<br>2013 |
| <b>For The Quarter</b>                               |                                  |                                  |                                 |                                      |                  |
| Total revenue  | \$ 320,201                       | \$ 301,046                       | \$ 285,128                      | 6%                                   | 12%              |
| Net income attributable to City National Corporation | 66,701                           | 54,511                           | 59,741                          | 22                                   | 12               |
| Net income available to common shareholders          | 62,607                           | 50,417                           | 57,335                          | 24                                   | 9                |
| Net income per common share, basic                   | 1.13                             | 0.91                             | 1.05                            | 24                                   | 8                |
| Net income per common share, diluted                 | 1.11                             | 0.90                             | 1.04                            | 23                                   | 7                |
| Dividends per common share                           | 0.33                             | 0.33                             | 0.25                            |                                      | 32               |
| <b>At Quarter End</b>                                |                                  |                                  |                                 |                                      |                  |
| Assets   | \$ 30,819,092                    | \$ 29,738,252                    | \$ 27,379,502                   | 4                                    | 13               |
| Securities   | 8,832,942                        | 8,651,359                        | 8,597,199                       | 2                                    | 3                |
| Loans and leases, excluding covered loans            | 18,474,788                       | 17,751,385                       | 15,819,252                      | 4                                    | 17               |
| Covered loans (2)                                    | 605,770                          | 673,294                          | 867,996                         | (10)                                 | (30)             |
| Deposits   | 26,651,525                       | 25,731,766                       | 23,651,757                      | 4                                    | 13               |
| Common shareholders equity                           | 2,585,537                        | 2,528,344                        | 2,374,848                       | 2                                    | 9                |
| Total shareholders equity                            | 2,853,153                        | 2,795,960                        | 2,544,768                       | 2                                    | 12               |
| Book value per common share                          | 47.38                            | 46.38                            | 44.16                           | 2                                    | 7                |
| <b>Average Balances</b>                              |                                  |                                  |                                 |                                      |                  |
| Assets   | \$ 29,978,947                    | \$ 29,426,360                    | \$ 27,469,581                   | 2                                    | 9                |
| Securities   | 8,668,011                        | 8,585,220                        | 8,866,911                       | 1                                    | (2)              |
| Loans and leases, excluding covered loans            | 17,959,191                       | 17,338,419                       | 15,434,102                      | 4                                    | 16               |
| Covered loans (2)                                    | 643,690                          | 696,163                          | 909,728                         | (8)                                  | (29)             |
| Deposits   | 25,912,081                       | 25,371,598                       | 23,118,818                      | 2                                    | 12               |
| Common shareholders equity                           | 2,562,555                        | 2,512,775                        | 2,412,148                       | 2                                    | 6                |
| Total shareholders equity                            | 2,830,171                        | 2,780,392                        | 2,582,068                       | 2                                    | 10               |
| <b>Selected Ratios</b>                               |                                  |                                  |                                 |                                      |                  |
| Return on average assets (annualized)                | 0.89%                            | 0.75%                            | 0.87%                           | 19                                   | 2                |
| Return on average common equity (annualized)         | 9.80                             | 8.14                             | 9.53                            | 20                                   | 3                |
| Corporation's tier 1 leverage                        | 7.43                             | 7.41                             | 7.00                            | 0                                    | 6                |
| Corporation's tier 1 risk-based capital              | 10.00                            | 10.18                            | 9.74                            | (2)                                  | 3                |
| Corporation's total risk-based capital               | 12.81                            | 13.08                            | 12.78                           | (2)                                  | 0                |
| Period-end common equity to period-end assets        | 8.39                             | 8.50                             | 8.67                            | (1)                                  | (3)              |
| Period-end equity to period-end assets               | 9.26                             | 9.40                             | 9.29                            | (1)                                  | (0)              |
| Common dividend payout ratio                         | 29.26                            | 36.15                            | 23.81                           | (19)                                 | 23               |
| Net interest margin                                  | 3.21                             | 3.02                             | 3.24                            | 6                                    | (1)              |
| Expense to revenue ratio (3)                         | 68.48                            | 69.73                            | 71.51                           | (2)                                  | (4)              |
| <b>Asset Quality Ratios (4)</b>                      |                                  |                                  |                                 |                                      |                  |
| Nonaccrual loans to total loans and leases           | 0.35%                            | 0.40%                            | 0.48%                           | (13)                                 | (27)             |
|  | 0.37                             | 0.45                             | 0.61                            | (18)                                 | (39)             |

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Nonaccrual loans and OREO to total loans and leases and OREO

|   |        |        |        |       |       |
|---|--------|--------|--------|-------|-------|
| Allowance for loan and lease losses to total loans and leases               | 1.68   | 1.72   | 1.83   | (2)   | (8)   |
| Allowance for loan and lease losses to nonaccrual loans                     | 480.50 | 429.21 | 378.12 | 12    | 27    |
| Net (charge-offs) recoveries to average total loans and leases (annualized) | (0.08) | 0.10   | 0.20   | (180) | (140) |

**At Quarter End**

|   |               |               |               |     |    |
|---|---------------|---------------|---------------|-----|----|
| Assets under management (5)                   | \$ 47,123,652 | \$ 46,374,203 | \$ 41,256,549 | 2   | 14 |
| Assets under management or administration (5) | 65,780,023    | 66,399,813    | 59,755,285    | (1) | 10 |

- 
- (1) Certain prior period amounts have been reclassified to conform to the current period presentation.
  - (2) Covered loans represent acquired loans that are covered under loss-sharing agreements with the Federal Deposit Insurance Corporation ( FDIC ).
  - (3) The expense to revenue ratio is defined as noninterest expense excluding other real estate owned ( OREO ) expense divided by total net interest income on a fully taxable-equivalent basis and noninterest income.
  - (4) Excludes covered assets, which consist of acquired loans and OREO that are covered under loss-sharing agreements with the FDIC.
  - (5) Excludes \$27.85 billion, \$26.09 billion and \$25.11 billion of assets under management for asset managers in which the Company held a noncontrolling ownership interest as of June 30, 2014, March 31, 2014 and June 30, 2013, respectively.

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**CRITICAL ACCOUNTING POLICIES**

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

The Company's critical accounting policies include those that address accounting for business combinations, financial assets and liabilities reported at fair value, securities, acquired impaired loans, allowance for loan and lease losses and reserve for off-balance sheet credit commitments, OREO, goodwill and other intangible assets, noncontrolling interest, share-based compensation plans, income taxes, and derivatives and hedging activities. The Company has not made any significant changes in its critical accounting policies or its estimates and assumptions from those disclosed in its 2013 Annual Report other than the adoption of new accounting pronouncements and other authoritative guidance that became effective for the Company on or after January 1, 2014. Refer to Note 1, *Summary of Significant Accounting Policies*, of the Notes to the Unaudited Consolidated Financial Statements for further discussion. Management has applied its critical accounting policies and estimation methods consistently in all periods presented in these financial statements.

**HIGHLIGHTS**

- Consolidated net income attributable to City National Corporation (CNC) was \$66.7 million for the second quarter of 2014, up 12 percent from \$59.7 million in the year-ago period and up 22 percent from \$54.5 million for the first quarter of 2014. For the second quarter of 2014, consolidated net income available to common shareholders was \$62.6 million, or \$1.11 per diluted share. Net income available to common shareholders was \$57.3 million, or \$1.04 per diluted share, for the year-earlier quarter and \$50.4 million, or 0.90 per diluted share for the quarter ended March 31, 2014.
- Revenue, which consists of net interest income and noninterest income, was \$320.2 million for the second quarter of 2014, up 12 percent from \$285.1 million in the year-earlier quarter and up 6 percent from \$301.0 million in the first quarter of 2014.
- Fully taxable-equivalent net interest income, including dividend income, amounted to \$226.1 million for the second quarter of 2014, up 9 percent from the second quarter of 2013 and 10 percent higher from the first quarter of 2014.
- The Company's net interest margin in the second quarter of 2014 was 3.21 percent, down from 3.24 percent in the second quarter of 2013, but up from 3.02 percent in the first quarter of 2014. The increase from the first quarter of 2014 was primarily due to higher income on covered loans that were paid off or fully-charged off in the second quarter of 2014.

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- Noninterest income was \$101.1 million for the second quarter of 2014, up 23 percent from the second quarter of 2013 and down slightly from the first quarter of 2014. The increase from the year-earlier quarter was primarily attributable to higher wealth management fee income and lower FDIC loss-sharing expense, as well as a higher net gain on the disposal of assets. The decrease from the first quarter was due largely to higher FDIC loss-sharing expense offset by higher wealth management fee income and higher net gain on disposal of assets. Results for the second quarter of 2014 also included a \$5.1 million net gain on securities, compared to a \$5.6 million net gain in the second quarter of 2013 and a \$2.1 million net gain in the first quarter of 2014.
- Trust and investment fee income grew to \$54.6 million in the second quarter of 2014, up 10 percent from the year-earlier quarter and up 2 percent from the first quarter of 2014. Assets under management or administration totaled \$65.8 billion, up 10 percent from the second quarter of 2013, but down 1 percent from the first quarter of 2014.
- Noninterest expense for the second quarter of 2014 was \$225.6 million, up 7 percent from the second quarter of 2013 and 5 percent higher from the first quarter of 2014. The increase from the year-ago period largely reflects higher compensation costs, as well as an increase in legal and professional fees. Legal and professional fees for the second

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quarter of 2014 included sub-advisory expense related to the merger of two funds. These costs were offset in part by lower other real estate owned expenses and FDIC assessments.

- The base yield on the covered loan portfolio generated net interest income of \$12.4 million in the second quarter of 2014, compared to \$16.7 million for the year-earlier quarter and \$12.5 million in the first quarter of 2014. Base yield is the yield on covered loans, excluding income from covered loans that were paid off or fully charged-off. The Company recognizes other components of other income and expense related to its covered assets including income from covered loans that were paid off or fully charged-off, net impairment charges and other covered assets income and expenses. These components fluctuate from period to period. When aggregated, the impact of those items to the income statement, excluding the base yield, was total net expense of \$2.8 million for the second quarter of 2014, compared to net expense of \$2.0 million for the second quarter of 2013 and \$3.6 million for the first quarter of 2014. Refer to the Net Interest Income, Provision for Credit Losses and Covered Assets sections included elsewhere in this report for further discussion.
- The Company's effective tax rate was 30.7 percent for the second quarter of 2014, compared with 29.7 percent for the year-earlier period and 32.3 percent for the first quarter of 2014.
- Total assets were \$30.82 billion at June 30, 2014, up 13 percent from \$27.38 billion at June 30, 2013 and up 4 percent from \$29.74 billion at March 31, 2014. Total average assets were \$29.98 billion for the second quarter of 2014, up 9 percent from \$27.47 billion for the second quarter of 2013 and up 2 percent from \$29.43 billion for the first quarter of 2014.
- Loans and leases, excluding covered loans, grew to \$18.47 billion at June 30, 2014, an increase of 17 percent from \$15.82 billion at June 30, 2013 and 4 percent from \$17.75 billion at March 31, 2014. Average loan and lease balances, excluding covered loans, were \$17.96 billion for the second quarter of 2014, up 16 percent from the same period of last year and 4 percent from the first quarter of 2014. Average commercial loan balances were up 18 percent from the year-earlier period and 4 percent from the first quarter of 2014. Average commercial real estate balances increased 18 percent from the second quarter of 2013 and 3 percent from the first quarter of 2014.
- Excluding covered loans, second quarter 2014 results included a \$1.0 million reversal of provision for loan and lease losses. The Company recorded no provisions or provision reversal in either the second quarter of 2013 or first quarter of 2014. The allowance for loan and lease losses on non-covered loans was \$311.3 million at June 30, 2014, compared with \$289.9 million at June 30, 2013 and \$305.8 million at March 31, 2014. The Company remains appropriately reserved at 1.68 percent of total loans and leases, excluding covered loans, at June 30, 2014, compared with 1.83 percent at June 30, 2013 and 1.72 percent at March 31, 2014.
- In the second quarter of 2014, net loan charge-offs totaled \$3.6 million, or 0.08 percent of average total loans and leases, excluding covered loans, on an annualized basis, compared with net recoveries of \$7.5 million, or 0.20 percent, in the year-earlier quarter, and net recoveries of \$4.2 million, or 0.10 percent, for the first quarter of 2014. Nonaccrual loans, excluding covered loans, totaled \$64.8 million at June 30, 2014, down from \$76.7 million at June 30, 2013 and \$71.2 million at March 31, 2014. At June 30, 2014, nonperforming assets, excluding covered assets, were \$69.1 million, down from \$96.3 million at June 30, 2013 and \$80.7 million at March 31, 2014.

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- Average securities for the second quarter of 2014 totaled \$8.67 billion, down 2 percent from the second quarter of 2013, but up 1 percent from the first quarter of 2014.
- Period-end deposits at June 30, 2014 were \$26.65 billion, up 13 percent from \$23.65 billion at June 30, 2013 and 4 percent from \$25.73 billion at March 31, 2014. Deposit balances for the second quarter of 2014 averaged \$25.91 billion, up 12 percent from \$23.12 billion for the second quarter of 2013 and 2 percent from \$25.37 billion for the first quarter of 2014. Average core deposits, which equal 98 percent of total deposit balances for the second quarter of 2014, were up 14 percent from the second quarter of 2013 and 2 percent from the first quarter of 2014.
- The Company remains well capitalized. The ratio of Tier 1 common shareholders' equity to risk-based assets was 8.8 percent at June 30, 2014, compared with 8.8 percent at June 30, 2013 and 8.9 percent at March 31, 2014. Refer to the "Capital" section included elsewhere in this report for further discussion of this non-GAAP measure. All of the Company's pro-forma capital ratios are above the Basel III rules, which were approved by the Federal Reserve on July 2, 2013. These rules are expected to be fully implemented by January 1, 2019.

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**OUTLOOK**

Management expects moderate net income growth in 2014. Loan and deposit balances are expected to continue to increase, and credit quality should remain strong, though rising loan balances are expected to require a loan-loss provision later this year. Low interest rates and competitive loan pricing continue to put pressure on the Company's net interest margin. This outlook reflects management's expectations for moderate economic growth throughout the remainder of 2014. This does not take into account the effect that any changes in monetary policy could have on short-term interest rates, which are not expected to rise this year.

**RESULTS OF OPERATIONS**

**Net Interest Income**

Net interest income is the difference between interest income (which includes yield-related loan fees) and interest expense. Net interest income on a fully taxable-equivalent basis expressed as a percentage of average total earning assets is referred to as the net interest margin, which represents the average net effective yield on earning assets. The following table presents the components of net interest income on a fully taxable-equivalent basis for the three and six months ended June 30, 2014 and 2013:



Table of Contents**Net Interest Income Summary**

| (in thousands) (1)  | For the three months ended<br>June 30, 2014 |                                       |                             | For the three months ended<br>June 30, 2013 |                                       |                             |
|---|---|---------------------------------------|-----------------------------|---|---------------------------------------|-----------------------------|
|   | Average<br>balance                          | Interest<br>income/<br>expense (2)(3) | Average<br>interest<br>rate | Average<br>balance                          | Interest<br>income/<br>expense (2)(3) | Average<br>interest<br>rate |
| <b>Assets</b>   |   |                                       |                             |   |                                       |                             |
| Interest-earning assets   |   |                                       |                             |   |                                       |                             |
| Loans and leases  |   |                                       |                             |   |                                       |                             |
| Commercial  | \$ 8,605,421                                | \$ 74,969                             | 3.49%                       | \$ 7,300,447                                | \$ 65,156                             | 3.58%                       |
| Commercial real estate mortgages  | 3,354,672                                   | 29,838                                | 3.57                        | 2,847,979                                   | 28,397                                | 4.00                        |
| Residential mortgages   | 4,715,528                                   | 41,359                                | 3.51                        | 4,083,044                                   | 37,927                                | 3.72                        |
| Real estate construction  | 418,353                                     | 3,915                                 | 3.75                        | 352,775                                     | 3,733                                 | 4.24                        |
| Home equity loans and lines of credit                                   | 697,178                                     | 6,411                                 | 3.69                        | 704,418                                     | 6,315                                 | 3.60                        |
| Installment   | 168,039                                     | 1,820                                 | 4.34                        | 145,439                                     | 1,702                                 | 4.69                        |
| Total loans and leases, excluding covered loans (4)                     | 17,959,191                                  | 158,312                               | 3.54                        | 15,434,102                                  | 143,230                               | 3.72                        |
| Covered loans   | 643,690                                     | 31,061                                | 19.30                       | 909,728                                     | 32,610                                | 14.34                       |
| Total loans and leases  | 18,602,881                                  | 189,373                               | 4.08                        | 16,343,830                                  | 175,840                               | 4.32                        |
| Due from banks - interest-bearing                                       | 577,591                                     | 378                                   | 0.26                        | 236,119                                     | 158                                   | 0.27                        |
| Federal funds sold and securities purchased under resale agreements     | 355,747                                     | 1,477                                 | 1.67                        | 277,019                                     | 1,555                                 | 2.25                        |
| Securities  | 8,668,011                                   | 46,924                                | 2.17                        | 8,866,911                                   | 43,829                                | 1.98                        |
| Other interest-earning assets   | 72,166                                      | 1,165                                 | 6.47                        | 96,004                                      | 1,073                                 | 4.48                        |
| Total interest-earning assets   | 28,276,396                                  | 239,317                               | 3.39                        | 25,819,883                                  | 222,455                               | 3.46                        |
| Allowance for loan and lease losses                                     | (327,820)                                   |                                       |                             | (325,043)                                   |                                       |                             |
| Cash and due from banks   | 187,710                                     |                                       |                             | 128,489                                     |                                       |                             |
| Other non-earning assets  | 1,842,661                                   |                                       |                             | 1,846,252                                   |                                       |                             |
| Total assets  | \$ 29,978,947                               |                                       |                             | \$ 27,469,581                               |                                       |                             |
| <b>Liabilities and Equity</b>   |   |                                       |                             |   |                                       |                             |
| Interest-bearing deposits   |   |                                       |                             |   |                                       |                             |
| Interest checking accounts  | \$ 2,327,248                                | \$ 327                                | 0.06%                       | \$ 2,173,015                                | \$ 390                                | 0.07%                       |
| Money market accounts   | 6,617,913                                   | 1,142                                 | 0.07                        | 5,758,428                                   | 1,645                                 | 0.11                        |
| Savings deposits  | 462,316                                     | 68                                    | 0.06                        | 414,478                                     | 99                                    | 0.10                        |
| Time deposits - under \$100,000   | 169,455                                     | 86                                    | 0.20                        | 192,550                                     | 178                                   | 0.37                        |
| Time deposits - \$100,000 and over                                      | 451,197                                     | 437                                   | 0.39                        | 707,980                                     | 678                                   | 0.38                        |
| Total interest-bearing deposits   | 10,028,129                                  | 2,060                                 | 0.08                        | 9,246,451                                   | 2,990                                 | 0.13                        |
| Federal funds purchased and securities sold under repurchase agreements | 934   |                                       | 0.07                        | 374,571                                     | 123                                   | 0.13                        |
| Other borrowings  | 737,159                                     | 11,163                                | 6.07                        | 927,829                                     | 10,963                                | 4.74                        |
| Total interest-bearing liabilities                                      | 10,766,222                                  | 13,223                                | 0.49                        | 10,548,851                                  | 14,076                                | 0.54                        |
| Noninterest-bearing deposits  | 15,883,952                                  |                                       |                             | 13,872,367                                  |                                       |                             |
| Other liabilities   | 498,602                                     |                                       |                             | 466,295                                     |                                       |                             |
| Total equity  | 2,830,171                                   |                                       |                             | 2,582,068                                   |                                       |                             |
| Total liabilities and equity  | \$ 29,978,947                               |                                       |                             | \$ 27,469,581                               |                                       |                             |
| Net interest spread   |   |                                       | 2.90%                       |   |                                       | 2.92%                       |
| Fully taxable-equivalent net interest and dividend income               |   | \$ 226,094                            |                             |   | \$ 208,379                            |                             |
| Net interest margin   |   |                                       | 3.21%                       |   |                                       | 3.24%                       |
| Less: Dividend income included in other income                          |   | 1,165                                 |                             |   | 1,073                                 |                             |
| Fully taxable-equivalent net interest income                            |   | \$ 224,929                            |                             |   | \$ 207,306                            |                             |

- 
- (1) Certain prior period balances have been reclassified to conform to the current period presentation.
  - (2) Net interest income is presented on a fully taxable-equivalent basis.
  - (3) Loan income includes loan fees of \$8,884 and \$6,534 for 2014 and 2013, respectively.
  - (4) Includes average nonaccrual loans of \$63,934 and \$74,981 for 2014 and 2013, respectively.

Table of Contents**Net Interest Income Summary**

| (in thousands) (1)  | For the six months ended<br>June 30, 2014 |                                       |                             | For the six months ended<br>June 30, 2013 |                                       |                             |
|---|---|---------------------------------------|-----------------------------|---|---------------------------------------|-----------------------------|
|   | Average<br>balance                        | Interest<br>income/<br>expense (2)(3) | Average<br>interest<br>rate | Average<br>balance                        | Interest<br>income/<br>expense (2)(3) | Average<br>interest<br>rate |
| <b>Assets</b>   |   |                                       |                             |   |                                       |                             |
| Interest-earning assets   |   |                                       |                             |   |                                       |                             |
| Loans and leases  |   |                                       |                             |   |                                       |                             |
| Commercial  | \$ 8,435,115                              | \$ 143,138                            | 3.42%                       | \$ 7,089,246                              | \$ 128,115                            | 3.64%                       |
| Commercial real estate mortgages  | 3,305,008                                 | 59,164                                | 3.61                        | 2,808,007                                 | 55,522                                | 3.99                        |
| Residential mortgages   | 4,656,094                                 | 82,224                                | 3.53                        | 4,032,470                                 | 76,014                                | 3.77                        |
| Real estate construction  | 397,409                                   | 7,385                                 | 3.75                        | 342,906                                   | 7,539                                 | 4.43                        |
| Home equity loans and lines of credit                                   | 696,137                                   | 12,620                                | 3.66                        | 707,971                                   | 12,778                                | 3.64                        |
| Installment   | 160,757                                   | 3,515                                 | 4.41                        | 142,847                                   | 3,162                                 | 4.46                        |
| Total loans and leases, excluding covered loans (4)                     | 17,650,520                                | 308,046                               | 3.52                        | 15,123,447                                | 283,130                               | 3.78                        |
| Covered loans   | 669,781                                   | 52,913                                | 15.80                       | 949,370                                   | 64,726                                | 13.64                       |
| Total loans and leases  | 18,320,301                                | 360,959                               | 3.97                        | 16,072,817                                | 347,856                               | 4.36                        |
| Due from banks - interest-bearing                                       | 621,146                                   | 820                                   | 0.27                        | 214,535                                   | 270                                   | 0.25                        |
| Federal funds sold and securities purchased under resale agreements     | 317,569                                   | 2,848                                 | 1.81                        | 215,880                                   | 2,690                                 | 2.51                        |
| Securities  | 8,626,844                                 | 91,699                                | 2.13                        | 9,329,014                                 | 90,660                                | 1.94                        |
| Other interest-earning assets   | 74,538                                    | 2,375                                 | 6.42                        | 100,364                                   | 2,035                                 | 4.09                        |
| Total interest-earning assets   | 27,960,398                                | 458,701                               | 3.31                        | 25,932,610                                | 443,511                               | 3.45                        |
| Allowance for loan and lease losses                                     | (325,595)                                 |                                       |                             | (326,483)                                 |                                       |                             |
| Cash and due from banks   | 217,631                                   |                                       |                             | 128,596                                   |                                       |                             |
| Other non-earning assets  | 1,851,746                                 |                                       |                             | 1,853,985                                 |                                       |                             |
| Total assets  | \$ 29,704,180                             |                                       |                             | \$ 27,588,708                             |                                       |                             |
| <b>Liabilities and Equity</b>   |   |                                       |                             |   |                                       |                             |
| Interest-bearing deposits   |   |                                       |                             |   |                                       |                             |
| Interest checking accounts  | \$ 2,373,545                              | \$ 710                                | 0.06%                       | \$ 2,195,086                              | \$ 807                                | 0.07%                       |
| Money market accounts   | 6,492,299                                 | 2,242                                 | 0.07                        | 5,725,378                                 | 3,242                                 | 0.11                        |
| Savings deposits  | 458,293                                   | 136                                   | 0.06                        | 416,652                                   | 214                                   | 0.10                        |
| Time deposits - under \$100,000   | 171,749                                   | 179                                   | 0.21                        | 196,363                                   | 360                                   | 0.37                        |
| Time deposits - \$100,000 and over                                      | 467,224                                   | 927                                   | 0.40                        | 656,425                                   | 1,307                                 | 0.40                        |
| Total interest-bearing deposits   | 9,963,110                                 | 4,194                                 | 0.08                        | 9,189,904                                 | 5,930                                 | 0.13                        |
| Federal funds purchased and securities sold under repurchase agreements | 470                                       |                                       | 0.07                        | 606,058                                   | 400                                   | 0.13                        |
| Other borrowings  | 738,021                                   | 22,316                                | 6.10                        | 1,188,474                                 | 22,473                                | 3.81                        |
| Total interest-bearing liabilities                                      | 10,701,601                                | 26,510                                | 0.50                        | 10,984,436                                | 28,803                                | 0.53                        |
| Noninterest-bearing deposits  | 15,680,222                                |                                       |                             | 13,576,936                                |                                       |                             |
| Other liabilities   | 516,938                                   |                                       |                             | 469,454                                   |                                       |                             |
| Total equity  | 2,805,419                                 |                                       |                             | 2,557,882                                 |                                       |                             |
| Total liabilities and equity  | \$ 29,704,180                             |                                       |                             | \$ 27,588,708                             |                                       |                             |
| Net interest spread   |   |                                       | 2.81%                       |   |                                       | 2.92%                       |
| Fully taxable-equivalent net interest and dividend income               |   | \$ 432,191                            |                             |   | \$ 414,708                            |                             |
| Net interest margin   |   |                                       | 3.12%                       |   |                                       | 3.22%                       |
| Less: Dividend income included in other income                          |   | 2,375                                 |                             |   | 2,035                                 |                             |
| Fully taxable-equivalent net interest income                            |   | \$ 429,816                            |                             |   | \$ 412,673                            |                             |

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- (1) Certain prior period balances have been reclassified to conform to the current period presentation.
  - (2) Net interest income is presented on a fully taxable-equivalent basis.
  - (3) Loan income includes loan fees of \$15,115 and \$12,719 for 2014 and 2013, respectively.
  - (4) Includes average nonaccrual loans of \$66,116 and \$83,945 for 2014 and 2013, respectively.

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Net interest income is impacted by the volume (changes in volume multiplied by prior rate), interest rate (changes in rate multiplied by prior volume) and mix of interest-earning assets and interest-bearing liabilities. The following table provides a breakdown of the changes in net interest income and dividend income on a fully taxable-equivalent basis due to volume and rate between the second quarter and first six months of 2014 and 2013, as well as the second quarter and first six months of 2013 and 2012. The impact of interest rate swaps, which affect interest income on loans and leases and interest expense on deposits and borrowings, is included in rate changes.

**Changes in Net Interest Income**

| (in thousands)  | For the three months ended June 30,<br>2014 vs 2013 |                |                               | For the three months ended June 30,<br>2013 vs 2012 |                 |                               |
|---|---|----------------|-------------------------------|---|-----------------|-------------------------------|
|   | Increase (decrease)<br>due to                       |                | Net<br>increase<br>(decrease) | Increase (decrease)<br>due to                       |                 | Net<br>increase<br>(decrease) |
|   | Volume  | Rate           |                               | Volume  | Rate            |                               |
| <b>Interest earned on:</b>  |   |                |                               |   |                 |                               |
| Total loans and leases (1)  | \$ 23,362   | \$ (9,829)     | \$ 13,533                     | \$ 22,848   | \$ (34,909)     | \$ (12,061)                   |
| Securities  | (996)   | 4,091          | 3,095                         | 6,058   | (8,156)         | (2,098)                       |
| Due from banks - interest-bearing   | 224   | (4)            | 220                           | (36)  | 21              | (15)                          |
| Federal funds sold and securities<br>purchased under resale<br>agreements | 381   | (459)          | (78)                          | 188   | 1,271           | 1,459                         |
| Other interest-earning assets   | (309)   | 401            | 92                            | (142)   | 521             | 379                           |
| <b>Total interest-earning assets</b>                                      | <b>22,662</b>                                       | <b>(5,800)</b> | <b>16,862</b>                 | <b>28,916</b>                                       | <b>(41,252)</b> | <b>(12,336)</b>               |
| <b>Interest paid on:</b>  |   |                |                               |   |                 |                               |
| Interest checking deposits  | 26  | (89)           | (63)                          | 62  | (128)           | (66)                          |
| Money market deposits   | 219   | (722)          | (503)                         | (30)  | (201)           | (231)                         |
| Savings deposits  | 10  | (41)           | (31)                          | 17  | (45)            | (28)                          |
| Time deposits   | (243)   | (90)           | (333)                         | (67)  | (184)           | (251)                         |
| Total borrowings  | (6,139)   | 6,216          | 77                            | 4,894   | (3,652)         | 1,242                         |
| <b>Total interest-bearing liabilities</b>                                 | <b>(6,127)</b>                                      | <b>5,274</b>   | <b>(853)</b>                  | <b>4,876</b>  | <b>(4,210)</b>  | <b>666</b>                    |
|   | \$ 28,789   | \$ (11,074)    | \$ 17,715                     | \$ 24,040   | \$ (37,042)     | \$ (13,002)                   |

| (in thousands)  | For the six months ended June 30,<br>2014 vs 2013 |                 |                               | For the six months ended June 30,<br>2013 vs 2012 |                 |                               |
|---|---|-----------------|-------------------------------|---|-----------------|-------------------------------|
|   | Increase (decrease)<br>due to                     |                 | Net<br>increase<br>(decrease) | Increase (decrease)<br>due to                     |                 | Net<br>increase<br>(decrease) |
|   | Volume  | Rate            |                               | Volume  | Rate            |                               |
| <b>Interest earned on:</b>  |   |                 |                               |   |                 |                               |
| Total loans and leases (1)  | \$ 45,985   | \$ (32,882)     | \$ 13,103                     | \$ 44,165   | \$ (54,089)     | \$ (9,924)                    |
| Securities  | (7,047)   | 8,086           | 1,039                         | 15,925  | (18,776)        | (2,851)                       |
| Due from banks - interest-bearing   | 536   | 14              | 550                           | (19)  | 23              | 4                             |
| Federal funds sold and securities<br>purchased under resale<br>agreements | 1,045   | (887)           | 158                           | 492   | 2,092           | 2,584                         |
| Other interest-earning assets   | (617)   | 957             | 340                           | (242)   | 892             | 650                           |
| <b>Total interest-earning assets</b>                                      | <b>39,902</b>                                     | <b>(24,712)</b> | <b>15,190</b>                 | <b>60,321</b>                                     | <b>(69,858)</b> | <b>(9,537)</b>                |
| <b>Interest paid on:</b>  |   |                 |                               |   |                 |                               |
| Interest checking deposits  | 62  | (159)           | (97)                          | 125   | (298)           | (173)                         |
| Money market deposits   | 391   | (1,391)         | (1,000)                       | (143)   | (693)           | (836)                         |
| Savings deposits  | 19  | (97)            | (78)                          | 37  | (77)            | (40)                          |

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|                                    |           |             |           |           |             |             |
|------------------------------------|-----------|-------------|-----------|-----------|-------------|-------------|
| Time deposits                      | (385)     | (176)       | (561)     | (218)     | (402)       | (620)       |
| Total borrowings                   | (19,003)  | 18,446      | (557)     | 14,816    | (10,633)    | 4,183       |
| Total interest-bearing liabilities | (18,916)  | 16,623      | (2,293)   | 14,617    | (12,103)    | 2,514       |
|                                    | \$ 58,818 | \$ (41,335) | \$ 17,483 | \$ 45,704 | \$ (57,755) | \$ (12,051) |

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(1) Includes covered loans.

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Net interest income was \$219.1 million for the second quarter of 2014, an increase of 10 percent from \$199.8 million for the first quarter of 2014, and an 8 percent increase from \$202.9 million for the second quarter of 2013. The increase in net interest income from the first quarter of 2014 was largely due to growth in non-covered loans, higher interest income from covered loans and higher interest income from the securities portfolio. The increase in net interest income from the prior-year quarter was due to higher income on loans and securities and lower interest expense on deposits and borrowings. Fully taxable-equivalent net interest income and dividend income was \$226.1 million for the second quarter of 2014, compared to \$206.1 million for the first quarter of 2014 and \$208.4 million for the second quarter of 2013.

Interest income on total loans was \$187.0 million for the second quarter of 2014, up 10 percent from the first quarter of 2014 and up 7 percent from the second quarter of 2013. The increase in loan interest income from the prior quarter was driven by growth in the loan portfolio and higher income from the net accelerated accretable yield recognition on covered loans that were paid off or fully charged off in the second quarter of 2014. Compared to the year-earlier quarter, the increase in loan interest income was largely due to growth in non-covered loans. Income from accelerated accretable yield recognition during the second quarter of 2014 was \$18.7 million, compared to \$9.3 million in the first quarter of 2014 and \$15.9 million in the year-earlier quarter. Refer to Covered Assets included elsewhere in this report for further discussion of interest income on covered loans.

Average loans and leases, excluding covered loans, totaled \$18.00 billion for the second quarter of 2014, an increase of 4 percent from \$17.34 billion for the first quarter of 2014 and up 16 percent from \$15.43 billion for the second quarter of 2013. Average commercial loans grew 4 percent and 18 percent from the first quarter of 2014 and second quarter of 2013, respectively. Average commercial real estate loans grew 3 percent and 18 percent for the same periods. Average covered loans decreased to \$643.7 million for the second quarter of 2014 from \$696.2 million for the first quarter of 2014 and \$909.7 million for the year-ago quarter.

Interest income on securities was \$43.5 million for the second quarter of 2014, a 5 percent increase from both \$41.6 million for the first quarter of 2014 and \$41.2 million for the second quarter of 2013. Average total securities were \$8.67 billion for the second quarter of 2014, up by 1 percent from \$8.59 billion for the first quarter of 2014 and down 2 percent from \$8.87 billion for the year-earlier quarter. The decrease from the second quarter of 2013 was largely due to sales of longer-duration securities in the second half of 2013 to shorten the duration of the investment portfolio in anticipation of higher interest rates.

Total interest expense was \$13.2 million for the second quarter of 2014, virtually unchanged from the first quarter of 2014 and down 6 percent from \$14.1 million for the second quarter of 2013. Interest expense on borrowings was \$11.2 million for the second quarter of 2014, unchanged from \$11.2 million for the first quarter of 2014 and up 1 percent from \$11.1 million for the second quarter of 2013. The decrease in total interest expense from the year-earlier quarter was attributable to lower expense on interest-bearing deposits.

Interest expense on deposits was \$2.1 million for the second quarter of 2014, unchanged from \$2.1 million for the first quarter of 2014 and down 31 percent from \$3.0 million for the year-earlier quarter. The decrease in interest expense from the year-earlier quarter was due to lower deposit rates. The impact of lower rates more than offset the impact of higher average interest-bearing deposit balances in the second quarter of 2014. Average deposits were \$25.91 billion for the second quarter of 2014, up 2 percent from \$25.37 billion for the first quarter of 2014, and up 12 percent from \$23.12 billion for the second quarter of 2013. Average core deposits, which do not include certificates of deposits of \$100,000 or more, were \$25.46 billion for the second quarter of 2014, \$24.89 billion for the first quarter of 2014 and \$22.41 billion for the year-earlier quarter. Average core deposits represented 98 percent of total average deposits for the second and first quarter of 2014, and 97 percent for the second quarter of 2013. Average interest-bearing deposits were \$10.03 billion for the second quarter of 2014, up 1 percent from the first quarter of 2014, and up 8 percent from the second quarter of 2013. Average noninterest-bearing deposits were \$15.88 billion, up 3 percent from the first quarter of 2014 and up 15 percent from the year-earlier quarter.





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Net interest margin was 3.21 percent for the second quarter of 2014, up from 3.02 percent for the first quarter of 2014 and down from 3.24 percent for the second quarter of 2013. The average yield on earning assets for the second quarter of 2014 was 3.39 percent, up 17 basis points from 3.22 percent for the first quarter of 2014 and down 7 basis points from 3.46 percent for the year-earlier quarter. The average cost of interest-bearing liabilities was 0.49 percent, down from 0.51 percent for the first quarter of 2014 and down from 0.54 percent for the same period in 2013. The increase in the net interest margin from the first quarter of 2014 was primarily attributable to higher income from the net accelerated accretable yield recognition on covered loans that were paid off or fully charged off. The decrease in the net interest margin compared to the year-earlier quarter was primarily due to lower yields on loans and leases and declining volumes of covered loans, partially offset by higher fees and interest recoveries and a lower cost of interest-bearing liabilities.

**Provision for Credit Losses**

The Company accounts for the credit risk associated with lending activities through its allowance for loan and lease losses, reserve for off-balance sheet credit commitments and provision for credit losses. The provision for credit losses on loans and leases, excluding covered loans, is the expense recognized in the consolidated statements of income to adjust the allowance and the reserve for off-balance sheet credit commitments to the levels deemed appropriate by management, as determined through application of the Company's allowance methodology procedures. See *Critical Accounting Policies Allowance for Loan and Lease Losses and Reserve for Off-Balance Sheet Credit Commitments* in the Company's Form 10-K for the year ended December 31, 2013.

The Company recorded a \$1.0 million reversal of provision for credit losses on loans and leases, excluding covered loans, in the three months and six months ended June 30, 2014. The Company recorded no provision for credit losses on loans and leases, excluding covered loans, during the comparable periods in 2013. The provision reflects management's continuing assessment of the credit quality of the Company's loan portfolio, which is affected by a broad range of economic factors. Additional factors affecting the provision include net loan charge-offs or recoveries, nonaccrual loans, specific reserves, risk rating migration and changes in the portfolio size and composition. See *Balance Sheet Analysis Allowance for Loan and Lease Losses and Reserve for Off-Balance Sheet Credit Commitments* included elsewhere in this report for further information on factors considered by the Company in assessing the credit quality of the loan portfolio and establishing the allowance for loan and lease losses.

Covered loans represent loans acquired from the FDIC that are subject to loss-sharing agreements, and are primarily accounted for as acquired impaired loans under Accounting Standards Codification Topic 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality* (ASC 310-30). The provision for losses on covered loans is the expense recognized in the consolidated statements of income related to impairment losses resulting from the Company's quarterly review and update of cash flow projections on its covered loan portfolio. The Company recorded a \$1.5 million reversal of provision for losses on covered loans during the second quarter of 2014, compared to a \$4.7 million provision on covered loans in the first quarter of 2014 and an \$11.9 million reversal of provision during the second quarter of 2013. Refer to *Covered Assets* included elsewhere in this report for further discussion of the provision for losses on covered loans.

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

Refer to *Loans and Leases Asset Quality* included elsewhere in this report for further discussion of credit quality.

**Noninterest Income**

Noninterest income was \$101.1 million in the second quarter of 2014, down slightly from the first quarter of 2014 but up 23 percent from the second quarter of 2013. Higher FDIC loss sharing expense in the second quarter of 2014 compared with the first quarter was largely offset by higher wealth management fee income and higher gains on sales of securities and foreclosed assets. The increase from the year-earlier quarter was due largely to strong growth in wealth management fee income, higher gains on sales of foreclosed assets and lower FDIC loss sharing expense. Noninterest income represented 32 percent of the Company's revenue in the second quarter of 2014, compared to 34 percent in the first quarter of 2014 and 29 percent for the second quarter of 2013.

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

| (in thousands)                                  | For the three months ended |                   |                  |
|---|----------------------------|-------------------|------------------|
|   | June 30,<br>2014           | March 31,<br>2014 | June 30,<br>2013 |
| Trust and investment fees                       | \$ 54,599                  | \$ 53,306         | \$ 49,830        |
| Brokerage and mutual fund fees                  | 14,240                     | 10,042            | 8,107            |
| Total wealth management fees                    | 68,839                     | 63,348            | 57,937           |
| Cash management and deposit transaction charges | 12,128                     | 12,033            | 12,880           |
| International services                          | 11,483                     | 10,395            | 10,911           |
| FDIC loss sharing expense, net                  | (24,161)                   | (7,083)           | (26,477)         |
| Other noninterest income                        | 20,853                     | 17,607            | 20,401           |
| Total noninterest income before gain (loss)     | 89,142                     | 96,300            | 75,652           |
| Gain on disposal of assets                      | 6,838                      | 2,826             | 949              |
| Gain on sale of securities                      | 5,367                      | 2,122             | 5,790            |
| Impairment loss on securities                   | (248)                      |                   | (182)            |
| Total noninterest income                        | \$ 101,099                 | \$ 101,248        | \$ 82,209        |

*Wealth Management*

The Company provides various trust, investment and wealth advisory services to its individual, institutional and business clients. The Company delivers these services through the Bank's wealth management division as well as through its wealth management affiliates. Trust services are provided only by the Bank. Trust and investment fee revenue includes fees from trust, investment and asset management, and other wealth advisory services. The majority of these fees are based on the market value of client assets managed, advised, administered or held in custody. The remaining portion of these fees is based on the specific service provided, such as estate and financial planning services, or may be fixed fees. For those fees based on market valuations, the mix of assets held in client accounts, as well as the type of managed account, impacts how closely changes in trust and investment fee income correlate with changes in the financial markets. Changes in market valuations are reflected in fee income on a trailing day, month or quarter basis. Also included in total trust and investment fees is the Company's portion of income from certain investments accounted for under the equity method. Trust and investment fees were \$54.6 million for the second quarter of 2014, an increase of 2 percent from \$53.3 million for the first quarter of 2014 and an increase of 10 percent from \$49.8 million for the second quarter of 2013. The increases compared to prior periods were largely due to the growth in assets under management (AUM) generated through asset inflows and market appreciation. Money market mutual fund and brokerage fees were \$14.2 million for the second quarter of 2014, an increase of 42 percent from \$10.0 million for the first quarter of 2014, and up 76 percent from \$8.1 million for the year-earlier quarter. Second quarter 2014 brokerage and mutual fund fees included the recognition of \$3.8 million in performance fees related to the merger of two funds. The higher fee income was partially offset by a \$1.9 million increase in legal and professional fees for sub-advisory expense related to the merged funds. See Noninterest Expense below. The increase in fee income compared to the second quarter of 2013 was also due to asset inflows and market appreciation.

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

| (in millions) | 2014 | June 30,<br>2013 | %<br>Change | March 31,<br>2014 | %<br>Change |
|---------------|------|------------------|-------------|-------------------|-------------|
|---------------|------|------------------|-------------|-------------------|-------------|

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|   |    |        |    |        |     |    |        |     |
|---|----|--------|----|--------|-----|----|--------|-----|
| <b>Assets Under Management</b>                      | \$ | 47,124 | \$ | 41,257 | 14  | \$ | 46,374 | 2   |
| <b>Assets Under Administration</b>                  |    |        |    |        |     |    |        |     |
| Brokerage   |    | 5,218  |    | 5,251  | (1) |    | 5,628  | (7) |
| Custody and other fiduciary                         |    | 13,438 |    | 13,247 | 1   |    | 14,398 | (7) |
| Subtotal  |    | 18,656 |    | 18,498 | 1   |    | 20,026 | (7) |
| Total assets under management or administration (1) | \$ | 65,780 | \$ | 59,755 | 10  | \$ | 66,400 | (1) |

(1) Excludes \$27.85 billion, \$26.09 billion and \$25.11 billion of assets under management for asset managers in which the Company held a noncontrolling ownership interest as of June 30, 2014, March 31, 2014 and June 30, 2013, respectively.

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AUM totaled \$47.12 billion as of June 30, 2014, up 14 percent from the year-earlier quarter and up 2 percent from the first quarter of 2014. Assets under management or administration were \$65.78 billion at June 30, 2014, an increase of 10 percent from the year-earlier quarter but down 1 percent from the first quarter of 2014. The growth in AUM from the prior year period was primarily attributable to the addition of client assets and higher market valuations.

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

| Investment                | % of Assets Under Management |                   |                  |
|---------------------------|------------------------------|-------------------|------------------|
|                           | June 30,<br>2014             | March 31,<br>2014 | June 30,<br>2013 |
| Equities                  | 49%                          | 48%               | 46%              |
| U.S. fixed income         | 26                           | 27                | 25               |
| Cash and cash equivalents | 15                           | 16                | 18               |
| Other (1)                 | 10                           | 9                 | 11               |
|                           | 100%                         | 100%              | 100%             |

(1) Includes private equity and other alternative investments.

*Other Noninterest Income*

Cash management and deposit transaction fees for the second quarter of 2014 were \$12.1 million, up 1 percent from the first quarter of 2014 and down 6 percent from the second quarter of 2013. The decrease from the year-earlier quarter was due largely to higher deposit balances used to offset service charge fees.

International services income for the second quarter of 2014 was \$11.5 million, up 10 percent from the first quarter of 2014, and up 5 percent from the year-earlier quarter. International services income is comprised of foreign exchange fees, fees on commercial letters of credit and standby letters of credit, foreign collection fees, and gains and losses associated with fluctuations in foreign currency exchange rates. The increases from prior periods were due to increased client activity and the addition of new clients.

Net FDIC loss sharing expense increased to \$24.2 million for the second quarter of 2014 from \$7.1 million for the first quarter of 2014. Net FDIC loss sharing expense was \$26.5 million for the year-earlier quarter. See *Covered Assets* included elsewhere in this report for further discussion of FDIC loss sharing income and expense.

Net gain on disposal of assets was \$6.8 million in the second quarter of 2014, compared to \$2.8 million in the first quarter of 2014 and \$0.9 million in the year-earlier quarter. The increase from the prior periods was due primarily to the sale of assets that served as collateral for previously charged-off loans, as well as higher gains recognized on the sale of covered and non-covered OREO.

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The Company recognized net gains on sales of securities of \$5.4 million during the second quarter of 2014. Net gains on sales of securities were \$2.1 million in the first quarter of 2014 and \$5.8 million for the second quarter of 2013. Impairment losses of \$0.2 million were recognized in earnings on securities available-for-sale in the second quarter of 2014 and 2013. There were no impairment losses recognized in earnings on securities available-for-sale in the first quarter of 2014.

Other income for the second quarter of 2014 was \$20.9 million, up 18 percent from \$17.6 million for the first quarter of 2014, and up 2 percent from \$20.4 million for the second quarter of 2013. The increase from the first quarter of 2014 was due primarily to higher lease residual income and credit card and interchange fees. Compared to the year-earlier quarter, the increase was mainly due to higher income from private equity investments and credit card and interchange fee income, largely offset by lower income from client swap transactions in the second quarter of 2014.

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Noninterest expense was \$225.6 million for the second quarter of 2014, up 5 percent from \$214.9 million for the first quarter of 2014, and up 7 percent from \$211.4 million for the second quarter of 2013. The following table provides a summary of noninterest expense by category:

| (in thousands)                 | June 30,<br>2014 | For the three months ended<br>March 31,<br>2014 | June 30,<br>2013 |
|--------------------------------|------------------|---|------------------|
| Salaries and employee benefits | \$ 138,859       | \$ 136,833                                      | \$ 127,168       |
| All other:                     |                  |   |                  |
| Net occupancy of premises      | 16,595           | 16,094  | 16,205           |
| Legal and professional fees    | 18,393           | 12,950  | 13,514           |
| Information services           | 9,463            | 9,346   | 9,183            |
| Depreciation and amortization  | 7,885            | 7,828   | 8,249            |
| Amortization of intangibles    | 1,454            | 1,487   | 1,931            |
| Marketing and advertising      | 8,982            | 9,775   | 8,293            |
| Office services and equipment  | 5,287            | 4,910   | 5,034            |
| Other real estate owned        | 2,372            | 1,433   | 4,385            |
| FDIC assessments               | 2,765            | 1,391   | 3,663            |
| Other operating                | 13,567           | 12,846  | 13,804           |
| Total all other                | 86,763           | 78,060  | 84,261           |
| Total noninterest expense      | \$ 225,622       | \$ 214,893                                      | \$ 211,429       |

Salaries and employee benefits expense was \$138.9 million for the second quarter of 2014, up 1 percent from \$136.8 million for the first quarter of 2014, and up 9 percent from \$127.2 million for the year-earlier quarter. Full-time equivalent staff was 3,638 at June 30, 2014, up from 3,587 at March 31, 2014 and 3,551 at June 30, 2013. The increase in salaries and employee benefits expense in the second quarter compared with the prior and year-earlier quarters was primarily attributable to the addition of staff and higher incentive compensation. The increase in incentive compensation expense in the second quarter of 2014 compared with the first quarter was partially offset by lower payroll taxes.

Salaries and employee benefits expense for the second quarter of 2014 includes \$5.2 million of share-based compensation expense compared with \$5.4 million for the first quarter of 2014 and \$5.4 million for the year-earlier quarter. The decrease from the first quarter of 2014 was attributable to expense associated with cash-settled restricted stock units, which fluctuates based on the Company's stock price. Cash-settled restricted stock unit expense was higher during the first quarter of 2014 due to a higher average stock price during that quarter. See Note 10, *Share-Based Compensation*, of the Notes to the Unaudited Consolidated Financial Statements for further discussion of share-based compensation.

The remaining noninterest expense categories totaled \$86.8 million for the second quarter of 2014, up 11 percent from \$78.1 million for the first quarter of 2014 and 3 percent from \$84.3 million for the second quarter of 2013. The increase from the first quarter of 2014 was mostly due to higher legal and professional fees, OREO expense and FDIC assessments. The increase from the year-earlier quarter was primarily due to higher legal and professional fees that were partially offset by lower OREO expense and FDIC assessments.

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Legal and professional fees were \$18.4 million for the second quarter of 2014, up 42 percent from \$13.0 million in the first quarter of 2014, and up 36 percent from \$13.5 million in the year-earlier quarter. The increase from the first quarter of 2014 and second quarter of 2013 was primarily due to higher legal and professional fees recognized in the current quarter from collection and defense matters, and \$1.9 million of sub-advisory fees associated with the merger of two City National Rochdale funds. Legal and professional fees associated with covered loans and OREO declined to \$1.0 million for the second quarter of 2014, from \$1.6 million for the first quarter of 2014 and \$1.7 million for the second quarter of 2013. Under the loss-sharing agreements, 80 percent of qualifying legal and professional fees associated with covered loans and OREO are reimbursable by the FDIC and reflected in FDIC loss sharing income (expense), net in the noninterest income section of the consolidated statements of income.



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The following table provides a summary of OREO expense for non-covered and covered OREO. Qualifying covered OREO expense is reimbursable by the FDIC at 80 percent.

| (in thousands)                        | For the three months ended<br>June 30, |          | For the six months ended<br>June 30, |          |
|---------------------------------------|--|----------|--------------------------------------|----------|
|                                       | 2014                                   | 2013     | 2014                                 | 2013     |
| <b>Non-covered OREO expense</b>       |  |          |                                      |          |
| Valuation write-downs                 | \$                                     | \$ 61    | \$ 14                                | \$ 171   |
| Holding costs and foreclosure expense | 72                                     | 246      | 178                                  | 458      |
| Total non-covered OREO expense        | \$ 72                                  | \$ 307   | \$ 192                               | \$ 629   |
| <b>Covered OREO expense</b>           |  |          |                                      |          |
| Valuation write-downs                 | \$ 934                                 | \$ 2,184 | \$ 1,089                             | \$ 5,219 |
| Holding costs and foreclosure expense | 1,366                                  | 1,894    | 2,524                                | 3,787    |
| Total covered OREO expense            | \$ 2,300                               | \$ 4,078 | \$ 3,613                             | \$ 9,006 |
| Total OREO expense                    | \$ 2,372                               | \$ 4,385 | \$ 3,805                             | \$ 9,635 |

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The following table summarizes the components of income and expense related to covered assets for the three and six months ended June 30, 2014 and 2013:

| (in thousands)   | For the three months ended<br>June 30, |             | For the six months ended<br>June 30, |             |
|--|--|-------------|--------------------------------------|-------------|
|  | 2014                                   | 2013        | 2014                                 | 2013        |
| <b>Interest income on covered loans</b>  |  |             |                                      |             |
| Base yield   | \$ 12,379                              | \$ 16,730   | \$ 24,907                            | \$ 33,221   |
| Income on loans paid-off or fully charged-off  | 18,682                                 | 15,880      | 28,006                               | 31,505      |
| Total interest income on covered loans   | \$ 31,061                              | \$ 32,610   | \$ 52,913                            | \$ 64,726   |
| <b>(Reversal of) provision for losses on covered loans</b>                                   |  |             |                                      |             |
| (Reversal of) provision for losses on covered loans  | \$ (1,461)                             | \$ (11,927) | \$ 3,194                             | \$ (2,035)  |
| <b>Noninterest income related to covered assets</b>  |  |             |                                      |             |
| <b>FDIC loss sharing expense, net</b>  |  |             |                                      |             |
| Loss on indemnification asset  | \$ (4,392)                             | \$ (13,102) | \$ (793)                             | \$ (2,486)  |
| Indemnification asset amortization   | (3,320)                                | (4,746)     | (6,484)                              | (9,645)     |
| Net FDIC reimbursement for OREO and loan expenses  | 2,160                                  | 4,995       | 3,813                                | 10,188      |
| Removal of indemnification asset for loans paid-off or fully charged-off                     | (4,994)                                | (7,650)     | (7,993)                              | (13,723)    |
| Removal of indemnification asset for unfunded loan commitments and loans transferred to OREO | (773)                                  | (1,163)     | (1,449)                              | (3,732)     |
| Removal of indemnification asset for OREO and net reimbursement to FDIC for OREO sales       | (1,827)                                | (428)       | (2,138)                              | (1,272)     |
| Loan recoveries shared with FDIC   | (9,866)                                | (4,095)     | (14,088)                             | (9,076)     |
| Increase in FDIC clawback liability  | (1,149)                                | (288)       | (2,112)                              | (1,083)     |
| Total FDIC loss sharing expense, net   | (24,161)                               | (26,477)    | (31,244)                             | (30,829)    |
| <b>Gain on disposal of assets</b>  |  |             |                                      |             |
| Net gain on sale of OREO   | 2,613                                  | 616         | 3,002                                | 1,590       |
| <b>Other income</b>  |  |             |                                      |             |
| Net gain on transfers of covered loans to OREO   | 867                                    | 1,445       | 1,730                                | 4,951       |
| Amortization of fair value on acquired unfunded loan commitments                             | 218                                    | 283         | 433                                  | 677         |
| OREO income  | 289                                    | 456         | 724                                  | 1,282       |
| Other  | 543                                    | (318)       | 387                                  | (652)       |
| Total other income   | 1,917                                  | 1,866       | 3,274                                | 6,258       |
| <b>Total noninterest income related to covered assets</b>                                    | \$ (19,631)                            | \$ (23,995) | \$ (24,968)                          | \$ (22,981) |
| <b>Noninterest expense related to covered assets (1)</b>                                     |  |             |                                      |             |
| <b>Other real estate owned</b>   |  |             |                                      |             |
| Valuation write-downs  | \$ 934                                 | \$ 2,184    | \$ 1,089                             | \$ 5,219    |
| Holding costs and foreclosure expense  | 1,366                                  | 1,894       | 2,524                                | 3,787       |
| Total other real estate owned  | 2,300                                  | 4,078       | 3,613                                | 9,006       |

|  |          |          |          |           |
|--|----------|----------|----------|-----------|
| <b>Legal and professional fees</b>                             | 992      | 1,701    | 2,572    | 3,721     |
| <b>Other operating expense</b>                                 |          |          |          |           |
| Other covered asset expenses                                   | 5        | 16       | 24       | 30        |
| <b>Total noninterest expense related to covered assets (2)</b> | \$ 3,297 | \$ 5,795 | \$ 6,209 | \$ 12,757 |

- 
- (1) OREO, legal and professional fees and other expenses related to covered assets must meet certain FDIC criteria in order for the expense amounts to be reimbursed. Certain amounts reflected in these categories may not be reimbursed by the FDIC.
- (2) Excludes personnel and other corporate overhead expenses that the Company incurs to service covered assets and costs associated with the branches acquired in FDIC-assisted acquisitions.

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The Company accounts for its covered loans under ASC 310-30. Loans are accounted for under ASC 310-30 when there is evidence of credit deterioration since origination and for which it is probable, at acquisition, that the Company would be unable to collect all contractually required payments. These loans were recorded at fair value at the time of acquisition. In connection with its FDIC-assisted acquisitions, the Company entered into loss-sharing agreements with the FDIC under which the FDIC will reimburse the Company for 80 percent of eligible losses with respect to covered loans, OREO and unfunded loan commitments. The expected reimbursements under the loss-sharing agreements were recorded as an indemnification asset at their initial estimated fair value on the date of acquisition.

*Covered Loan Base Yield and FDIC Indemnification Asset Amortization/Accretion*

For covered loans, the excess of cash flows expected to be collected over the carrying value of the underlying acquired impaired loans is referred to as accretable yield. The accretion of this amount is recognized in interest income over the expected life of the covered loans and is herein referred to as base yield. For the FDIC indemnification asset, the difference between the cash flows the Company expects to collect from the FDIC ( FDIC cash flows ) and the carrying value of the indemnification asset is amortized or accreted into noninterest income up until the expiration date of the FDIC loss sharing. Both the base yield and the amortization or accretion of the indemnification asset are calculated using a level yield method that takes into consideration the remaining life of the covered loans and the terms of the FDIC loss-sharing agreements.

The quarterly review and update of cash flow projections (further discussed below) may adjust the rates used for loan accretion and indemnification asset amortization or accretion. As credit improves, expected loan cash flows will generally improve, resulting in higher accretable yield. Accordingly, as credit improves, expected FDIC cash flows will decrease, resulting in a larger difference between FDIC cash flows and indemnification asset carrying value. Such increases would result in higher rates of loan accretion and indemnification asset amortization.

The Company recorded base yield on covered loans of \$12.4 million in the second quarter of 2014, compared to \$12.5 million in the first quarter of 2014 and \$16.7 million in the second quarter of 2013. The decrease in base yield on covered loans compared to prior periods was a result of portfolio run-off. Average covered loans were \$643.7 million during the second quarter of 2014, down from \$696.2 million during the first quarter of 2014 and \$909.7 million for the year-earlier quarter. The Company recorded indemnification asset amortization expense of \$3.3 million in the second quarter of 2014, compared to \$3.2 million and \$4.7 million for the first quarter of 2014 and second quarter of 2013, respectively. The indemnification asset amortization expense did not change significantly from prior periods because the effects of portfolio run-off were offset by an increase in the rate of amortization, which was higher due to portfolio credit improvement.

*Quarterly Update of Cash Flow Projections*

The Company reviews and updates cash flow projections on covered loans and the related FDIC loss-sharing agreements on a quarterly basis. These projections take into consideration such inputs as the contractual terms of the covered loans, the contractual terms of the FDIC loss-sharing agreements, credit assumptions and prepayment assumptions. The quarterly update of cash flow projections impacts the following balance sheet and income statement items:

| Balance Sheet Line Item | Corresponding Income Statement Line Item |
|-------------------------|--|
| Covered loan            | Base yield in interest income            |

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|                                       |   |
|---------------------------------------|---|
| Allowance for losses on covered loans | (Reversal of) provision for losses on covered loans                               |
| FDIC indemnification asset            | FDIC loss sharing income or expense, net  |
|                                       | - <i>Gain or loss on indemnification asset</i>                                    |
|                                       | - <i>Indemnification asset amortization or accretion (on a prospective basis)</i> |
| FDIC clawback liability               | FDIC loss sharing income or expense, net  |
|                                       | - <i>Increase or decrease in FDIC clawback liability</i>                          |

Generally, for covered loans, decreases in estimated loan cash flows over those expected at the acquisition date and subsequent measurement periods are recognized by recording a provision for losses on covered loans. Decreases in estimated loan cash flows are typically accompanied by higher expected losses which would result in increases in FDIC cash flows. Increases in expected FDIC cash flows are recognized as gains on the FDIC indemnification asset.

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Increases in estimated loan cash flows over those expected at the acquisition date and subsequent measurement periods are recognized as interest income, prospectively, after previously recorded allowances are reversed. Increases in estimated loan cash flows are typically accompanied by lower expected losses which would result in decreases in FDIC cash flows. Decreases in expected FDIC cash flows are recognized as indemnification asset amortization expense on a prospective basis, after previously recorded gains on the indemnification asset have been reversed.

The FDIC clawback liability represents contingent consideration expected to be paid to the FDIC. The Company is required to reimburse the FDIC if actual cumulative losses are lower than the adjusted intrinsic losses contractually set forth in the FDIC loss-sharing agreements. The total FDIC clawback liability may increase as actual and expected losses decrease. The liability to the FDIC may decrease if actual and expected losses grow. The Company measures the FDIC clawback liability at fair value.

As a result of improvements in the portfolio's credit quality and general market conditions, the Company recorded a \$1.5 million reversal of provision for losses on covered loans during the second quarter of 2014, compared to a \$4.7 million provision for losses in the first quarter of 2014 and an \$11.9 million reversal of provision during the second quarter of 2013. Loss on indemnification asset was \$4.4 million in the second quarter of 2014, compared to a gain of \$3.6 million and a loss of \$13.1 million for the first quarter of 2014 and second quarter of 2013, respectively. Expense from the increase in FDIC clawback liability was \$1.1 million, \$1.0 million and \$0.3 million for the second quarter of 2014, first quarter of 2014, and second quarter of 2013, respectively. The provision for losses on covered loans, the gain on indemnification asset and the change in FDIC clawback liability are the result of changes, both in amount and timing, in expected loan cash flows and FDIC cash flows due to actual loan performance and the Company's revised loan loss and prepayment forecasts. During the second quarter of 2014, the expected lifetime cash flows of the covered loan portfolio improved. The covered loans that were removed, mostly due to pay-offs, performed better than previously expected. Loans are removed when they have been fully paid off, fully charged-off, sold or transferred to OREO. The credit performance of the remaining covered loans improved, which resulted in the recognition of the reversal of provision for losses on covered loans and the loss on indemnification asset during the second quarter of 2014 and the year-earlier quarter. The provision for losses on covered loans and the gain on indemnification asset in the first quarter of 2014 were attributable to credit deterioration for the remaining covered loans during the quarter. The increase in the FDIC clawback liability was driven by an overall improvement in portfolio credit.

The revisions of the loss forecasts were based on the results of management's review of market conditions, the credit quality of the outstanding covered loans and loan performance data since the acquisition of covered loans. The Company will continue updating cash flow projections on covered loans and related FDIC loss-sharing agreements on a quarterly basis. Due to the uncertainty in the future performance of the covered loans, additional provision expense or provision reversal, gain or loss on indemnification asset and changes in FDIC clawback liability may be recognized in future periods.

*Covered Asset Removals*

A covered asset removal event occurs when a loan is fully paid-off, fully charged-off, sold or transferred to OREO, or when OREO is liquidated. The difference between the carrying value of the covered asset and the cash or non-cash proceeds received upon its removal is recognized as a gain or loss in the income statement. The gain or loss on covered loans that are fully paid-off and fully charged-off, also referred to as net accelerated accretable yield recognition, is recorded in interest income. Gain or loss recognized on the transfer of covered loans to OREO is calculated as the difference between the carrying value of the covered loan and the fair value of the underlying foreclosed collateral, and is recognized in other noninterest income. The Company also recognizes gains and losses from the sale of covered OREO through noninterest income.

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When a covered asset is removed, the FDIC indemnification asset associated with the covered asset is also removed. The FDIC indemnification asset balance associated with unfunded loan commitments is also removed when an unfunded commitment has been funded. The difference between the FDIC indemnification asset and the expected payment from the FDIC for the removed asset represents the expense or income on removal of the indemnification asset. These amounts are recognized in FDIC loss sharing income or expense.

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Interest income from net accelerated accretable yield recognition increased to \$18.7 million in the second quarter of 2014, compared to \$9.3 million in the first quarter of 2014 and \$15.9 million in the year-earlier quarter. The net expense from the removal of indemnification asset for loans that were paid off or fully charged-off was \$5.0 million, \$3.0 million and \$7.7 million in the second quarter of 2014, first quarter of 2014 and second quarter of 2013, respectively. The increase in both balances in the second quarter of 2014 compared to the first quarter of 2014 was due to higher volumes of covered loans that were paid off or fully charged-off.

Net gains on transfers of covered loans to OREO were \$0.9 million in both the second and first quarter of 2014, down from \$1.4 million in the year-earlier quarter. Net gain on sale of covered OREO was \$2.6 million in the second quarter of 2014, an increase from \$0.4 million in the first quarter of 2014 and \$0.6 million in the year-earlier quarter. Total net expense from the removal of the indemnification asset for all other covered asset removals, which excludes the removal of indemnification asset for loans that were paid off or fully charged-off, was \$2.6 million in the second quarter of 2014, \$1.0 million in the first quarter of 2014 and \$1.6 million in the year-earlier quarter. The increase in net gain on sale of covered OREO and related expense from the indemnification asset recognized in the second quarter of 2014 was driven by higher OREO sale volume.

Loan recoveries on previously charged-off covered loans are also shared with the FDIC. The portion that is payable to the FDIC is recognized as Loan recoveries shared with FDIC under FDIC loss sharing income or expense. The Company recognized expenses of \$9.9 million in the second quarter of 2014, \$4.2 million in the first quarter of 2014 and \$4.1 million in the year-earlier quarter. The Company recognized significant loan recoveries during the first two quarters of 2014 and past two years as a result of increases in the value of real estate collateral and improvements in the financial condition of borrowers or guarantors.

*Other Expenses*

Noninterest expense related to covered assets includes OREO expense, legal and professional expense, and other covered asset expenses. These expenses are subject to FDIC reimbursement, but must meet certain FDIC criteria in order to be reimbursed. Certain amounts reflected in the table above may not be reimbursable by the FDIC. The FDIC reimbursements related to qualified expenses are recognized as income in Net FDIC reimbursement for OREO and loan expenses under FDIC loss sharing income or expense.

Total OREO expense, which includes valuation write-downs, holding costs and foreclosure expenses was \$2.3 million for the second quarter of 2014, up from \$1.3 million for the first quarter of 2014, but down from \$4.1 million for the year-earlier quarter. The decrease in total OREO expense from the prior-year period was due primarily to lower OREO volume and improvements in property values. Legal and professional fees related to covered assets were \$1.0 million in the second quarter of 2014, down from \$1.6 million in the first quarter of 2014 and \$1.7 million in the year-earlier quarter. Correspondingly, net FDIC reimbursement for these expenses of \$2.2 million for the second quarter of 2014 increased from \$1.7 million for the first quarter of 2014, but was down from \$5.0 million for the second quarter of 2013.

*Other Information on the FDIC Indemnification Asset*

The following table is a summary of activity in the FDIC indemnification asset for the three and six months ended June 30, 2014 and 2013:



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| (in thousands)                     | For the three months ended<br>June 30, |            | For the six months ended<br>June 30, |            |
|------------------------------------|--|------------|--------------------------------------|------------|
|                                    | 2014                                   | 2013       | 2014                                 | 2013       |
| Balance, beginning of period       | \$ 84,851                              | \$ 142,906 | \$ 89,227                            | \$ 150,018 |
| Indemnification asset amortization | (3,320)                                | (4,746)    | (6,484)                              | (9,645)    |
| Loss on indemnification asset      | (4,392)                                | (13,102)   | (793)                                | (2,486)    |
| Reductions (1)                     | (9,101)                                | (7,763)    | (13,912)                             | (20,592)   |
| Balance, end of period             | \$ 68,038                              | \$ 117,295 | \$ 68,038                            | \$ 117,295 |

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(1) The FDIC indemnification asset is reduced upon covered asset removals, funding of covered unfunded loan commitments, partial charge-offs and OREO write-downs.

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The indemnification asset amortization, gain on indemnification asset, and the impact of the reduction of indemnification asset for covered asset removals and funding of unfunded commitments are recognized in the FDIC loss sharing income or expense line item on the consolidated statements of income.

When a covered asset is charged-off or written down and is subject to FDIC reimbursement under the FDIC loss-sharing agreements, the Company records the estimated amount of reimbursement in an FDIC receivable account, which is classified in the Other Assets line of the consolidated balance sheet.

**Segment Operations**

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

*Commercial and Private Banking*

Net income for the Commercial and Private Banking segment increased to \$47.8 million for the second quarter of 2014 from \$36.9 million for the second quarter of 2013. Net income for the six months ended June 30, 2014 was \$87.2 million, up from \$72.2 million for the year-earlier period. The increase from the prior year quarter was largely due to higher net interest income and noninterest income, partially offset by a lower reversal of provision for losses on covered loans. Net interest income increased to \$208.4 million for the second quarter of 2014 from \$185.0 million for the year-earlier quarter. Net interest income for the six months ended June 30, 2014 increased to \$398.2 million from \$369.0 million for the same period in 2013. The increase in net interest income from the year-earlier periods was largely attributable to an increase in interest income from non-covered loans driven by loan growth and lower deposit rates. Average loans, excluding covered loans, increased to \$17.90 billion, or by 16 percent, for the second quarter of 2014 from \$15.38 billion for the year-earlier quarter. Average loans, excluding covered loans, increased to \$17.59 billion, or by 17 percent, for the six months ended June 30, 2014 from \$15.07 billion for the year-earlier period. Average covered loans were \$643.7 million for the second quarter of 2014, compared to \$909.7 million for the second quarter of 2013, and \$669.8 million for the first six months of 2014 compared to \$949.4 million for the same period in 2013. The growth in net interest income was also a result of an increase in deposits, as the Asset Liability Funding Center ( *Funding Center* ), which is used for funds transfer pricing, pays the business line units for generating deposits. Average deposits increased to \$25.58 billion for the three months ended June 30, 2014 from \$22.41 billion for the year-earlier quarter, and increased to \$25.32 billion for the six months ended June 30, 2014 from \$22.13 billion for the same period in 2013, reflecting a 14 percent increase for both respective periods. The growth in average deposits compared with the prior-year period was driven by new client relationships and growth in deposits of existing clients.

The segment recorded a \$1.0 million reversal of provision for credit losses on loans and leases, excluding covered loans, for the three months and six months ended June 30, 2014, while no provision was recorded for the same periods in 2013. On covered loans, the segment recorded a \$1.5 million reversal of provision for losses and a \$3.2 million provision during the three months and six months ended June 30, 2014, respectively, compared to an \$11.9 million and \$2.0 million reversal of provision for losses during the three months and six months ended June 30, 2013, respectively. Refer to *Results of Operations Provision for Credit Losses* and *Balance Sheet Analysis Loan and Lease Portfolio Asset Quality* included elsewhere in this report for further discussion of the provision. Refer to *Results of Operations Covered Assets* included elsewhere in this report for further discussion of the provision for losses on covered loans.

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Noninterest income for the second quarter of 2014 was \$40.9 million, up 34 percent from \$30.6 million for the prior-year quarter. Noninterest income for the six months ended June 30, 2014 increased 10 percent to \$89.1 million compared to \$80.8 million for the year-earlier period. The increase from the prior periods was due primarily to the sale of assets that served as collateral for previously charged-off loans, as well as higher gains recognized on the sale of covered and non-covered OREO. Noninterest expense, including depreciation and amortization, increased to \$182.7 million, or by 4 percent, for the second quarter of 2014 from \$174.9 million for the year-earlier quarter. Noninterest expense, including depreciation and amortization, increased to \$357.6 million, or by 2 percent, for the first half of 2014 from \$349.4 million for the same period in 2013.

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*Wealth Management*

The Wealth Management segment had net income attributable to CNC of \$7.3 million for the second quarter of 2014, an increase from net income of \$5.4 million for the year-earlier quarter. Net income attributable to CNC for the six months ended June 30, 2014 was \$13.5 million compared to \$9.8 million for the year-earlier period. Noninterest income increased 19 percent to \$69.5 million for the second quarter of 2014 from \$58.5 million for the year-earlier quarter, and by 17 percent to \$133.6 million for the six months ended June 30, 2014 from \$113.9 million for the same period in 2013. The increases from the year-earlier periods were mainly due to higher wealth management fees, driven by asset inflows and equity markets appreciation. Additionally, second quarter 2014 brokerage and mutual fund fees included the recognition of \$3.8 million in performance fees related to the merger of two funds. Refer to Results of Operations Noninterest Income Wealth Management included elsewhere in this report for further discussion of the factors impacting fee income for the Wealth Management segment. Noninterest expense, including depreciation and amortization, was \$58.9 million for the second quarter of 2014, an increase of 16 percent from \$50.6 million for the year-earlier quarter. Noninterest expense, including depreciation and amortization, increased 14 percent to \$113.4 million in the first six months of 2014 from \$99.5 million in the year-earlier period. The increase in expense compared with the year-earlier period was primarily due to higher incentive compensation expense and sub-advisory expenses, which included \$1.9 million in expense related to the merged funds.

*Other*

Net income for the Other segment decreased to \$11.7 million for the second quarter of 2014 from \$17.4 million for the second quarter of 2013. Net income decreased to \$20.5 million for the six months ended June 30, 2014, from \$29.3 million for the same period in 2013. The decrease in net income was due mostly to lower net interest income, partially offset by lower noninterest expense. Net interest income was \$10.2 million and \$19.9 million for the three and six months ended June 30, 2014, respectively, down from \$17.6 million and \$34.4 million for the same periods in 2013. The Funding Center, which is included in the Other segment and is used for funds transfer pricing, charges the business line units for loans and pays them for generating deposits. During the second quarter of 2014, funding credit given to the Commercial and Private Banking segment increased compared with the year-earlier quarter due to higher average deposit balances. Also, funding charges applied to loan balances in the lending units remain low due to the low interest rate environment. Both of these circumstances resulted in lower net interest income in the Other segment and higher net interest income in the Commercial and Private Banking segment.

Noninterest income (loss) increased to (\$9.3) million for the current quarter from (\$6.8) million for the year-earlier quarter. Noninterest income (loss) increased to (\$20.4) million for the six months ended June 30, 2014 from (\$19.0) million for the year-earlier period. The change in noninterest income (loss) for the three and six months ended June 30, 2014 compared with the same periods in 2013 was primarily due to an increase in the elimination of inter-segment revenues (recorded in the Other segment) due to higher wealth management income compared to the year-earlier periods.

**Income Taxes**

The Company recognized income tax expense of \$29.8 million during the second quarter of 2014, compared with tax expense of \$26.3 million in the first quarter of 2014 and \$25.4 million in the year-earlier quarter. The effective tax rate was 30.7 percent of pretax income for the second quarter of 2014, compared with 32.3 percent for the first quarter of 2014 and 29.7 percent for the year-earlier quarter. The lower tax rate during the second quarter of 2014, when compared to the prior quarter was attributable to tax refunds resulting from ordinary tax audits during 2014. The effective tax rates differ from the applicable statutory federal and state tax rates due to various factors, including tax benefits from investments in affordable housing partnerships, tax-exempt income on municipal bonds, bank-owned life insurance and other adjustments. See Note 13, *Income Taxes*, of the Notes to the Unaudited Consolidated Financial Statements for further discussion of income taxes.

**BALANCE SHEET ANALYSIS**

Total assets were \$30.82 billion at June 30, 2014, an increase of 13 percent from \$27.38 billion at June 30, 2013 and 4 percent from \$29.72 billion at December 31, 2013. Average assets for the second quarter of 2014 increased to \$29.98 billion from \$27.47 billion for the second quarter of 2013. Total average interest-earning assets for the second quarter of 2014 were \$28.28 billion, up from \$25.82 billion for the second quarter of 2013. The increase in assets from the year-earlier quarter primarily reflects higher loan balances.

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At June 30, 2014, the Company had total securities of \$8.83 billion, comprised of securities available-for-sale at fair value of \$5.33 billion, securities held-to-maturity at amortized cost of \$3.42 billion and trading securities at fair value of \$86.1 million. The Company had total securities of \$9.28 billion at December 31, 2013, comprised of securities available-for-sale at fair value of \$6.24 billion, securities held-to-maturity at amortized cost of \$2.96 billion and trading securities at fair value of \$82.4 million. At June 30, 2013, the Company had total securities of \$8.60 billion, comprised of securities available-for-sale at fair value of \$7.04 billion, securities held-to-maturity at amortized cost of \$1.50 billion and trading securities at fair value of \$48.7 million. The increase in the held-to-maturity category from the year-earlier quarter was due primarily to the transfer of \$994.3 million of debt securities from the available-for-sale category to the held-to-maturity category during the fourth quarter of 2013. The transfer was made as part of a change in the Company's strategy to mitigate the potential volatility of higher interest rates on market values in the available-for-sale securities portfolio. The decrease in total securities from December 31, 2013 is due to growth in loan balances in excess of deposit growth.

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

| (in thousands)                           | June 30, 2014  |              | December 31, 2013 |              | June 30, 2013  |              |
|--|----------------|--------------|-------------------|--------------|----------------|--------------|
|  | Amortized Cost | Fair Value   | Amortized Cost    | Fair Value   | Amortized Cost | Fair Value   |
| <b>Securities available-for-sale:</b>    |                |              |                   |              |                |              |
| U.S. Treasury                            | \$ 36,213      | \$ 36,258    | \$ 35,312         | \$ 35,335    | \$ 30,293      | \$ 30,285    |
| Federal agency - Debt                    | 1,027,192      | 1,026,516    | 1,417,509         | 1,410,536    | 987,467        | 980,025      |
| Federal agency - MBS                     | 121,501        | 123,229      | 156,399           | 157,226      | 422,699        | 438,182      |
| CMOs - Federal agency                    | 3,552,834      | 3,539,319    | 4,037,348         | 3,997,298    | 4,736,335      | 4,728,613    |
| CMOs - Non-agency                        | 27,168         | 26,903       | 38,383            | 37,462       | 47,079         | 45,327       |
| State and municipal                      | 384,359        | 392,593      | 407,312           | 415,995      | 457,869        | 466,760      |
| Other debt securities                    | 174,723        | 177,987      | 175,091           | 178,822      | 351,171        | 350,244      |
| Total available-for-sale debt securities | 5,323,990      | 5,322,805    | 6,267,354         | 6,232,674    | 7,032,913      | 7,039,436    |
| Equity securities and mutual funds       | 621            | 5,687        | 337               | 8,443        | 337            | 5,135        |
| Total available-for-sale securities      | \$ 5,324,611   | \$ 5,328,492 | \$ 6,267,691      | \$ 6,241,117 | \$ 7,033,250   | \$ 7,044,571 |
| <b>Securities held-to-maturity (1):</b>  |                |              |                   |              |                |              |
| Federal agency - Debt                    | \$ 302,918     | \$ 306,381   | \$ 178,413        | \$ 173,424   | \$ 109,562     | \$ 108,033   |
| Federal agency - MBS                     | 554,421        | 559,691      | 445,360           | 434,435      | 315,529        | 308,011      |
| CMOs - Federal agency                    | 1,883,461      | 1,889,954    | 1,781,219         | 1,742,437    | 797,715        | 783,754      |
| State and municipal                      | 579,473        | 587,591      | 454,155           | 435,562      | 281,167        | 266,759      |
| Other debt securities                    | 98,080         | 98,367       | 98,696            | 98,077       |                |              |
| Total held-to-maturity securities        | \$ 3,418,353   | \$ 3,441,984 | \$ 2,957,843      | \$ 2,883,935 | \$ 1,503,973   | \$ 1,466,557 |

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

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The average duration of the \$5.33 billion available-for-sale portfolio was 2.2 years at June 30, 2014, down from 3.2 years at June 30, 2013 and 2.4 years at December 31, 2013. The decrease in average duration reflects the transfer of debt securities from the available-for-sale category to the held-to-maturity category in the fourth quarter of 2013 and a rotation from longer-duration to shorter-duration securities in the available-for-sale portfolio. The decrease was also partly the result of the sale of some longer duration securities from the available-for-sale portfolio in the second half of 2013.

Changes in the fair value of securities available-for-sale will impact other comprehensive income, and thus shareholders' equity, on an after-tax basis. Securities held-to-maturity are presented in the consolidated balance sheets at amortized cost. Changes in the fair value of securities held-to-maturity do not have an impact on other comprehensive income. At June 30, 2014, the available-for-sale securities portfolio had a net unrealized gain of \$3.9 million, consisting of \$49.1 million of unrealized gains and \$45.2 million of unrealized losses. At December 31, 2013, the available-for-sale securities portfolio had a net unrealized loss of \$26.6 million, comprised of \$56.1 million of unrealized gains and \$82.6 million of unrealized losses. At June 30, 2013, the available-for-sale securities portfolio had a net unrealized gain of \$11.3 million, comprised of \$89.7 million of unrealized gains and \$78.4 million of unrealized losses. The net unrealized gain at June 30, 2014 compared to the net unrealized loss at December 31, 2013 was due to lower market rates. The decrease in the unrealized gain compared to June 30, 2013 was primarily due to an increase in medium and long-term interest rates as well as an overall decrease in the size of the available-for-sale portfolio.

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The following table provides the expected remaining maturities of debt securities included in the securities portfolio at June 30, 2014, except for maturities of mortgage-backed securities which are allocated according to the average life of expected cash flows. Average expected maturities will differ from contractual maturities because of the amortizing nature of the loan collateral and prepayment behavior of borrowers.

| (in thousands)  | One year or<br>less | Over 1 year<br>through<br>5 years | Over 5 years<br>through<br>10 years | Over 10<br>years | Total        |
|---|---------------------|-----------------------------------|-------------------------------------|------------------|--------------|
| <b>Securities available-for-sale:</b>                       |                     |                                   |                                     |                  |              |
| U.S. Treasury   | \$ 23,194           | \$ 13,064                         | \$                                  | \$               | \$ 36,258    |
| Federal agency - Debt                                       | 639,733             | 347,513                           | 39,270                              |                  | 1,026,516    |
| Federal agency - MBS  |                     | 105,432                           | 17,797                              |                  | 123,229      |
| CMOs - Federal agency                                       | 98,070              | 3,236,456                         | 204,793                             |                  | 3,539,319    |
| CMOs - Non-agency   | 2,237               | 24,666                            |                                     |                  | 26,903       |
| State and municipal   | 100,959             | 288,314                           |                                     | 3,320            | 392,593      |
| Other   | 58,751              | 119,236                           |                                     |                  | 177,987      |
| Total debt securities available-for-sale                    | \$ 922,944          | \$ 4,134,681                      | \$ 261,860                          | \$ 3,320         | \$ 5,322,805 |
| Amortized cost  | \$ 919,336          | \$ 4,135,324                      | \$ 265,930                          | \$ 3,400         | \$ 5,323,990 |
| <b>Securities held-to-maturity:</b>                         |                     |                                   |                                     |                  |              |
| Federal agency - Debt                                       | \$                  | \$ 26,000                         | \$ 86,170                           | \$ 190,748       | \$ 302,918   |
| Federal agency - MBS  |                     | 75,854                            | 467,171                             | 11,396           | 554,421      |
| CMOs - Federal agency                                       |                     | 805,601                           | 1,077,860                           |                  | 1,883,461    |
| State and municipal   |                     | 80,107                            | 399,352                             | 100,014          | 579,473      |
| Other   |                     | 98,080                            |                                     |                  | 98,080       |
| Total debt securities held-to-maturity at<br>amortized cost | \$                  | \$ 1,085,642                      | \$ 2,030,553                        | \$ 302,158       | \$ 3,418,353 |

*Impairment Assessment*

The Company performs a quarterly assessment of the debt and equity securities held in its investment portfolio to determine whether a decline in fair value below amortized cost is other-than-temporary. If a decline in fair value is determined to be other-than-temporary, the cost basis of the individual security is written down to fair value which then becomes the security's new cost basis. The new cost basis is not adjusted for subsequent recoveries in fair value.

The Company recorded impairment losses in earnings on securities available-for-sale of \$0.2 million for the three and six months ended June 30, 2014 and 2013, respectively. The Company recognized \$0.3 million and \$0.2 million of non-credit-related other-than-temporary impairment in accumulated other comprehensive income or loss ( AOCI ) on securities available-for-sale at June 30, 2014 and 2013, respectively. No impairment losses were recognized in earnings or AOCI for securities held-to-maturity during the three and six months ended June 30, 2014 and 2013.

Of the total securities available-for-sale in an unrealized loss position at June 30, 2014, approximately \$739.0 million of securities with unrealized losses of \$2.0 million were in a continuous unrealized loss position for less than 12 months, and \$1.67 billion of securities with unrealized losses of \$43.2 million were in a continuous loss position for more than 12 months. Securities in a loss position and total gross unrealized losses were comprised mostly of federal agency CMOs and federal agency debt securities. At December 31, 2013, approximately



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\$2.71 billion of securities with unrealized losses of \$44.3 million were in a continuous unrealized loss position for less than 12 months and \$784.3 million of securities with unrealized losses of \$38.4 million were in a continuous loss position for more than 12 months. At June 30, 2013, approximately \$3.91 billion of securities with unrealized losses of \$72.6 million were in a continuous unrealized loss position for less than 12 months and \$27.7 million of securities with unrealized losses of \$5.8 million were in a continuous loss position for more than 12 months. Unrealized losses on debt securities generally decreased in the first half of 2014 compared to December 31, 2013 due to lower market interest rates. Unrealized losses decreased compared to the year-earlier period largely due to the decrease in the size of the available-for-sale portfolio.

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See Note 3, *Securities*, of the Notes to the Unaudited Consolidated Financial Statements for further disclosures related to the securities portfolio.

**Loan and Lease Portfolio**

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

**Loans and Leases**

| (in thousands) (1)                             | June 30,<br>2014 | December 31,<br>2013 | June 30,<br>2013 |
|--|------------------|----------------------|------------------|
| Commercial                                     | \$ 8,230,112     | \$ 7,562,300         | \$ 6,910,175     |
| Commercial real estate mortgages               | 3,464,918        | 3,223,001            | 2,978,975        |
| Residential mortgages                          | 4,814,435        | 4,554,311            | 4,153,051        |
| Real estate construction                       | 457,557          | 367,004              | 340,002          |
| Home equity loans and lines of credit          | 716,816          | 709,344              | 700,681          |
| Installment                                    | 183,518          | 151,955              | 149,438          |
| Lease financing                                | 607,432          | 602,523              | 586,930          |
| Loans and leases, excluding covered loans      | 18,474,788       | 17,170,438           | 15,819,252       |
| Less: Allowance for loan and lease losses      | (311,276)        | (302,584)            | (289,914)        |
| Loans and leases, excluding covered loans, net | 18,163,512       | 16,867,854           | 15,529,338       |
| Covered loans                                  | 605,770          | 716,911              | 867,996          |
| Less: Allowance for loan losses                | (9,103)          | (15,922)             | (24,414)         |
| Covered loans, net                             | 596,667          | 700,989              | 843,582          |
| Total loans and leases                         | \$ 19,080,558    | \$ 17,887,349        | \$ 16,687,248    |
| Total loans and leases, net                    | \$ 18,760,179    | \$ 17,568,843        | \$ 16,372,920    |

(1) Commercial loans as of December 31, 2013 and June 30, 2013 have been corrected to include \$158.2 million and \$136.3 million, respectively, of loans that were previously reported as lease financing. Real estate construction loans as of June 30, 2013 have been corrected to include \$122.2 million of loans that were previously reported as commercial real estate mortgages.

Total loans and leases were \$19.08 billion, \$17.89 billion and \$16.69 billion at June 30, 2014, December 31, 2013 and June 30, 2013, respectively. Total loans, excluding covered loans, were \$18.47 billion, \$17.17 billion and \$15.82 billion at June 30, 2014, December 31, 2013 and June 30, 2013, respectively.

Total loans and leases, excluding covered loans, at June 30, 2014 increased 8 percent from December 31, 2013 and 17 percent from June 30, 2013. Commercial loans, including lease financing, were up 8 percent from year-end 2013 and 18 percent from the year-earlier quarter. Commercial real estate mortgage loans increased by 8 percent from year-end 2013 and 16 percent from the year-earlier quarter. Residential mortgages grew by 6 percent and 16 percent from the same periods, respectively. Real estate construction loans increased 25 percent from

year-end 2013 and 35 percent from the second quarter of 2013.

*Covered Loans*

Covered loans represent loans acquired from the FDIC that are subject to loss-sharing agreements and were \$605.8 million at June 30, 2014, \$716.9 million as of December 31, 2013 and \$868.0 million as of June 30, 2013. Covered loans, net of allowance for loan losses, were \$596.7 million as of June 30, 2014, \$701.0 million as of December 31, 2013 and \$843.6 million as of June 30, 2013.

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

| (in thousands)                        | June 30,<br>2014 | December 31,<br>2013 | June 30,<br>2013 |
|---------------------------------------|------------------|----------------------|------------------|
| Commercial                            | \$ 6,992         | \$ 10,009            | \$ 8,675         |
| Commercial real estate mortgages      | 568,902          | 666,628              | 789,521          |
| Residential mortgages                 | 5,525            | 4,976                | 5,560            |
| Real estate construction              | 20,742           | 31,184               | 60,007           |
| Home equity loans and lines of credit | 3,342            | 3,695                | 3,673            |
| Installment                           | 267              | 419                  | 560              |
| Covered loans                         | 605,770          | 716,911              | 867,996          |
| Less: Allowance for loan losses       | (9,103)          | (15,922)             | (24,414)         |
| Covered loans, net                    | \$ 596,667       | \$ 700,989           | \$ 843,582       |

*Other*

To grow loans and diversify and manage concentration risk of the Company's loan portfolio, the Company purchases and sells participations in loans. Included in this portfolio are purchased participations in Shared National Credits ( SNC ). Purchased SNC commitments at June 30, 2014 totaled \$3.79 billion or 14 percent of total loan commitments, compared to \$3.49 billion or 13 percent at December 31, 2013 and \$3.11 billion or 13 percent at June 30, 2013. Outstanding loan balances on purchased SNCs were \$1.83 billion, or approximately 10 percent of total loans outstanding, excluding covered loans, at June 30, 2014, compared to \$1.60 billion or 9 percent at December 31, 2013 and \$1.39 billion or 9 percent at June 30, 2013.

Bank regulatory guidance on risk management practices for financial institutions with high or increasing concentrations of commercial real estate ( CRE ) loans on their balance sheets emphasizes the need for sound internal risk management practices for those institutions that have experienced rapid growth in CRE lending, have notable exposure to specific types of CRE, or are approaching or exceeding the supervisory criteria used to evaluate CRE concentration risk. The supervisory criteria are: total reported loans for construction, land development and other land represent 100 percent of the institution's total risk-based capital, and both total CRE loans represent 300 percent or more of the institution's total risk-based capital and the institution's CRE loan portfolio has increased 50 percent or more within the last 36 months. As of June 30, 2014, total loans for construction, land development and other land represented 17 percent of total risk-based capital; total CRE loans represented 126 percent of total risk-based capital and the total portfolio of loans for construction, land development, other land and CRE increased 9 percent over the last 36 months.

**Asset Quality***Credit Risk Management*

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

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exposure. The concentration limits are approved by the Bank's Credit Policy Committee and reviewed annually by the Audit & Risk Committee of the Board of Directors.

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

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*Geographic Concentrations and Economic Trends by Geographic Region*

Although the Company's lending activities are predominantly in California, and to a lesser extent, New York and Nevada, the Company has various specialty lending businesses that lend to businesses located throughout the United States of America. Excluding covered loans, California represented 73 percent of total loans outstanding and New York and Nevada represented 9 percent and 2 percent, respectively, as of June 30, 2014. The remaining 16 percent of total loans outstanding represented other states. Concentrations of credit risk arise when a number of clients are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic conditions. Although the Company has a diversified loan portfolio, a substantial portion of the loan portfolio and credit performance depends on the economic stability of California. The Company has most of its loans in large metropolitan California cities such as Los Angeles, San Francisco and San Diego, rather than in the outlying suburban communities that have seen higher declines in real estate values during the recession. Within the Company's Commercial loan portfolio, the five California counties with the largest exposures at June 30, 2014 are Los Angeles (39 percent), Orange (5 percent), San Diego (3 percent), San Bernardino (2 percent) and Ventura (2 percent). Within the Commercial Real Estate Mortgage loan portfolio, the five California counties with the largest exposures are Los Angeles (35 percent), Orange (8 percent), San Diego (8 percent), Santa Clara (4 percent) and San Bernardino (4 percent). For the Real Estate Construction loan portfolio, the concentration in California is predominately in Los Angeles (26 percent), San Diego (14 percent), Orange (12 percent), Ventura (8 percent) and Alameda (7 percent).

Within the Company's covered loan portfolio at June 30, 2014, the five states with the largest concentration were California (35 percent), Texas (12 percent), Nevada (7 percent), Arizona (6 percent) and Ohio (5 percent). The remaining 35 percent of total covered loans outstanding represented other states.

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

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

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

The provision is the expense recognized in the consolidated statements of income to adjust the allowance and reserve to the level deemed appropriate by management, as determined through application of the Company's allowance methodology procedures. See "Critical Accounting Policies - Allowance for Loan and Lease Losses and Reserve for Off-Balance Sheet Credit Commitments" in the Company's 2013 Annual Report on Form 10-K. The process used for determining the adequacy of the reserve for off-balance sheet credit commitments is consistent with the process for the allowance for loan and lease losses.



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The following table summarizes activity in the allowance for loan and lease losses and the reserve for off-balance sheet credit commitments, excluding covered loans, for the three and six months ended June 30, 2014 and 2013. Activity is provided by loan type which is consistent with the Company's methodology for determining the allowance for loan and lease losses:

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

| (in thousands)  | For the three months ended<br>June 30, |               | For the six months ended<br>June 30, |               |
|---|--|---------------|--------------------------------------|---------------|
|   | 2014                                   | 2013          | 2014                                 | 2013          |
| Loans and leases outstanding, excluding covered loans   | \$ 18,474,788                          | \$ 15,819,252 | \$ 18,474,788                        | \$ 15,819,252 |
| Average loans and leases outstanding, excluding covered loans                                     | \$ 17,959,191                          | \$ 15,434,102 | \$ 17,650,520                        | \$ 15,123,447 |
| <b>Allowance for loan and lease losses (1)</b>  |  |               |                                      |               |
| Balance, beginning of period  | \$ 305,790                             | \$ 282,328    | \$ 302,584                           | \$ 277,888    |
| Loan charge-offs:   |  |               |                                      |               |
| Commercial  | (12,862)                               | (2,869)       | (14,821)                             | (4,231)       |
| Commercial real estate mortgages  |  |               | (5)                                  | (45)          |
| Residential mortgages   |  | (1)           | (482)                                | (106)         |
| Real estate construction  |  | (100)         |                                      | (100)         |
| Home equity loans and lines of credit   | (149)                                  | (35)          | (165)                                | (275)         |
| Installment   | (142)                                  | (81)          | (188)                                | (352)         |
| Total charge-offs   | (13,153)                               | (3,086)       | (15,661)                             | (5,109)       |
| Recoveries of loans previously charged-off:   |  |               |                                      |               |
| Commercial  | 7,503                                  | 5,724         | 9,235                                | 9,259         |
| Commercial real estate mortgages  | 27                                     | 1,034         | 127                                  | 1,082         |
| Residential mortgages   | 190                                    | 38            | 225                                  | 75            |
| Real estate construction  | 687                                    | 2,782         | 5,075                                | 5,448         |
| Home equity loans and lines of credit   | 43                                     | 410           | 202                                  | 538           |
| Installment   | 1,068                                  | 603           | 1,332                                | 1,020         |
| Total recoveries  | 9,518                                  | 10,591        | 16,196                               | 17,422        |
| Net (charge-offs) recoveries  | (3,635)                                | 7,505         | 535                                  | 12,313        |
| (Reversal of) provision for credit losses   | (1,000)                                |               | (1,000)                              |               |
| Transfers from (to) reserve for off-balance sheet credit commitments                              | 10,121                                 | 81            | 9,157                                | (287)         |
| Balance, end of period  | \$ 311,276                             | \$ 289,914    | \$ 311,276                           | \$ 289,914    |
| Net (charge-offs) recoveries to average loans and leases, excluding covered loans (annualized)    | (0.08)%                                | 0.20%         | 0.01%                                | 0.16%         |
| Allowance for loan and lease losses to total period-end loans and leases, excluding covered loans | 1.68%                                  | 1.83%         | 1.68%                                | 1.83%         |
| <b>Reserve for off-balance sheet credit commitments</b>   |  |               |                                      |               |
| Balance, beginning of period  | \$ 34,908                              | \$ 25,205     | \$ 33,944                            | \$ 24,837     |
| Transfers (to) from allowance   | (10,121)                               | (81)          | (9,157)                              | 287           |
| Balance, end of period  | \$ 24,787                              | \$ 25,124     | \$ 24,787                            | \$ 25,124     |



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

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During the economic recession, the Company recognized significant charge-offs from 2008 to 2010. Total loan charge-offs have declined significantly in recent years compared to prior periods due to improving economic and business conditions in the markets served by the Company. Higher loan recoveries in recent years were largely due to increases in the value of real estate collateral, improvements in the financial condition of the Company's clients and guarantors, and increases in recoveries related to the use of legal remedies available to the Company. Recoveries occurred throughout the loan portfolio; however the majority of recoveries during the last few years relate to a small group of credit relationships and were primarily concentrated in the commercial and real estate construction portfolios. Approximately 64 percent of total recoveries during the second quarter of 2014 were related to two credit relationships.

The timing and amount of recoveries is inherently uncertain, imprecise and potentially volatile and is subject to a variety of factors, including but not limited to: general economic conditions, the willingness and financial capacity of the borrower, guarantors or third parties; additional changes in the realizable value of the collateral between the date of charge-off and the date of recovery, and the legal remedies available to the Company needed to effect recovery.

Based on an evaluation of individual credits, previous loan and lease loss experience, management's evaluation of the current loan portfolio, and current economic conditions, management has allocated the allowance for loan and lease losses on non-covered loans for June 30, 2014, December 31, 2013 and June 30, 2013 as shown in the table below:

| (in thousands) (1)                    | Allowance amount |                      |                  | Percentage of total allowance |                      |                  |
|---------------------------------------|------------------|----------------------|------------------|-------------------------------|----------------------|------------------|
|                                       | June 30,<br>2014 | December 31,<br>2013 | June 30,<br>2013 | June 30,<br>2014              | December 31,<br>2013 | June 30,<br>2013 |
| Commercial and lease financing        | \$ 126,279       | \$ 117,103           | \$ 116,619       | 41%                           | 38%                  | 40%              |
| Commercial real estate mortgages      | 50,651           | 50,678               | 53,339           | 16                            | 17                   | 18               |
| Residential mortgages                 | 10,296           | 11,540               | 8,004            | 3                             | 4                    | 3                |
| Real estate construction              | 7,191            | 6,351                | 8,335            | 2                             | 2                    | 3                |
| Home equity loans and lines of credit | 6,575            | 6,677                | 5,400            | 2                             | 2                    | 2                |
| Installment                           | 2,284            | 1,842                | 1,355            | 1                             | 1                    | 1                |
| Qualitative                           | 108,000          | 108,393              | 96,862           | 35                            | 36                   | 33               |
| Total                                 | \$ 311,276       | \$ 302,584           | \$ 289,914       | 100%                          | 100%                 | 100%             |

(1) Certain balances as of June 30, 2013 have been revised as a result of correcting the real estate construction loan balance to include loans that were previously reported as commercial real estate mortgages.

The Company has a qualitative factor matrix to determine the amount of reserves needed for judgmental factors that are not attributable to or reflected in quantitative models. Examples of these factors include industry concentration, size of loans, general business and economic environment, internal systems and procedures, credit quality trends, changes in underwriting standards, risk appetite, loan growth and acquisitions. The qualitative factor matrix is divided into three segments: CRE, Commercial and Consumer. For each segment, the matrix evaluates the qualitative factors that could cause the quantitative models to vary from historic loss values. Each factor is assigned a risk level and a risk weight in points which is aggregated to determine the level of qualitative reserves. The factors are updated and supported quarterly to reflect changing conditions. At June 30, 2014, the Company had total qualitative reserves of \$108.0 million, of which \$28.7 million, \$52.1 million and \$27.2 million were assigned to the CRE, Commercial and Consumer segments, respectively. Currently, the primary drivers of the qualitative reserves are uncertainty in the macroeconomic environment, industry concentration, loan size and loan growth.

Nonaccrual loans, excluding covered loans, were \$64.8 million at June 30, 2014, down from \$68.7 million at December 31, 2013 and \$76.7 million at June 30, 2013. Net loan charge-offs were \$3.6 million in the second quarter of 2014 and net loan recoveries were \$0.5 million for the six months ended June 30, 2014, compared to net loan recoveries of \$7.5 million and \$12.3 million for the same periods in 2013. Classified loans were \$226.1 million at June 30, 2014, down from \$315.5 million at December 31, 2013 and \$351.3 million at June 30, 2013. In accordance with the Company's allowance for loan and lease losses methodology and in response to continuing credit quality improvement, the Company recorded a \$1.0 million reversal of provision for loan and lease losses for the three months ended June 30, 2014. The Company recorded no provision in the first quarter of 2014 and second quarter of 2013. The reversal of provision for the current quarter reflects management's ongoing assessment of the credit quality of the loan portfolio. Credit quality continued to improve in the second quarter of 2014 as evidenced by the decline in nonaccrual and classified loans from the prior and year-earlier quarters.

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The allowance for loan and lease losses, excluding covered loans, was \$311.3 million as of June 30, 2014, compared with \$302.6 million as of December 31, 2013 and \$289.9 million as of June 30, 2013. The ratio of the allowance for loan and lease losses as a percentage of total loans and leases, excluding covered loans, was 1.68 percent at June 30, 2014, compared to 1.76 percent at December 31, 2013 and 1.83 percent at June 30, 2013. The allowance for loan and lease losses as a percentage of nonperforming assets, excluding covered assets, was 450.79 percent, 372.36 percent and 300.90 percent at June 30, 2014, December 31, 2013 and June 30, 2013, respectively. The Company believes that its allowance for loan and lease losses continues to be appropriate.

The following table summarizes the activity in the allowance for loan losses on covered loans for the three and six months ended June 30, 2014 and 2013:

| (in thousands)                              | For the three months ended |           | For the six months ended |           |
|---|----------------------------|-----------|--------------------------|-----------|
|   | June 30,                   |           | June 30,                 |           |
|   | 2014                       | 2013      | 2014                     | 2013      |
| Balance, beginning of period                | \$ 18,439                  | \$ 42,354 | \$ 15,922                | \$ 44,781 |
| (Reversal of) provision for losses          | (1,461)                    | (11,927)  | 3,194                    | (2,035)   |
| Reduction in allowance due to loan removals | (7,875)                    | (6,013)   | (10,013)                 | (18,332)  |
| Balance, end of period                      | \$ 9,103                   | \$ 24,414 | \$ 9,103                 | \$ 24,414 |

The allowance for losses on covered loans was \$9.1 million as of June 30, 2014, compared to \$15.9 million at December 31, 2013 and \$24.4 million at June 30, 2013. As a result of improvements in the portfolio's credit quality and general market conditions, the Company recorded a \$1.5 million reversal of provision for losses on covered loans during the three months ended June 30, 2014. Provision expense was \$3.2 million for the six months ended June 30, 2014. The Company recorded an \$11.9 million and \$2.0 million reversal of provision during the three and six months ended June 30, 2013, respectively. The Company updates its cash flow projections for covered loans accounted for under ASC 310-30 on a quarterly basis, and may recognize provision expense or reversal of provision for loan losses as a result of that analysis. The provision expense or reversal of provision for losses on covered loans is the result of changes in expected cash flows, both in amount and timing, due to actual loan performance and the Company's revised loan loss and prepayment forecasts. The revisions of these forecasts were based on the results of management's review of the market conditions, the credit quality of the outstanding covered loans and the analysis of loan performance data since the acquisition of covered loans. The allowance for loan losses on covered loans is reversed for any loan removals, which occur when a loan has been fully paid off, fully charged off, sold or transferred to OREO.

*Impaired Loans*

Loans, other than those included in large groups of smaller-balance homogeneous loans, are considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement, including scheduled interest payments. The assessment for impairment occurs when and while such loans are on nonaccrual, or when the loan has been restructured. When a loan with unique risk characteristics has been identified as being impaired, the amount of impairment will be measured by the Company using discounted cash flows, except when it is determined that the primary (remaining) source of repayment for the loan is the operation or liquidation of the underlying collateral. In these cases, the current fair value of the collateral, reduced by costs to sell, will be used in place of discounted cash flows. As a final alternative, the observable market price of the debt may be used to assess impairment.

If the measurement of the impaired loan is less than the recorded investment in the loan (including accrued interest, net deferred loan fees or costs and unamortized premium or discount), an impairment allowance is recognized by creating or adjusting the existing allocation of the

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allowance for loan and lease losses. Interest payments received on impaired loans are generally applied as follows: (1) to principal if the loan is on nonaccrual principal recapture status, (2) to interest income if the loan is on cash basis nonaccrual and (3) to interest income if the impaired loan has been returned to accrual status.

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The following table presents information on impaired loans as of June 30, 2014, December 31, 2013 and June 30, 2013. Loan and lease balances reflect the recorded investment as of the reporting date.

| (in thousands)                                | June 30, 2014    |                   | December 31, 2013 |                   | June 30, 2013    |                   |
|---|------------------|-------------------|-------------------|-------------------|------------------|-------------------|
|   | Loans and Leases | Related Allowance | Loans and Leases  | Related Allowance | Loans and Leases | Related Allowance |
| Impaired loans, excluding covered loans (1):  |                  |                   |                   |                   |                  |                   |
| Impaired loans with an allowance              | \$ 31,525        | \$ 8,833          | \$ 21,194         | \$ 3,025          | \$ 24,444        | \$ 2,960          |
| Impaired loans with no related allowance      | 58,090           |                   | 79,470            |                   | 94,085           |                   |
| Total impaired loans, excluding covered loans | \$ 89,615        |                   | \$ 100,664        |                   | \$ 118,529       |                   |
| Total impaired loans by loan type:            |                  |                   |                   |                   |                  |                   |
| Commercial                                    | \$ 29,231        | \$ 8,477          | \$ 31,857         | \$ 1,961          | \$ 34,915        | \$ 478            |
| Commercial real estate mortgages              | 33,456           | 301               | 38,154            | 586               | 41,932           | 2,252             |
| Residential mortgages                         | 10,596           | 5                 | 9,211             | 478               | 7,979            | 230               |
| Real estate construction                      | 12,846           |                   | 19,097            |                   | 30,446           |                   |
| Home equity loans and lines of credit         | 3,436            |                   | 2,329             |                   | 3,257            |                   |
| Installment                                   | 50               | 50                | 16                |                   |                  |                   |
| Total impaired loans, excluding covered loans | \$ 89,615        | \$ 8,833          | \$ 100,664        | \$ 3,025          | \$ 118,529       | \$ 2,960          |

(1) Impaired loans include \$34.7 million, \$42.1 million and \$54.3 million of loans that are on accrual status at June 30, 2014, December 31, 2013 and June 30, 2013, respectively.

The recorded investment in impaired loans, excluding covered loans, was \$89.6 million at June 30, 2014, \$100.7 million at December 31, 2013 and \$118.5 million at June 30, 2013. There were no impaired covered loans at June 30, 2014, December 31, 2013 or June 30, 2013.

*Troubled Debt Restructured Loans*

At June 30, 2014, troubled debt restructured loans were \$45.4 million, before specific reserves of \$1.6 million. Troubled debt restructured loans were \$52.2 million, before specific reserves of \$0.8 million, at December 31, 2013 and \$64.4 million, before specific reserves of \$0.6 million, at June 30, 2013. Troubled debt restructured loans included \$22.0 million, \$25.8 million and \$38.7 million of restructured loans on accrual status at June 30, 2014, December 31, 2013 and June 30, 2013, respectively. At June 30, 2014, commitments to lend additional funds on restructured loans totaled \$0.2 million.

*Nonaccrual and Past Due Loans*

Total nonperforming assets (nonaccrual loans and OREO), excluding covered assets, were \$69.1 million, or 0.37 percent of total loans and OREO, excluding covered assets, at June 30, 2014, compared with \$81.3 million, or 0.47 percent, at December 31, 2013, and \$96.3 million, or 0.61 percent, at June 30, 2013. Total nonperforming covered assets (nonaccrual covered loans and covered OREO) were \$17.9 million at June 30, 2014, \$25.5 million at December 31, 2013 and \$41.8 million at June 30, 2013.

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

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

| (in thousands)                                   | June 30,<br>2014 | December 31,<br>2013 | June 30,<br>2013 |
|--|------------------|----------------------|------------------|
| <b>Past due loans, excluding covered loans</b>   |                  |                      |                  |
| 30-89 days past due                              | \$ 13,644        | \$ 11,116            | \$ 20,420        |
| 90 days or more past due on accrual status:      |                  |                      |                  |
| Commercial real estate mortgages                 | 1,418            |                      |                  |
| Residential mortgages                            | 379              | 379                  | 379              |
| Home equity loans and lines of credit            |                  | 74                   | 249              |
| Installment                                      | 4                |                      |                  |
| Lease financing                                  |                  |                      | 15               |
| Total 90 days or more past due on accrual status | \$ 1,801         | \$ 453               | \$ 643           |
| <b>Past due covered loans</b>                    |                  |                      |                  |
| 30-89 days past due                              | \$ 11,572        | \$ 15,494            | \$ 3,107         |
| 90 days or more past due on accrual status       | 31,011           | 45,662               | 89,439           |

The following table presents information on nonaccrual loans and OREO as of June 30, 2014, December 31, 2013 and June 30, 2013:

| (in thousands)  | June 30,<br>2014 | December 31,<br>2013 | June 30,<br>2013 |
|---|------------------|----------------------|------------------|
| <b>Nonperforming assets, excluding covered assets</b>             |                  |                      |                  |
| Nonaccrual loans, excluding covered loans                         |                  |                      |                  |
| Commercial  | \$ 27,314        | \$ 14,248            | \$ 11,654        |
| Commercial real estate mortgages                                  | 9,216            | 18,449               | 22,433           |
| Residential mortgages   | 9,031            | 11,661               | 10,580           |
| Real estate construction  | 12,834           | 19,067               | 25,718           |
| Home equity loans and lines of credit                             | 6,090            | 5,144                | 6,239            |
| Installment   | 125              | 32                   | 24               |
| Lease financing   | 172              | 50                   | 25               |
| Total nonaccrual loans, excluding covered loans                   | 64,782           | 68,651               | 76,673           |
| OREO, excluding covered OREO                                      | 4,269            | 12,611               | 19,676           |
| Total nonperforming assets, excluding covered assets              | \$ 69,051        | \$ 81,262            | \$ 96,349        |
| <b>Nonperforming covered assets</b>                               |                  |                      |                  |
| OREO  | \$ 17,944        | \$ 25,481            | \$ 41,801        |
| <b>Ratios (excluding covered assets):</b>                         |                  |                      |                  |
| Nonaccrual loans as a percentage of total loans                   | 0.35%            | 0.40%                | 0.48%            |
| Nonperforming assets as a percentage of total loans and OREO      | 0.37             | 0.47                 | 0.61             |
| Allowance for loan and lease losses to nonaccrual loans           | 480.50           | 440.76               | 378.12           |
| Allowance for loan and lease losses to total nonperforming assets | 450.79           | 372.36               | 300.90           |

All nonaccrual loans greater than \$1 million are considered impaired and are individually analyzed. The Company does not maintain a reserve for impaired loans where the carrying value of the loan is less than the fair value of the collateral, reduced by costs to sell. Where the carrying value of the impaired loan is greater than the fair value of the collateral, less costs to sell, the Company specifically establishes an allowance for



loan and lease losses to cover the deficiency. This analysis ensures that the non-accruing loans have been appropriately reserved.

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The table below summarizes the total activity in non-covered and covered nonaccrual loans for the three and six months ended June 30, 2014 and 2013:

**Changes in Nonaccrual Loans**

| (in thousands)                                       | For the three months ended<br>June 30, |           |  | For the six months ended<br>June 30, |           |  |
|--|--|-----------|--|--------------------------------------|-----------|--|
|  | 2014                                   | 2013      |  | 2014                                 | 2013      |  |
| Balance, beginning of the period                     | \$ 71,245                              | \$ 83,275 |  | \$ 68,651                            | \$ 99,787 |  |
| Loans placed on nonaccrual                           | 11,542                                 | 22,081    |  | 24,097                               | 25,927    |  |
| Net (charge-offs) recoveries                         | (239)                                  | 133       |  | (2,159)                              | 5,966     |  |
| Loans returned to accrual status                     | (3,961)                                | (346)     |  | (5,443)                              | (11,458)  |  |
| Repayments (including interest applied to principal) | (13,694)                               | (28,218)  |  | (20,253)                             | (42,915)  |  |
| Transfers to OREO                                    | (111)                                  | (252)     |  | (111)                                | (634)     |  |
| Balance, end of the period                           | \$ 64,782                              | \$ 76,673 |  | \$ 64,782                            | \$ 76,673 |  |

In addition to loans disclosed above as past due or nonaccrual, management has also identified \$19.6 million of credit facilities to 17 borrowers as of July 28, 2014, where the ability to comply with the present loan payment terms in the future is questionable. However, the inability of the borrowers to comply with repayment terms was not sufficiently probable to place the loan on nonaccrual status at June 30, 2014, and the identification of these loans is not necessarily indicative of whether the loans will be placed on nonaccrual status. This amount was determined based on analysis of information known to management about the borrowers' financial condition and current economic conditions. In the Form 10-Q for the period ended March 31, 2014, the Company reported that management had identified \$51.4 million of loans to 16 borrowers where the ability to comply with the loan payment terms in the future was questionable. Management's classification of credits as nonaccrual, restructured or problems does not necessarily indicate that the principal is uncollectible in whole or part.

**Other Real Estate Owned**

The following tables provide a summary of OREO activity for the three and six months ended June 30, 2014 and 2013:

| (in thousands)               | For the three months ended<br>June 30, 2014 |                 |           | For the three months ended<br>June 30, 2013 |                 |           |
|------------------------------|---|-----------------|-----------|---|-----------------|-----------|
|                              | Non-Covered<br>OREO                         | Covered<br>OREO | Total     | Non-Covered<br>OREO                         | Covered<br>OREO | Total     |
| Balance, beginning of period | \$ 9,412                                    | \$ 24,855       | \$ 34,267 | \$ 19,786                                   | \$ 43,751       | \$ 63,537 |
| Additions                    | 110   | 1,987           | 2,097     | 341   | 4,612           | 4,953     |
| Sales                        | (5,253)                                     | (7,964)         | (13,217)  | (390)                                       | (4,378)         | (4,768)   |
| Valuation adjustments        |   | (934)           | (934)     | (61)  | (2,184)         | (2,245)   |
| Balance, end of period       | \$ 4,269                                    | \$ 17,944       | \$ 22,213 | \$ 19,676                                   | \$ 41,801       | \$ 61,477 |

| (in thousands) | For the six months ended<br>June 30, 2014 |  |  | For the six months ended<br>June 30, 2013 |  |  |
|----------------|---|--|--|---|--|--|
|                | Total                                     |  |  | Total                                     |  |  |

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|                              | Non-Covered<br>OREO |         | Covered<br>OREO |          | Non-Covered<br>OREO |          | Covered<br>OREO |         |    |          |    |          |
|------------------------------|---------------------|---------|-----------------|----------|---------------------|----------|-----------------|---------|----|----------|----|----------|
| Balance, beginning of period | \$                  | 12,611  | \$              | 25,481   | \$                  | 38,092   | \$              | 21,027  | \$ | 58,276   | \$ | 79,303   |
| Additions                    |                     | 111     |                 | 4,020    |                     | 4,131    |                 | 723     |    | 13,906   |    | 14,629   |
| Sales                        |                     | (8,439) |                 | (10,468) |                     | (18,907) |                 | (1,781) |    | (25,162) |    | (26,943) |
| Valuation adjustments        |                     | (14)    |                 | (1,089)  |                     | (1,103)  |                 | (293)   |    | (5,219)  |    | (5,512)  |
| Balance, end of period       | \$                  | 4,269   | \$              | 17,944   | \$                  | 22,213   | \$              | 19,676  | \$ | 41,801   | \$ | 61,477   |

OREO was \$22.2 million at June 30, 2014, \$38.1 million at December 31, 2013 and \$61.5 million at June 30, 2013, respectively. The OREO balance at June 30, 2014 includes covered OREO of \$17.9 million, compared with \$25.5 million at December 31, 2013 and \$41.8 million at June 30, 2013. The balance of OREO at June 30, 2014, December 31, 2013 and June 30, 2013 is net of valuation allowances of \$11.1 million, \$17.4 million and \$28.7 million, respectively.

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The Company recognized \$6.9 million in total net gain on the sale of OREO in the second quarter of 2014, compared to \$2.8 million in the first quarter of 2014 and \$0.8 million in the year-earlier quarter. Net gain on the sale of OREO in the second quarter of 2014 included \$2.6 million of net gain related to the sale of covered OREO, compared to \$0.4 million in the first quarter of 2014 and \$0.6 million in the year-earlier quarter.

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

**Other Assets**

The following table presents information on other assets:

| (in thousands)                             | June 30,<br>2014 | December 31,<br>2013 | June 30,<br>2013 |
|--|------------------|----------------------|------------------|
| Accrued interest receivable                | \$ 74,250        | \$ 70,346            | \$ 70,154        |
| Deferred compensation fund assets          | 88,613           | 81,058               | 73,433           |
| Stock in government agencies               | 58,376           | 64,354               | 77,962           |
| Private equity and alternative investments | 29,748           | 33,952               | 34,942           |
| Bank-owned life insurance                  | 86,694           | 85,596               | 84,243           |
| Derivative assets                          | 43,264           | 34,613               | 40,066           |
| Income tax receivable                      |                  |                      | 13,296           |
| FDIC (payable) receivable                  | (4,249)          | 2,782                | 1,482            |
| Equipment on operating leases, net         | 26,085           | 31,982               | 27,677           |
| Other                                      | 96,380           | 101,484              | 102,378          |
| Total other assets                         | \$ 499,161       | \$ 506,167           | \$ 525,633       |

**Deposits**

Deposits totaled \$26.65 billion, \$25.68 billion and \$23.65 billion at June 30, 2014, December 31, 2013 and June 30, 2013, respectively. Average deposits totaled \$25.91 billion for the second quarter of 2014, a slight decrease from \$25.94 billion for the fourth quarter of 2013 and an increase of 12 percent from \$23.12 billion for the second quarter of 2013. Core deposits, which include noninterest-bearing deposits and interest-bearing deposits excluding time deposits of \$100,000 and over, provide a stable source of low cost funding. Average core deposits were \$25.46 billion, \$25.42 billion and \$22.41 billion for the quarters ended June 30, 2014, December 31, 2013 and June 30, 2013, respectively, and represented 98 percent, 98 percent and 97 percent of total deposits for each respective period. Average noninterest-bearing deposits in the second quarter of 2014 decreased 1 percent from the fourth quarter of 2013 and increased 15 percent from the year-earlier quarter.

Treasury Services deposit balances, which consist primarily of title, escrow, community association and property management deposits, averaged \$2.87 billion in the second quarter of 2014, compared with \$2.59 billion in the fourth quarter of 2013 and \$2.59 billion for the second quarter of 2013. The growth in Treasury Services deposits was due primarily to mortgage transaction activity on higher priced homes.

**Borrowed Funds**

Total borrowed funds were \$788.1 million, \$739.9 million and \$709.2 million at June 30, 2014, December 31, 2013 and June 30, 2013, respectively. Total average borrowed funds were \$738.1 million, \$728.5 million and \$1.30 billion for the quarters ended June 30, 2014, December 31, 2013 and June 30, 2013, respectively.

Short-term borrowings consist of funds with remaining maturities of one year or less and the current portion of long-term debt. Short-term borrowings were \$160.3 million as of June 30, 2014 compared to \$3.9 million as of December 31, 2013 and \$2.7 million as of June 30, 2013. Short-term borrowings at June 30, 2014 consist of federal funds purchased and the current portions of subordinated debt and nonrecourse debt.

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Long-term debt consists of borrowings with remaining maturities greater than one year and is primarily comprised of senior notes, subordinated debt, junior subordinated debt and nonrecourse debt. Long-term debt was \$627.8 million, \$736.0 million and \$706.5 million as of June 30, 2014, December 31, 2013 and June 30, 2013, respectively. The Company's long-term borrowings have maturity dates ranging from July 2015 to November 2034.

**Off-Balance Sheet**

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

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

Commitments to extend credit are agreements to lend to a client as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since a portion of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company had off-balance sheet credit commitments totaling \$8.78 billion at June 30, 2014, \$7.99 billion at December 31, 2013 and \$6.85 billion at June 30, 2013.

Standby letters of credit are commitments issued by the Company to guarantee the obligations of its customer to beneficiaries. Commercial letters of credit are issued on behalf of customers to ensure payment in connection with trade transactions. The Company had \$679.0 million in letters of credit at June 30, 2014, of which \$574.3 million relate to standby letters of credit and \$104.7 million relate to commercial letters of credit. The Company had \$733.5 million outstanding in letters of credit at December 31, 2013, of which \$617.3 million relate to standby letters of credit and \$116.2 million relate to commercial letters of credit.

As of June 30, 2014, the Company had private equity fund and alternative investment fund commitments of \$66.4 million, of which \$58.5 million was funded. As of December 31, 2013 and June 30, 2013, the Company had private equity and alternative investment fund commitments of \$70.9 million and \$67.9 million respectively, of which \$62.2 million and \$61.4 million was funded.

**Capital**

The ratio of period-end equity to period-end assets was 9.26 percent, 9.22 percent and 9.29 percent as of June 30, 2014, December 31, 2013 and June 30, 2013, respectively. Period-end common shareholders' equity to period-end assets was 8.39 percent, 8.32 percent and 8.67 percent for the

same periods, respectively.

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The following table presents the regulatory standards for well-capitalized institutions and the capital ratios for the Corporation and the Bank at June 30, 2014, December 31, 2013 and June 30, 2013:

|   | Regulatory<br>Well-Capitalized<br>Standards | June 30,<br>2014 | December 31,<br>2013 | June 30,<br>2013 |
|---|---|------------------|----------------------|------------------|
| <b>City National Corporation</b>              |   |                  |                      |                  |
| Tier 1 leverage                               | %   | 7.43%            | 7.17%                | 7.00%            |
| Tier 1 risk-based capital                     | 6.00  | 10.00            | 10.09                | 9.74             |
| Total risk-based capital                      | 10.00                                       | 12.81            | 13.00                | 12.78            |
| Tangible common equity to tangible assets (1) |   | 6.32             | 6.17                 | 6.32             |
| Tier 1 common equity to risk-based assets (2) |   | 8.75             | 8.78                 | 8.83             |
| <b>City National Bank</b>                     |   |                  |                      |                  |
| Tier 1 leverage                               | 5.00%                                       | 7.45%            | 7.25%                | 7.21%            |
| Tier 1 risk-based capital                     | 6.00  | 10.00            | 10.20                | 10.04            |
| Total risk-based capital                      | 10.00                                       | 12.78            | 13.08                | 13.03            |

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

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

Reconciliation of GAAP financial measure to non-GAAP financial measure:

| (in thousands)                                    | June 30,<br>2014 | December 31,<br>2013 | June 30,<br>2013 |
|---|------------------|----------------------|------------------|
| Common equity                                     | \$ 2,585,537     | \$ 2,473,370         | \$ 2,374,848     |
| Less: Goodwill and other intangible assets        | (680,302)        | (683,243)            | (686,897)        |
| Tangible common equity (A)                        | \$ 1,905,235     | \$ 1,790,127         | \$ 1,687,951     |
| Total assets                                      | \$ 30,819,092    | \$ 29,717,951        | \$ 27,379,502    |
| Less: Goodwill and other intangible assets        | (680,302)        | (683,243)            | (686,897)        |
| Tangible assets (B)                               | \$ 30,138,790    | \$ 29,034,708        | \$ 26,692,605    |
| Tangible common equity to tangible assets (A)/(B) | 6.32%            | 6.17%                | 6.32%            |
| Tier 1 capital                                    | \$ 2,191,711     | \$ 2,095,576         | \$ 1,874,999     |



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|   |    |            |    |            |    |            |
|---|----|------------|----|------------|----|------------|
| Less: Preferred stock                             |    | (267,616)  |    | (267,616)  |    | (169,920)  |
| Less: Trust preferred securities                  |    | (5,155)    |    | (5,155)    |    | (5,155)    |
| Tier 1 common equity (C)                          | \$ | 1,918,940  | \$ | 1,822,805  | \$ | 1,699,924  |
| Risk-weighted assets (D)                          | \$ | 21,922,982 | \$ | 20,766,237 | \$ | 19,255,862 |
| Tier 1 common equity to risk-based assets (C)/(D) |    | 8.75%      |    | 8.78%      |    | 8.83%      |

In July 2013, the FDIC, the Office of the Comptroller of the Currency and the Board of Governors of the Federal Reserve System adopted a final rule that revises its risk-based and leverage capital requirements (referred to as the Basel III rule). A key goal of the Basel III agreement is to strengthen the capital resources of banking organizations during normal and challenging business environments. The Basel III final rule implements a revised definition of regulatory capital, a new common equity Tier 1 minimum capital requirement, and a higher minimum Tier 1 capital requirement. For banking organizations not subject to the advanced approaches rule, compliance with the standardized approach for determining risk-weighted assets and compliance with the transition period for the revised minimum regulatory capital ratios will begin on January 1, 2015. The transition period for the capital conservation buffer will begin on January 1, 2016 and the fully implemented regulatory capital ratios will be effective on January 1, 2019. Important elements of the Basel III rule include the following:

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- Increased minimum capital requirements;
- Higher quality of capital so banks are better able to absorb losses;
- A leverage ratio concept for international banks and U.S. bank holding companies;
- Specific capital conservation buffers; and
- A more uniform supervisory standard for U.S. financial institution regulatory agencies.

Based on the final Basel III rules, the Company has estimated its capital ratios as of June 30, 2014 using the new standards and the pro forma ratios already exceed the requirements of the fully implemented capital rules.

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

**ASSET/LIABILITY MANAGEMENT**

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

A quantitative and qualitative discussion about market risk is included on pages 68 to 72 of the Corporation's Form 10-K for the year ended December 31, 2013.

**Liquidity Risk**

Liquidity risk results from the mismatching of asset and liability cash flows. Funds for this purpose can be obtained in cash markets, by borrowing, or by selling certain assets. The objective of liquidity management is to manage cash flow and liquidity reserves so that they are adequate to fund the Company's operations and meet obligations and other commitments on a timely basis and at a reasonable cost. The Company achieves this objective through the selection of asset and liability maturity mixes that it believes best meet its needs. The Company's liquidity position is enhanced by its ability to raise additional funds as needed in the wholesale markets. Liquidity risk management is an

important element in the Company's ALCO process, and is managed within limits approved by the Board of Directors and guidelines set by management. Attention is also paid to potential outflows resulting from disruptions in the financial markets or to unexpected credit events. These factors are incorporated into the Company's contingency funding analysis, and provide the basis for the identification of primary and secondary liquidity reserves.

In recent years, the Company's core deposit base has provided the majority of the Company's funding requirements. This relatively stable and low-cost source of funds, along with shareholders' equity, provided 94 percent of funding for average total assets in both the second quarter and first six months of 2014, and 91 percent and 89 percent for the year-earlier periods, respectively. Strong core deposits are indicative of the strength of the Company's franchise in its chosen markets and reflect the confidence that clients have in the Company. The Company places a very high priority in maintaining this confidence through conservative credit and capital management practices and by maintaining significant on-balance sheet liquidity reserves.

Funding obtained through short-term wholesale or market sources averaged \$0.9 million and \$0.5 million for the three and six months ended June 30, 2014, respectively, and \$594.4 million and \$1.04 billion for the year-earlier periods. The Company's liquidity position was also supported through longer-term borrowings (including the current portion of long-term debt) which averaged \$737.2 million and \$738.0 million for the three and six months ended June 30, 2014, respectively, compared with \$708.0 million and \$758.9 million for the year-earlier periods. Market sources of funds comprise a modest portion of total Bank funding and are managed within concentration and maturity guidelines reviewed by management and implemented by the Company's treasury department.

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Liquidity is further provided by assets such as federal funds sold, reverse repurchase agreements, balances held at the Federal Reserve Bank, and trading securities, which may be immediately converted to cash at minimal cost. The aggregate of these assets averaged \$930.9 million and \$917.1 million for the second quarter and first six months of 2014, respectively, compared with \$496.7 million and \$415.6 million in the year-earlier periods, respectively. In addition, the Company has committed and unutilized secured borrowing capacity of \$5.32 billion as of June 30, 2014 from the Federal Home Loan Bank of San Francisco, of which the Bank is a member. The Company's investment portfolio also provides a substantial liquidity reserve. The portfolio of securities available-for-sale averaged \$5.28 billion and \$5.40 billion for the quarter and six months ended June 30, 2014, respectively. The portfolio of securities available-for-sale averaged \$7.38 billion and \$7.86 billion for the quarter and six months ended June 30, 2013, respectively. The unpledged portion of securities available-for-sale and held-to-maturity at fair value totaled \$7.03 billion at June 30, 2014. These securities could be used as collateral for borrowing or a portion of the securities available-for-sale could be sold.

**Interest Rate Risk**

*Net Interest Income Simulation:* As part of its overall interest rate risk management process, the Company performs stress tests on net interest income projections based on a variety of factors, including interest rate levels, changes in the relationship between the prime rate and short-term interest rates, and the shape of the yield curve. The Company uses a simulation model to estimate the severity of this risk and to develop mitigation strategies, including interest-rate hedges. The magnitude of the change is determined from historical volatility analysis. The assumptions used in the model are updated periodically and reviewed and approved by ALCO. In addition, the Board of Directors has adopted limits within which interest rate exposure must be contained. Within these broader limits, ALCO sets management guidelines to further contain interest rate risk exposure.

The Company is naturally asset-sensitive due to its large portfolio of rate-sensitive commercial loans that are funded in part by noninterest bearing and rate-stable core deposits. As a result, if there are no significant changes in the mix of assets and liabilities, the net interest margin increases when interest rates increase and decreases when interest rates decrease. The Company uses on and off-balance sheet hedging vehicles to manage risk. The Company uses a simulation model to estimate the impact of changes in interest rates on net interest income. Interest rate scenarios include stable rates and a 400 basis point parallel shift in the yield curve occurring gradually over a two-year period. The model is used to project net interest income assuming no changes in loans or deposit mix as it stood at June 30, 2014, as well as a dynamic simulation that includes changes to balance sheet mix in response to changes in interest rates. In the dynamic simulation, loan and deposit balances are modeled based on experience in previous vigorous economic recovery cycles. Loans, excluding covered loans which are in a runoff mode, increase 10 percent per year compared to the base case. Similarly, deposits decline 7.5 percent per year. Loan yields and deposit rates change over the simulation horizon based on current spreads and adjustment factors that are statistically derived using historical rate and balance sheet data.

As of June 30, 2014, the Federal funds target rate was at a range of zero percent to 0.25 percent. Further declines in interest rates are not expected to significantly reduce earning asset yields or liability costs, nor have a meaningful effect on net interest margin. At June 30, 2014, a gradual 400 basis point parallel increase in the yield curve over the next 24 months assuming a static balance sheet would result in an increase in projected net interest income of approximately 11.3 percent in year one and a 42.3 percent increase in year two over the base case. This compares to an increase in projected net interest income of 9.7 percent in year one and a 33.0 percent increase in year two over the base case at June 30, 2013. Interest rate sensitivity has increased due to changes in the mix of the balance sheet, primarily significant growth in floating rate loans and non-rate sensitive deposits. The dynamic simulation incorporates balance sheet changes resulting from a gradual 400 basis point increase in rates. In combination, these rate and balance sheet effects result in an increase in projected net interest income of approximately 13.8 percent in year one and 45.1 percent increase in year two over the base case. The Company's asset sensitivity is primarily tied to changes in short-term rates due to its large portfolio of rate-sensitive loans and funding provided by noninterest bearing and rate-stable core deposits. The Company's interest rate risk exposure remains within Board limits and ALCO guidelines.

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The Company's loan portfolio includes floating rate loans which are tied to short-term market index rates, adjustable rate loans for which the initial rate is fixed for a period from one year to as much as ten years, and fixed-rate loans whose interest rate does not change through the life of the transaction. The following table shows the composition of the Company's loan portfolio, including covered loans, by major loan category as of June 30, 2014. Each loan category is further divided into Floating, Adjustable and Fixed rate components. Floating rate loans are generally tied to either the Prime rate or to a LIBOR-based index.

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| (in millions)                         | Prime    | Floating Rate<br>LIBOR | Total     | Adjustable | Fixed    | Total<br>Loans |
|---------------------------------------|----------|------------------------|-----------|------------|----------|----------------|
| Commercial and lease financing        | \$ 2,568 | \$ 4,936               | \$ 7,504  | \$ 49      | \$ 1,285 | \$ 8,838       |
| Commercial real estate mortgages      | 294      | 1,948                  | 2,242     | 64         | 1,159    | 3,465          |
| Residential mortgages                 |          |                        |           | 3,387      | 1,427    | 4,814          |
| Real estate construction              | 68       | 368                    | 436       |            | 22       | 458            |
| Home equity loans and lines of credit | 701      |                        | 701       | 4          | 12       | 717            |
| Installment                           | 106      |                        | 106       |            | 77       | 183            |
| Covered loans                         | 31       | 79                     | 110       | 400        | 96       | 606            |
| Total loans and leases                | \$ 3,768 | \$ 7,331               | \$ 11,099 | \$ 3,904   | \$ 4,078 | \$ 19,081      |
| Percentage of portfolio               | 20%      | 38%                    | 58%       | 21%        | 21%      | 100%           |

Certain floating rate loans have a floor rate which is absolute and below which the loan rate will not fall even though market rates may be unusually low. At June 30, 2014, \$11.10 billion (58 percent) of the Company's loan portfolio was floating rate, of which \$9.20 billion (83 percent) was not impacted by rate floors. This is because either the loan contract does not specify a minimum or floor rate, or because the contractual loan rate is above the minimum rate specified in the loan contract. Of the loans which were at their contractual minimum rate, \$1.43 billion (13 percent) were within 0.75 percent of the contractual loan rate absent the effects of the floor. Thus, the rate on these loans will be relatively responsive to increases in the underlying Prime or LIBOR index, and all will adjust upwards should the underlying index increase by more than 0.75 percent. Only \$46.2 million of floating rate loans have floors that are more than 2 percent above the contractual rate formula. Thus, the yield on the Company's floating rate loan portfolio is expected to be highly responsive to changes in market rates. The following table shows the balance of loans in the Floating Rate portfolio stratified by spread between the current loan rate and the floor rate as of June 30, 2014:

| (in millions)                  | Loans with No<br>Floor and<br>Current Rate<br>Greater than<br>Floor | Interest Rate Increase Needed for Loans<br>Currently at Floor Rate to Become Floating |               |         | Total     |
|--------------------------------|---|---|---------------|---------|-----------|
|                                |   | < 0.75%   | 0.76% - 2.00% | > 2.00% |           |
| Prime                          | \$ 2,675  | \$ 739  | \$ 347        | \$ 7    | \$ 3,768  |
| LIBOR                          | 6,524   | 691   | 77            | 39      | 7,331     |
| Total floating rate loans      | \$ 9,199  | \$ 1,430  | \$ 424        | \$ 46   | \$ 11,099 |
| % of total floating rate loans | 83%   | 13%   | 4%            | 0%      | 100%      |

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

As of June 30, 2014, an instantaneous 200 basis point increase in interest rates results in a 4.7 percent decline in EVE. This compares to an 8.6 percent decline in EVE a year-earlier. Prior year percentages have been restated to conform with current methodology. The decrease in sensitivity is primarily due to changes in the mix of the balance sheet and decline in long-term interest rates. Measurement of a 200 basis point decrease in rates as of June 30, 2014 and June 30, 2013 is not meaningful due to the current low rate environment.



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**Interest-Rate Risk Management**

Interest-rate swaps may be used to reduce cash flow variability and to moderate changes in the fair value of long-term financial instruments. Net interest income or expense associated with interest-rate swaps (the difference between the fixed and floating rates paid or received) is included in net interest income in the reporting periods in which they are earned. Derivatives are recorded on the consolidated balance sheets at their fair value. The treatment of changes in the fair value of derivatives depends on the character of the transaction. The Company had no interest-rate swaps designated as hedging instruments at June 30, 2014, December 31, 2013 and June 30, 2013.

The Company has not entered into any hedge transactions involving any other interest-rate derivative instruments, such as interest-rate floors, caps, and interest-rate futures contracts for its own portfolio in 2014. Under existing policy, the Company could use such financial instruments in the future if deemed appropriate.

*Other Derivatives*

The Company also offers various derivative products to clients and enters into derivative transactions in due course. These derivative contracts are offset by paired trades with unrelated bank counterparties. These transactions are not linked to specific Company assets or liabilities in the consolidated balance sheets or to forecasted transactions in a hedge relationship and, therefore, do not qualify for hedge accounting. The contracts are marked-to-market each reporting period with changes in fair value recorded as part of Other noninterest income in the consolidated statements of income. Fair values are determined from verifiable third-party sources that have considerable experience with the derivative markets. The Company provides client data to the third-party source for purposes of calculating the credit valuation component of the fair value measurement of client derivative contracts. At June 30, 2014 and 2013, the Company had entered into derivative contracts with clients (and offsetting derivative contracts with counterparties) having a notional balance of \$3.30 billion and \$2.93 billion, respectively.

**Counterparty Risk and Collateral**

Interest-rate swap agreements involve the exchange of fixed and variable-rate interest payments based upon a notional principal amount and maturity date. The Company's interest-rate swaps had \$0.2 million and \$1.4 million of credit risk exposure at June 30, 2014 and June 30, 2013, respectively. The credit exposure represents the cost to replace, on a present value basis and at current market rates, all contracts outstanding by trading counterparty having an aggregate positive market value, net of margin collateral received. The Company's swap agreements require the deposit of cash or marketable debt securities as collateral for this risk if it exceeds certain market value thresholds. These requirements apply individually to the Corporation and to the Bank. No collateral had been received from swap counterparties at June 30, 2014 and June 30, 2013. The Company delivered cash and securities collateral valued at \$29.4 million on swap agreements at June 30, 2014 and \$15.0 million at June 30, 2013.

**Market Risk Foreign Currency Exchange**



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The Company enters into foreign-exchange contracts with its clients and counterparty banks primarily for the purpose of offsetting or hedging clients' transaction and economic exposures arising out of commercial transactions. The Company's policies also permit taking proprietary currency positions within certain approved limits. The Company actively manages its foreign exchange exposures within prescribed risk limits and controls. At June 30, 2014, the Company's outstanding foreign exchange contracts, both proprietary and for customer accounts, totaled \$483.7 million. The mark-to-market on foreign exchange contracts included in other assets and other liabilities totaled \$3.5 million and \$2.8 million, respectively, at June 30, 2014.

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**ITEM 4. CONTROLS AND PROCEDURES**

**DISCLOSURE CONTROLS AND PROCEDURES**

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

**INTERNAL CONTROL OVER FINANCIAL REPORTING**

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

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**PART II OTHER INFORMATION**

**ITEM 1A. RISK FACTORS**

For a discussion of risk factors relating to the Company's business, refer to Item 1A of Part I of the Company's Annual Report on Form 10-K for the year ended December 31, 2013 ( Form 10-K ). There has been no material change in the risk factors as previously disclosed in the Company's Form 10-K.

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

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

The information required by subsection (c) of this item regarding purchases by the Company during the quarter ended June 30, 2014 of equity securities that are registered by the Company pursuant to Section 12 of the Exchange Act is incorporated by reference from the relevant portion of Part I, Item 1 of this report under Note 8.

**ITEM 6. EXHIBITS**

| No.     |   |
|---------|---|
| 12      | Statement Re: Computation of Ratio of Earnings to Fixed Charges and Preferred Stock Requirements.                       |
| 31.1    | Chief Executive Officer certification pursuant to section 302 of the Sarbanes-Oxley Act of 2002.                        |
| 31.2    | Chief Financial Officer certification pursuant to section 302 of the Sarbanes-Oxley Act of 2002.                        |
| 32.1    | Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002. |
| 101.INS | XBRL Instance Document  |
| 101.SCH | XBRL Taxonomy Extension Schema Document   |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document   |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document   |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document  |



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**SIGNATURES**

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

**CITY NATIONAL CORPORATION**  
(Registrant)

**DATE:** August 8, 2014

/s/ Christopher J. Carey

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