CVB FINANCIAL CORP
Form 10-Q
November 09, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2012

or

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

For the transition period from _______ to _______

Commission File Number: 0-10140

CVB FINANCIAL CORP.

(Exact name of registrant as specified in its charter)

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

(909) 980-4030

(Registrant s telephone number, including area code)

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

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

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

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

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

Number of shares of common stock of the registrant: 104,825,389 outstanding as of October 31, 2012.

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CVB FINANCIAL CORP.

2012 QUARTERLY REPORT ON FORM 10-Q

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GENERAL

Forward Looking Statements

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

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PART I FINANCIAL INFORMATION (UNAUDITED)

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

CVB FINANCIAL CORP. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except share data)

(Unaudited)

	September 30, 2012	December 31, 2011
ASSETS		
Cash and due from banks	$ 99,881	$ 35,407
Interest-earning balances due from Federal Reserve	148,304	309,936
Total cash and cash equivalents	248,185	345,343
Interest-earning balances due from depository institutions	70,000	60,000
Investment securities available-for-sale, at fair value (with amortized cost of $2,173,946 at September 30, 2012 and $ 2,130,029 at December 31, 2011)	2,257,507	2,201,526
Investment securities held-to-maturity	2,122	2,383
Investment in stock of Federal Home Loan Bank (FHLB)	62,428	72,689
Non-covered loans held-for-sale	996	348
Covered loans held-for-sale		5,664
Loans and lease finance receivables, excluding covered loans	3,227,405	3,219,727
Allowance for credit losses	(92,067)	(93,964)
Net non-covered loans and lease finance receivables	3,135,338	3,125,763
Covered loans and lease finance receivables, net	207,307	256,869
Premises and equipment, net	35,577	36,280
Bank owned life insurance	118,384	116,132
Accrued interest receivable	22,885	23,512
Intangibles	3,830	5,548
Goodwill	55,097	55,097
FDIC loss sharing asset	22,271	59,453
Non-covered other real estate owned	10,473	13,820
Covered other real estate owned	1,288	9,782
Income taxes	19,447	48,033
Other assets	48,206	44,673
TOTAL ASSETS	$ 6,321,341	$ 6,482,915
LIABILITIES AND STOCKHOLDERS EQUITY		
Liabilities:		
Deposits:		
Noninterest-bearing	$ 2,324,401	$ 2,027,876
Interest-bearing	2,456,715	2,576,672
Total deposits	4,781,116	4,604,548
Customer repurchase agreements	448,788	509,370

Borrowings	198,866	448,662
Accrued interest payable	1,574	3,526
Deferred compensation	8,957	8,735
Junior subordinated debentures	67,012	115,055
Other liabilities	60,821	78,205
TOTAL LIABILITIES	5,567,134	5,768,101
COMMITMENTS AND CONTINGENCIES		
Stockholders Equity:		
Preferred stock, authorized, 20,000,000 shares without par; none issued or outstanding		
Common stock, authorized, 225,000,000 shares without par; issued and outstanding 104,813,389 at September 30, 2012 and 104,482,271 at December 31, 2011	483,951	479,973
Retained earnings	221,791	193,372
Accumulated other comprehensive income, net of tax	48,465	41,469
Total stockholders equity	754,207	714,814
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 6,321,341	$ 6,482,915

See accompanying notes to the condensed consolidated financial statements.

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CVB FINANCIAL CORP. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS AND COMPREHENSIVE INCOME

(Dollars in thousands, except per share amounts)

(Unaudited)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2012	2011	2012	2011
Interest income:				
Loans held-for-sale	$ 6	$ 17	$ 16	$ 46
Loans and leases, including fees	45,553	48,791	139,273	147,116
Accretion on acquired loans	7,045	3,980	19,258	11,638
Loans, including fees	52,604	52,788	158,547	158,800
Investment securities:				
Taxable	7,246	9,407	25,202	28,397
Tax-advantaged	5,640	5,951	17,221	17,791
Total investment income	12,886	15,358	42,423	46,188
Dividends from FHLB	79	52	263	183
Federal funds sold and interest-bearing deposits with other institutions	276	332	856	1,053
Total interest income	65,845	68,530	202,089	206,224
Interest expense:				
Deposits	1,398	1,979	4,605	6,987
Borrowings	4,086	5,748	13,933	17,286
Junior subordinated debentures	617	823	2,245	2,467
Total interest expense	6,101	8,550	20,783	26,740
Net interest income before provision for credit losses	59,744	59,980	181,306	179,484
Provision for credit losses				7,068
Net interest income after provision for credit losses	59,744	59,980	181,306	172,416
Noninterest income:				
Net impairment loss on investment securities recognized in earnings		(427)		(546)
Service charges on deposit accounts	4,040	4,021	12,232	11,773
Trust and investment services	2,037	2,056	6,264	6,468
Bankcard services	962	771	2,888	2,295
BOLI Income	781	733	2,271	2,589
Decrease in FDIC loss sharing asset, net	(7,059)	(844)	(19,339)	(1,118)
Other	1,865	1,204	5,858	2,025
Total noninterest income	2,626	7,514	10,174	23,486

Noninterest expense:				
Salaries and employee benefits	17,489	17,579	50,856	53,459
Occupancy and equipment	4,010	4,152	11,582	12,554
Professional services	1,522	3,728	5,215	12,365
Software licenses and maintenance	1,062	795	2,960	2,830
Promotion	1,176	1,271	3,741	3,801
Amortization of Intangibles	449	862	1,717	2,629
Provision for unfunded commitments		(1,650)		(918)
Debt termination	20,379		20,379	
OREO expense	405	2,247	1,458	5,023
Other	3,528	3,874	11,273	14,575
Total noninterest expense	50,020	32,858	109,181	106,318
Earnings before income taxes	12,350	34,636	82,299	89,584
Income taxes	3,093	12,253	27,155	29,563
Net earnings	$ 9,257	$ 22,383	$ 55,144	$ 60,021
Other comprehensive income:				
Unrealized (loss) gain on securities arising during the period	$ 8,417	$ 23,975	$ 12,064	$ 56,582
Less: Reclassification adjustment for net gain on securities included in net income		(283)		(402)
Other comprehensive income, before tax	8,417	24,258	12,064	56,984
Income tax related to items of other comprehensive income	(3,536)	(10,188)	(5,068)	(23,933)
Other comprehensive income, net of tax	$ 4,881	$ 14,070	$ 6,996	$ 33,051
Comprehensive income	$ 14,138	$ 36,453	$ 62,140	$ 93,072
Basic earnings per common share	$ 0.09	$ 0.21	$ 0.53	$ 0.57
Diluted earnings per common share	$ 0.09	$ 0.21	$ 0.53	$ 0.57
Cash dividends per common share	$ 0.085	$ 0.085	$ 0.255	$ 0.255

See accompanying notes to condensed consolidated financial statements.

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CVB FINANCIAL CORP. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

Nine Months Ended September 30, 2012 and 2011

(Unaudited)

	Common Shares Outstanding	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income/(Loss)	Total
	(Dollars and shares in thousands)				
Balance January 1, 2011	106,076	$ 490,226	$ 147,444	$ 6,185	$ 643,855
Repurchase of common stock	(1,503)	$ (11,837)			(11,837)
Exercise of stock options	9	57			57
Tax benefit from exercise of stock options		2			2
Stock-based Compensation Expense		1,673			1,673
Cash dividends declared					
Common ($0.255 per share)			(26,947)		(26,947)
Net earnings			60,021		60,021
Other comprehensive income				33,051	33,051
Balance September 30, 2011	104,582	$ 480,121	$ 180,518	$ 39,236	$ 699,875
Balance January 1, 2012	104,482	$ 479,973	$ 193,372	$ 41,469	$ 714,814
Exercise of stock options	331	2,412			2,412
Tax benefit from exercise of stock options		179			179
Stock-based Compensation Expense		1,387			1,387
Cash dividends declared					
Common ($0.255 per share)			(26,725)		(26,725)
Net earnings			55,144		55,144
Other comprehensive income				6,996	6,996
Balance September 30, 2012	104,813	$ 483,951	$ 221,791	$ 48,465	$ 754,207

See accompanying notes to the condensed consolidated financial statements.

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CVB FINANCIAL CORP. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

(unaudited)

	For the Nine Months Ended September 30, 2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Interest and dividends received	$ 200,601	$ 203,106
Service charges and other fees received	28,144	24,889
Interest paid	(22,531)	(27,279)
Cash paid to vendors and employees	(105,347)	(91,806)
Income taxes paid	(3,455)	(57,000)
Proceeds from FDIC loss sharing agreement	17,842	43,891
Net cash provided by operating activities	115,254	95,801
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from redemption of FHLB Stock	10,261	10,537
Proceeds from repayment of investment securities	401,229	239,791
Proceeds from maturity of investment securities	74,287	84,410
Purchases of investment securities	(567,391)	(631,043)
Net decrease in loans and lease finance receivables	61,475	258,064
Proceeds from sales of premises and equipment	26	180
Proceeds from sales of other real estate owned	17,274	11,917
Purchase of premises and equipment	(3,382)	(679)
Net cash used in investing activities	(6,221)	(26,823)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in transaction deposits	275,109	315,291
Net decrease in time deposits	(98,541)	(244,975)
Repayment of advances from Federal Home Loan Bank	(250,000)	
Net decrease in other borrowings		13
Net decrease in customer repurchase agreements	(60,582)	(56,915)
Repayment of FCB Statutory Trust II	(6,805)	(5,000)
Repayment of CBB Statutory Trust I	(41,238)	
Cash dividends on common stock	(26,725)	(26,947)
Repurchase of common stock		(11,837)
Proceeds from exercise of stock options	2,412	57
Tax benefit related to exercise of stock options	179	2
Net cash used in financing activities	(206,191)	(30,311)
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(97,158)	38,667
CASH AND CASH EQUIVALENTS, beginning of period	345,343	404,275
CASH AND CASH EQUIVALENTS, end of period	$ 248,185	$ 442,942

See accompanying notes to the condensed consolidated financial statements.

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CVB FINANCIAL CORP. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)

(Dollars in thousands)

(unaudited)

	For the Nine Months Ended September 30,	
	2012	2011
RECONCILIATION OF NET EARNINGS TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Net earnings	$ 55,144	$ 60,021
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Amortization of capitalized prepayment penalty on borrowings	204	204
(Gain)/loss on sale of premises and equipment	(1)	11
Gain on sale of other real estate owned	(1,341)	(202)
Credit-related impairment loss on investment securities held-to-maturity		546
Increase from bank owned life insurance	(2,252)	(2,589)
Net amortization of premiums on investment securities	17,578	9,130
Accretion of SJB Discount	(19,258)	(11,638)
Provisions for credit losses		7,068
Valuation adjustment for losses on other real estate owned	490	3,849
Change in FDIC loss sharing Asset	19,339	1,118
Stock-based compensation	1,387	1,673
Depreciation and amortization	5,776	7,313
Proceeds from FDIC loss sharing agreement	17,842	43,891
Change in accrued interest receivable	627	507
Change in accrued interest payable	(1,952)	(742)
Change in other assets and liabilities	21,671	(24,359)
Total adjustments	60,110	35,780
NET CASH PROVIDED BY OPERATING ACTIVITIES	$ 115,254	$ 95,801
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING ACTIVITIES		
Securities purchased and not settled	$	$ 20,883
Transfer from loans to Other Real Estate Owned	$ 4,582	$ 29,117

See accompanying notes to the condensed consolidated financial statements.

CVB FINANCIAL CORP. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the Nine Months Ended September 30, 2012, and 2011

(unaudited)

1. BUSINESS

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

The Company s primary operations are related to traditional banking activities, including the acceptance of deposits and the lending and investing of money through the operations of the Bank. The Bank also provides automobile and equipment leasing to customers through its Citizens Financial Services Group and trust and investment-related services to customers through its CitizensTrust Division. The Bank s customers consist primarily of small to mid-sized businesses and individuals located in San Bernardino County, Riverside County, Orange County, Los Angeles County, Madera County, Fresno County, Tulare County, Kern County and San Joaquin County, California. The Bank operates 41 Business Financial Centers, five Commercial Banking Centers, and two trust office locations with its headquarters located in the city of Ontario, California.

2. BASIS OF PRESENTATION

The accompanying condensed consolidated unaudited financial statements and notes thereto have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission (SEC) for Form 10-Q and conform to practices within the banking industry and include all of the information and disclosures required by accounting principles generally accepted in the United States of America (GAAP) for interim financial reporting. The results of operations for the nine months ended September 30, 2012 are not necessarily indicative of the results for the full year. These unaudited financial statements should be read in conjunction with the financial statements, accounting policies and financial notes thereto included in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2011 filed with the Securities and Exchange Commission. In the opinion of management, the accompanying condensed consolidated unaudited financial statements reflect all adjustments (consisting only of normal recurring adjustments), which are necessary for a fair presentation of financial results for the interim periods presented. A summary of the significant accounting policies consistently applied in the preparation of the accompanying condensed consolidated financial statements follows.

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

3. SIGNIFICANT ACCOUNTING POLICIES

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

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

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

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

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

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

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

Troubled Debt Restructurings Loans are reported as a Troubled Debt Restructuring (TDR) if the Company for economic or legal reasons related to the debtor s financial difficulties grants a concession to the debtor that it would not otherwise consider. Types of modifications that may be considered concessions that result in a TDR include, but are not limited to, (i) a reduction of the stated interest rate for the remaining original life of the

debt, (ii) an extension of the maturity date or dates at a stated interest rate lower than the current market rate for new debt with similar risk, (iii) a reduction of the face amount or maturity amount of the debt as stated in the instrument or other agreement, or (iv) a reduction of interest. Where collateral is offered by a borrower and it is significant in proportion to the nature of the concession requested, to the extent that it substantially reduces the Company s risk of loss we may provide a concession. In such cases, these modifications are not considered a TDR as, in substance, no concession was made as a result of the significant additional collateral obtained.

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

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

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

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

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

    The frequency of payments due;

    The debt s original contractual maturity; or

    The debt s original expected duration.

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

collection and reduces the Company s risk of loss.

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

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

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

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

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

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

Provision and Allowance for Credit Losses The allowance for credit losses is management s estimate of probable losses inherent in the loan and lease receivables portfolio. The allowance is increased by the provision for losses and decreased by charge-offs when management believes the uncollectability of a loan is confirmed. Subsequent recoveries, if any, are credited to the allowance. The determination of the balance in the

allowance for credit losses is based on an analysis of the loan and lease finance receivables portfolio using a systematic methodology and reflects an amount that, in management s judgment, is appropriate to provide for probable credit losses inherent in the portfolio, after giving consideration to the character of the loan portfolio, current economic conditions, past credit loss experience, and such other factors that would deserve current recognition in estimating inherent credit losses.

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

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

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

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

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

Goodwill and Intangible Assets Goodwill resulting from business combinations prior to January 1, 2009, represents the excess of the purchase price over the fair value of the net assets of the businesses acquired. Goodwill resulting from business combinations after January 1, 2009, is generally determined as the excess of the fair value of the consideration transferred, plus the fair value of any noncontrolling interest in the acquiree, over the fair value of the net assets acquired and liabilities assumed as of the acquisition date. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but tested for impairment at least annually, or more frequently if events and circumstances exists that indicate that a goodwill impairment test should be performed. The Company selected July 1 as the date to perform the annual impairment test. Intangible assets with definite useful lives are amortized over their estimated useful lives to their estimated residual values. Goodwill is the only intangible asset with an indefinite life on our balance sheet. There was zero recorded impairment as of September 30, 2012.

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

At September 30, 2012, goodwill was $55.1 million. As of September 30, 2012, intangible assets that continue to be subject to amortization include core deposit premiums of $3.8 million (net of $28.2 million of accumulated amortization). Amortization expense for such intangible assets was $1.7 million for the nine months ended September 30, 2012. Estimated amortization expense for the remainder of 2012 is expected to be $442,000. Estimated amortization expense for the succeeding years is $1.1 million for 2013, $475,000 for 2014, $437,000 for 2015, $395,000 for 2016 and $955,000 for the period from 2017 to 2019. The weighted average remaining life of intangible assets is approximately 1.7 years.

Fair Value of Financial Instruments We use fair value measurements to record fair value adjustments to certain financial instruments and to determine fair value disclosures. Investment securities available-for-sale and interest-rate swaps are financial instruments recorded at fair value on a recurring basis. Additionally, from time to time, we may be required to record at fair value other financial assets on a non-recurring basis, such as impaired loans and OREO. These nonrecurring fair value adjustments typically involve application of lower-of-cost-or-market accounting or writedowns of individual assets. Further, we include in Note 7 to the condensed consolidated financial statements information about the extent to which fair value is used to measure assets and liabilities, the valuation methodologies used and its impact to earnings. Additionally, for financial instruments not recorded at fair value we disclose the estimate of their fair value.

Earnings per Common Share The Company calculates earnings per common share (EPS) using the two-class method. The two-class method requires the Company to present EPS as if all of the earnings for the period are distributed to common shareholders and any participating securities, regardless of whether any actual dividends or distributions are made. All outstanding unvested share-based payment awards that contain rights to non-forfeitable dividends are considered participating securities. The Company grants restricted shares under the 2008 Equity Incentive Plan that qualify as participating securities. Restricted shares issued under this plan are entitled to dividends at the same rate as common stock.

Basic earnings per common share are computed by dividing income allocated to common stockholders by the weighted-average number of common shares outstanding during each period. The computation of diluted earnings per common share considers the number of tax-effected shares issuable upon the assumed exercise of outstanding common stock options. Share and per share amounts have been retroactively restated to give effect to all stock dividends and splits. The number of shares outstanding at September 30, 2012 was 104,813,389. The tables below presents the reconciliation of earnings per share for the periods indicated.

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2012	2011	2012	2011
	(In thousands, except per share amount)			
Earnings per common share				
Net earnings available to common shareholders	$ 9,257	$ 22,383	$ 55,144	$ 60,021
Less: Net earnings allocated to restricted stock	30	81	179	229
Net earnings allocated to common shareholders (numerator)	$ 9,227	$ 22,302	$ 54,965	59,792
Weighted Average Shares Outstanding (denominator)	104,456	105,117	104,380	105,474
Earnings per common share	$ 0.09	$ 0.21	$ 0.53	0.57
Diluted earnings per common share				
Net income allocated to common shareholders (numerator)	$ 9,227	$ 22,302	$ 54,965	$ 59,792
Weighted Average Shares Outstanding	104,456	105,117	104,380	105,474
Incremental shares from assumed exercise of outstanding options	320	89	259	81
Diluted Weighted Average Shares Outstanding (denominator)	104,776	105,206	104,639	105,555
Diluted earnings per common share	$ 0.09	$ 0.21	$ 0.53	0.57

Stock-Based Compensation At September 30, 2012, the Company has three stock-based employee compensation plans, which are described more fully in Note 18 in the Company s Annual Report on Form 10-K. The Company accounts for stock compensation using the modified prospective method. Under this method, awards that are granted, modified, or settled after December 31, 2005, are fair valued as of grant date and compensation costs recognized over the vesting period on a straight-lined basis. Also under this method, unvested stock awards as of January 1, 2006 are recognized over the remaining service period with no change in historical reported earnings.

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

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

Other Contingencies In the ordinary course of business, the Company becomes involved in litigation. Based upon the Company s internal records and discussions with legal counsel, the Company records reserves as appropriate, for estimates of the probable outcome of all cases brought against the Company. Except as discussed in Part II Other Information Item 1. Legal Proceedings, at September 30, 2012 the Company does not have any litigation reserves and is not aware of any material pending legal actions or complaints asserted against the Company.

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4. FEDERALLY ASSISTED ACQUISITION OF SAN JOAQUIN BANK

On October 16, 2009 the Bank acquired SJB and entered into a loss sharing agreement with the FDIC that is more fully discussed in the Significant Accounting Policies (Note 3) included herein.

Loans acquired from the SJB acquisition have been performing better than originally expected. At September 30, 2012, the remaining discount associated with the SJB loans approximates $28.6 million. Based on the current re-forecast of expected cash flows, approximately $14.0 million of the discount is expected to accrete into interest income over the remaining average lives of the respective pools and individual loans, which approximates 4.25 years and 1.75 years, respectively. Due to the decrease in estimated losses to be incurred in the remaining portfolio, the expected reimbursement from the FDIC under the loss sharing agreement decreased. The FDIC loss sharing asset of $22.3 million at September 30, 2012 will be reduced by loss claims submitted to the FDIC with the remaining balance amortized on the same basis as the discount, not to exceed its remaining contract life of approximately 2 years.

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5. INVESTMENT SECURITIES

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

	September 30, 2012				
	Amortized Cost	Gross Unrealized Holding Gain	Gross Unrealized Holding Loss	Fair Value	Total Percent
	(Dollars in thousands)				
Investment Securities Available-for-Sale:					
Government agency & government-sponsored enterprises	$ 93,660	$ 247	$ (64)	$ 93,843	4.16%
Residential mortgage-backed securities	839,474	30,123		869,597	38.52%
CMO s / REMIC s Residential	643,150	7,944	(1,325)	649,769	28.78%
Municipal bonds	592,662	46,685	(124)	639,223	28.32%
Other securities	5,000	75		5,075	0.22%
Total Investment Securities	$ 2,173,946	$ 85,074	$ (1,513)	$ 2,257,507	100.00%

	December 31, 2011				
	Amortized Cost	Gross Unrealized Holding Gain	Gross Unrealized Holding Loss	Fair Value	Total Percent
	(Dollars in thousands)				
Investment Securities Available-for-Sale:					
Government agency & government-sponsored enterprises	$ 46,273	$ 234	$	$ 46,507	2.11%
Residential mortgage-backed securities	869,847	18,487	(334)	888,000	40.33%
CMO s / REMIC s Residential	594,866	10,307	(665)	604,508	27.46%
Municipal bonds	608,575	43,665	(203)	652,037	29.62%
Other securities	10,468	10	(4)	10,474	0.48%
Total Investment Securities	$ 2,130,029	$ 72,703	$ (1,206)	$ 2,201,526	100.00%

Approximately 69% of the available-for-sale portfolio at September 30, 2012 represents securities issued by the U.S government or U.S. government-sponsored enterprises, with the implied guarantee of payment of principal and interest. The remaining CMO/REMICs are backed by agency-pooled collateral or whole loan collateral. All non-agency available-for-sale CMO/REMIC issues held are rated investment grade or better by either Standard & Poor s or Moody s, as of September 30, 2012 and December 31, 2011. We have $2.9 million in CMO/REMIC s backed by whole loans issued by private-label companies (non-government sponsored).

There were zero realized gains or losses for the first nine months of 2012, compared to an impairment loss of $546,000 for the same period in 2011.

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	September 30, 2012					
	Less than 12 months		12 months or longer		Total	
Description of Securities	Fair Value	Gross Unrealized Holding Losses	Fair Value	Gross Unrealized Holding Losses	Fair Value	Gross Unrealized Holding Losses
	(Dollars in thousands)					
Held-To-Maturity						
CMO	$ 2,122	$	$	$	$ 2,122	$
Available-for-Sale						
Government agency	$ 25,454	$ 64	$	$	$ 25,454	$ 64
Residential mortgage-backed securities	22				22	
CMO/REMICs Residential	155,051	1,325			155,051	1,325
Municipal bonds	11,347	124			11,347	124
Other Securities						
	$ 191,874	$ 1,513	$	$	$ 191,874	$ 1,513

	December 31, 2011					
	Less than 12 months		12 months or longer		Total	
Description of Securities	Fair Value	Gross Unrealized Holding Losses	Fair Value	Gross Unrealized Holding Losses	Fair Value	Gross Unrealized Holding Losses
	(Dollars in thousands)					
Held-To-Maturity						
CMO	$ 2,383	$	$	$	$ 2,383	$
Available-for-Sale						
Government agency	$	$	$	$	$	$
Residential mortgage-backed securities	75,754	334			75,754	334
CMO/REMICs Residential	133,471	665			133,471	665
Municipal bonds	22,184	203			22,184	203
Other Securities	2,500	4			2,500	4
	$ 233,909	$ 1,206	$	$	$ 233,909	$ 1,206

The tables above show the Company s investment securities gross unrealized losses and fair value by investment category and length of time that individual securities have been in a continuous unrealized loss position at September 30, 2012 and December 31, 2011. The Company has reviewed individual securities to determine whether a decline in fair value below the amortized cost basis is other-than-temporary.

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

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

As of September 30, 2012, the unrealized loss on this security was zero and the fair value on the security was 76% of the current par value. The security is rated non-investment grade. We evaluated the security for an other-than-temporary decline in fair value as of September 30, 2012. The key assumptions include default rates, loss severities and prepayment rates. This security was determined to be credit impaired during 2009 due to continued degradation in expected cash flows primarily due to higher loss forecasts. We determined the amount of the credit impairment by discounting the expected future cash flows of the underlying collateral. In 2009, we recognized an other-than-

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temporary impairment of $2.0 million reduced by $1.7 million for the non-credit portion which was reflected in other comprehensive income. The remaining loss of $323,000 was recognized in earnings for the year ended December 31, 2009. This Alt-A bond, with a book value of $2.1 million as of September 30, 2012, has had $1.9 million in net impairment losses to date. These losses have been recorded as a reduction to noninterest income.

There were no changes in credit related other-than temporary impairment recognized in earnings for the nine months ended September 30, 2012, compared to an other-than-temporary impairment loss of $546,000 recognized during the same period in 2011.

Government Agency & Government-Sponsored Enterprise The government agency bonds are backed by the full faith and credit of Agencies of the U.S. Government. As of September 30, 2012, approximately $12.1 million in U.S. government agency bonds are callable. These securities are bullet securities, that is, they have a defined maturity date on which the principal is paid. The contractual term of these investments provides that the Company will receive the face value of the bond at maturity which will equal the amortized cost of the bond. Interest is received throughout the life of the security.

Mortgage-Backed Securities and CMO/REMICs Almost all of the available-for-sale mortgage-backed and CMO/REMICs securities are issued by the government-sponsored enterprises such as Ginnie Mae, Fannie Mae and Freddie Mac. These securities are collateralized or backed by the underlying residential mortgages. All mortgage-backed securities are considered to be rated investment grade with a weighted average life of approximately 3.5 years. Of the total MBS/CMO, 99.81% have the implied guarantee of U.S. government-sponsored agencies. The remaining 0.19% are issued by banks. Accordingly, it is expected the securities would not be settled at a price less than the amortized cost of the bonds.

Municipal Bonds The majority of our municipal bonds are insured by the largest bond insurance companies with maturities of approximately 9.7 years. The Company seeks to diversify its holdings by owning selections of securities from different issuers and by holding securities from geographically diversified municipal issuers, thus reducing the Company s exposure to any single adverse event. Because we believe the decline in fair value is attributable to the changes in interest rates and not credit quality, and because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized costs, which may be at maturity, management does not consider these investments to be other than temporarily impaired at September 30, 2012.

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

At September 30, 2012 and December 31, 2011, investment securities having an amortized cost of approximately $2.00 billion and $1.85 billion, respectively, were pledged to secure public deposits, short and long-term borrowings, and for other purposes as required or permitted by law.

The amortized cost and fair value of debt securities at September 30, 2012, by contractual maturity, are shown below. Although mortgage-backed securities and CMO/REMICs have contractual maturities through 2041, expected maturities may differ from contractual maturities because borrowers may have the right to prepay such obligations without penalty. Mortgage-backed securities and CMO/REMICs are included in maturity categories based upon estimated prepayment speeds.

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	Available-for-sale		
	Amortized Cost	Fair Value	Weighted-Average Yield
	(Dollars in thousands)		
Due in one year or less	$ 107,507	$ 108,817	2.07%
Due after one year through five years	1,748,952	1,810,289	2.66%
Due after five years through ten years	290,605	308,207	3.14%
Due after ten years	26,882	30,194	3.69%
	$ 2,173,946	$ 2,257,507	2.71%

The investment in FHLB stock is periodically evaluated for impairment based on, among other things, the capital adequacy of the FHLB and its overall financial condition. No impairment losses have been recorded through September 30, 2012.

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

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

	As of September 30, 2012		
	Non-Covered Loans	Covered Loans	Total
	(Dollars in thousands)		
Commercial and Industrial	$ 525,801	$ 28,199	$ 554,000
Real Estate:			
Construction	70,740	1,745	72,485
Commercial Real Estate	2,012,119	194,220	2,206,339
SFR Mortgage	158,074	1,656	159,730
Consumer	46,769	7,379	54,148
Municipal lease finance receivables	109,005		109,005
Auto and equipment leases, net of unearned discount	13,302		13,302
Dairy and Livestock	288,437		288,437
Agribusiness	9,495	2,698	12,193
Gross loans	$ 3,233,742	$ 235,897	$ 3,469,639
Less:			
Purchase accounting discount		(28,590)	(28,590)
Deferred loan fees, net	(6,337)		(6,337)
Gross loans, net of deferred loan fees	$ 3,227,405	$ 207,307	$ 3,434,712
Less: Allowance for credit losses	(92,067)		(92,067)
Net loans and lease finance receivables	$ 3,135,338	$ 207,307	$ 3,342,645

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	As of December 31, 2011		
	Non-Covered Loans	Covered Loans	Total
	(Dollars in thousands)		
Commercial and Industrial	$ 494,299	$ 29,651	$ 523,950
Real Estate:			
Construction	76,146	18,685	94,831
Commercial Real Estate	1,948,292	223,107	2,171,399
SFR Mortgage	176,442	3,289	179,731
Consumer	51,436	8,353	59,789
Municipal lease finance receivables	113,460	169	113,629
Auto and equipment leases, net of unearned discount	17,370		17,370
Dairy and Livestock	343,350	199	343,549
Agribusiness	4,327	24,196	28,523
Gross loans	$ 3,225,122	$ 307,649	$ 3,532,771
Less:			
Purchase accounting discount		(50,780)	(50,780)
Deferred loan fees, net	(5,395)		(5,395)
Gross loans, net of deferred loan fees	$ 3,219,727	$ 256,869	$ 3,476,596
Less: Allowance for credit losses	(93,964)		(93,964)
Net loans and lease finance receivables	$ 3,125,763	$ 256,869	$ 3,382,632

As of September 30, 2012, 63.59% of the total loan portfolio consisted of commercial real estate loans and 2.09% of the total loan portfolio consisted of construction loans, respectively. Substantially all of the Company s real estate loans and construction loans are secured by real properties located in California. At September 30, 2012, the Company held approximately $1.54 billion of fixed rate loans.

At September 30, 2012 and December 31, 2011, loans totaling $2.37 billion and $2.31 billion, respectively, were pledged to secure the borrowings from the FHLB and the Federal Reserve Bank.

The following is the activity of loans held-for-sale for the periods indicated:

Non-Covered Loans Held for Sale Activity

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2012	2011	2012	2011
	(Dollars in thousands)			
Balance, beginning of period	$ 2,880	$ 7,341	$ 348	$ 2,954
Originations of mortage loans	5,853	17,031	22,035	33,512
Sales of mortgage loans	(4,150)	(11,258)	(17,800)	(27,279)
Transfer of mortgage loans to held for investment	(3,587)	(2,875)	(3,587)	(3,292)
Sales of other loans		(6,000)		(6,000)
Transfers of other loans to held for sale				6,000
Write-down of loans held for sale				(1,656)
Balance, end of period	**$ 996**	**$ 4,239**	**$ 2,880**	**$ 4,239**

Covered Loans Held for Sale Activity

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2012	2011	2012	2011
	(Dollars in thousands)			
Balance, beginning of period	$	$	$ 5,664	$
Originations of mortage loans				
Sales of mortgage loans				
Transfer of other loans to held for investment				
Sales of other loans			(3,745)	
Transfers of other loans to held for sale		5,726		5,726
Write-down of loans held for sale			(1,219)	
Payment on other loans			(700)	
Balance, end of period	$	$ 5,726	$	$ 5,726

Occasionally, the Company may decide to retain and not sell certain mortgage loans originated and will transfer them to its held-for-investment loan portfolio. This is generally done for customer service purposes.

Credit Quality Indicators

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

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

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

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

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

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

Doubtful Loans classified doubtful have all the weaknesses inherent in those classified substandard with the added provision that the weaknesses make collection or the liquidation, on the basis of currently existing facts, conditions and values, highly questionable and improbable. The possibility of loss is extremely high, but because of certain important and reasonable specific pending factors which may work to the advantage and strengthening of the assets, their classifications as losses are deferred until their more exact status may be determined.

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

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The following table summarizes our internal risk grouping by loan class as of September 30, 2012 and December 31, 2011:

Credit Quality Indicators

As of September 30, 2012 and December 31, 2011

(Dollars in thousands)

Credit Risk Profile by Internally Assigned Grade

	September 30, 2012					
	Pass	Watch List	Special Mention	Substandard	Doubtful & Loss	Total
Commercial & Industrial	$ 347,463	$ 110,144	$ 46,246	$ 21,068	$ 880	$ 525,801
Construction Speculative	1,855		19,522	28,575		49,952
Construction Non-Speculative	6,408	5,161		9,219		20,788
Commercial Real Estate Owner-Occupied	442,706	117,652	67,178	82,421		709,957
Commercial Real Estate Non-Owner-Occupied	842,031	253,749	124,668	81,714		1,302,162
Residential Real Estate (SFR 1-4)	133,325	6,512	4,148	14,089		158,074
Dairy & Livestock	51,476	98,531	78,074	60,185	171	288,437
Agribusiness	5,262	3,168	1,065			9,495
Municipal Lease Finance Receivables	74,163	21,473	11,147	2,222		109,005
Consumer	39,701	3,484	2,054	1,530		46,769
Auto & Equipment Leases	9,517	3,190	143	452		13,302
Total Non-covered Loans	1,953,907	623,064	354,245	301,475	1,051	3,233,742
Covered Loans	90,469	68,672	38,944	37,812		235,897
Total Loans excluding held-for-sale	2,044,376	691,736	393,189	339,287	1,051	3,469,639
Non-covered loans held-for-sale	996					996
Covered loans held-for-sale						
Total Gross Loans	$ 2,045,372	$ 691,736	$ 393,189	$ 339,287	$ 1,051	$ 3,470,635

	December 31, 2011					
	Pass	Watch List	Special Mention	Substandard	Doubtful & Loss	Total
Commercial & Industrial	$ 323,653	$ 94,059	$ 55,140	$ 21,447	$	$ 494,299
Construction Speculative	2,654		25,610	35,191		63,455
Construction Non-Speculative	1,314	137	687	10,553		12,691
Commercial Real Estate Owner-Occupied	370,801	176,958	74,315	77,884		699,958
Commercial Real Estate Non-Owner-Occupied	836,465	193,751	108,798	108,482	838	1,248,334
Residential Real Estate (SFR 1-4)	143,841	8,336	6,807	17,458		176,442
Dairy & Livestock	73,074	106,024	91,416	72,619	217	343,350
Agribusiness	2,800	860	667			4,327
Municipal Lease Finance Receivables	70,781	23,106	8,927	10,646		113,460
Consumer	42,295	3,474	3,906	1,740	21	51,436
Auto & Equipment Leases	11,742	39	3,506	522	1,561	17,370
Total Non-covered Loans	1,879,420	606,744	379,779	356,542	2,637	3,225,122
Covered Loans	48,440	73,718	20,728	164,198	565	307,649
Total Loans excluding held-for-sale	1,927,860	680,462	400,507	520,740	3,202	3,532,771

Non-covered loans held-for-sale	348					348
Covered loans held-for-sale				5,664		5,664
Total Gross Loans	$ 1,928,208	$ 680,462	$ 400,507	$ 526,404	$ 3,202	$ 3,538,783

Allowance for Credit Losses

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

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

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

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

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

The methodology is consistently applied across all the portfolio segments taking into account the applicable historical loss rates and the qualitative factors applicable to each pool of loans. Periodically, we assess various attributes utilized in adjusting our historical loss factors to reflect current economic conditions. During the nine months ended September 30, 2012, many of our dairy and livestock borrowers experienced an increase in feed costs, a decrease in milk prices, and tightened profit margins. As part of our qualitative analysis during the nine months ended September 30, 2012, we adjusted the attributes used in the allowance for credit losses to account for challenges evident in the current economic environment of the dairy and livestock industry.

Management believes that the ALLL was adequate at September 30, 2012. No assurance can be given that economic conditions which adversely affect our service areas or other circumstances will not be reflected in increased provisions for credit losses in the future.

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The following table presents the balance and activity in the allowance for credit losses; and the recorded investment in held-for-investment loans by portfolio segment and based upon our impairment method as of September 30, 2012 and 2011:

Allowance for Credit Losses and Recorded Investment in Financing Receivables

(Dollars in thousands)

	Commercial and Industrial	Construction	Real Estate	Municipal Lease Finance Receivables	Dairy and Livestock	Consumer, Auto & Other	Covered Loans (1)	Unallocated	Total
Three and Nine Months Ended September 30, 2012									
Allowance for Credit Losses:									
Beginning balance, July 1, 2012	$ 12,332	$ 3,029	$ 48,358	$ 1,656	$ 16,867	$ 1,510	$	$ 8,140	$ 91,892
Charge-offs	(294)		(526)			(66)			(886)
Recoveries	106	77	138		9	3	728		1,061
Provision/Reallocation of ALLL	(13)	265	86	(110)	2,860	(51)	(728)	(2,309)	
Ending balance, September 30, 2012	$ 12,131	$ 3,371	$ 48,056	$ 1,546	$ 19,736	$ 1,396	$	$ 5,831	$ 92,067
Beginning balance, January 1, 2012	$ 10,654	$ 4,947	$ 51,873	$ 2,403	$ 17,230	$ 1,638	$	$ 5,219	$ 93,964
Charge-offs	(977)		(2,482)		(1,150)	(154)	(81)		(4,844)
Recoveries	694	1,129	373		11	12	728		2,947
Provision/Reallocation of ALLL	1,760	(2,705)	(1,708)	(857)	3,645	(100)	(647)	612	
Ending balance, September 30, 2012	$ 12,131	$ 3,371	$ 48,056	$ 1,546	$ 19,736	$ 1,396	$	$ 5,831	$ 92,067
Ending balance: Individually evaluated for impairment	$ 481	$	$ 373	$	$ 1,043	$ 113	$	$	$ 2,010
Ending balance: Collectively evaluated for impairment	$ 11,650	$ 3,371	$ 47,683	$ 1,546	$ 18,693	$ 1,283	$	$ 5,831	$ 90,057
Loans and financing receivables: (2)									
Ending balance, September 30, 2012	$ 525,801	$ 70,740	$ 2,170,193	$ 109,005	$ 288,437	$ 69,566	$ 207,307	$	$ 3,441,049
Ending balance: Individually evaluated for impairment	$ 6,976	$ 37,794	$ 49,233	$ 472	$ 22,762	$ 364	$	$	$ 117,601
	$ 518,825	$ 32,946	$ 2,120,960	$ 108,533	$ 265,675	$ 69,202	$	$	$ 3,116,141

Ending balance: Collectively evaluated for impairment									
Ending balance: Acquired loans, net of discount, with deteriorated credit quality	$	$	$	$	$	$	$ 207,307	$	$ 207,307

	Commercial and Industrial	Construction	Real Estate	Municipal Lease Finance Receivables	Dairy and Livestock	Consumer, Auto & Other	Covered Loans (1)	Unallocated	Total
<u>Three and Nine Months Ended September 30, 2011</u>									
Allowance for Credit Losses:									
Beginning balance, July 1, 2011	$ 11,286	$ 4,338	$ 45,265	$ 2,618	$ 23,511	$ 1,608	$	$ 8,269	$ 96,895
Charge-offs	(392)	(559)	(562)			(187)	(256)		(1,956)
Recoveries	73	343	148			23	2		589
Provision/Reallocation of ALLL	(116)	(88)	5,470	(89)	(5,045)	144	254	(530)	
Ending balance, September 30, 2011	$ 10,851	$ 4,034	$ 50,321	$ 2,529	$ 18,466	$ 1,588	$	$ 7,739	$ 95,528
Beginning balance, January 1, 2011	$ 11,472	$ 10,188	$ 43,529	$ 2,172	$ 36,061	$ 1,034	$	$ 803	$ 105,259
Charge-offs	(1,275)	(7,976)	(4,945)		(3,291)	(439)	(674)		(18,600)
Recoveries	244	746	582		39	183	7		1,801
Provision/Reallocation of ALLL	410	1,076	11,155	357	(14,343)	810	667	6,936	7,068
Ending balance, September 30, 2011	$ 10,851	$ 4,034	$ 50,321	$ 2,529	$ 18,466	$ 1,588	$	$ 7,739	$ 95,528
Ending balance: Individually evaluated for impairment	$ 415	$	$ 1,275	$	$ 1,372	$ 34	$		