CITY NATIONAL CORP
Form 10-Q
August 09, 2011
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# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**WASHINGTON, D.C. 20549**

# FORM 10-Q

**(Mark One)**

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

**For the quarterly period ended June 30, 2011**

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

**FOR THE TRANSITION PERIOD FROM TO**

**COMMISSION FILE NUMBER: 1-10521**

# CITY NATIONAL CORPORATION

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

| | |
|---|---|
| **Delaware** | **95-2568550** |
| (State of Incorporation) | (I.R.S. Employer Identification No.) |

**City National Plaza**

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

(Address of principal executive offices)(Zip Code)

**(213) 673-7700**

(Registrant s telephone number, including area code)

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

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

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 o

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 x | Accelerated filer o |
| Non-accelerated filer o | Smaller reporting company o |
| (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). o Yes x No

As of July 29, 2011, there were 53,195,181 shares of Common Stock outstanding (including unvested restricted shares).

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**PART I - FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS**

**CITY NATIONAL CORPORATION**

**CONSOLIDATED BALANCE SHEETS**

| (in thousands, except share amounts) | June 30, 2011 (Unaudited) | December 31, 2010 | June 30, 2010 (Unaudited) |
|---|---|---|---|
| **Assets** | | | |
| Cash and due from banks | $ 181,203 | $ 126,882 | $ 184,277 |
| Due from banks - interest-bearing | 725,304 | 142,807 | 336,244 |
| Federal funds sold | 123,000 | 165,000 | 404,760 |
| Securities available-for-sale - cost $6,250,759, $5,658,120, and $4,668,089 at June 30, 2011, December 31, 2010 and June 30, 2010, respectively: | | | |
| Securities pledged as collateral | | | 198,577 |
| Held in portfolio | 6,348,055 | 5,720,675 | 4,562,566 |
| Trading securities | 125,829 | 255,397 | 129,287 |
| Loans and leases, excluding covered loans | 11,663,123 | 11,386,628 | 11,483,044 |
| Less: Allowance for loan and lease losses | 265,933 | 257,007 | 290,492 |
| Loans and leases, excluding covered loans, net | 11,397,190 | 11,129,621 | 11,192,552 |
| Covered loans, net of allowance for loan losses | 1,657,004 | 1,790,133 | 2,034,591 |
| Net loans and leases | 13,054,194 | 12,919,754 | 13,227,143 |
| Premises and equipment, net | 134,511 | 128,426 | 121,960 |
| Deferred tax asset | 88,179 | 105,398 | 99,894 |
| Goodwill | 486,383 | 486,070 | 479,982 |
| Customer-relationship intangibles, net | 39,824 | 42,564 | 44,838 |
| Affordable housing investments | 113,486 | 99,670 | 101,999 |
| Customers acceptance liability | 1,737 | 1,715 | 2,515 |
| Other real estate owned ($114,907, $120,866 and $98,841 covered by FDIC loss share at June 30, 2011, December 31, 2010 and June 30, 2010, respectively) | 162,541 | 178,183 | 153,292 |
| FDIC indemnification asset | 261,734 | 295,466 | 394,012 |
| Other assets | 680,109 | 685,111 | 790,101 |
| Total assets | $ 22,526,089 | $ 21,353,118 | $ 21,231,447 |
| **Liabilities** | | | |
| Demand deposits | $ 9,403,425 | $ 8,457,178 | $ 8,173,386 |
| Interest checking deposits | 1,689,494 | 1,863,004 | 2,171,369 |
| Money market deposits | 6,720,604 | 6,344,749 | 5,742,069 |
| Savings deposits | 332,020 | 291,299 | 294,327 |
| Time deposits-under $100,000 | 293,573 | 338,112 | 434,626 |
| Time deposits-$100,000 and over | 826,004 | 882,520 | 1,157,136 |
| Total deposits | 19,265,120 | 18,176,862 | 17,972,913 |
| Short-term borrowings | 149,771 | 153,444 | 3,400 |
| Long-term debt | 701,829 | 704,971 | 985,974 |
| Reserve for off-balance sheet credit commitments. | 23,325 | 21,529 | 19,310 |
| Acceptances outstanding | 1,737 | 1,715 | 2,515 |
| Other liabilities | 256,560 | 264,203 | 272,753 |

| | | | |
|---|---|---|---|
| Total liabilities | 20,398,342 | 19,322,724 | 19,256,865 |
| **Redeemable noncontrolling interest** | 43,737 | 45,676 | 47,622 |
| **Commitments and contingencies** | | | |
| **Equity** | | | |
| Common stock, par value $1.00 per share; 75,000,000 shares authorized; 53,885,886 shares issued at June 30, 2011, December 31, 2010 and June 30, 2010 | 53,886 | 53,886 | 53,886 |
| Additional paid-in capital | 485,064 | 487,868 | 483,983 |
| Accumulated other comprehensive income | 56,293 | 36,853 | 58,050 |
| Retained earnings | 1,547,989 | 1,482,037 | 1,418,486 |
| Treasury shares, at cost - 1,410,483, 1,639,203 and 1,796,485 shares at June 30, 2011, December 31, 2010 and June 30, 2010, respectively | (84,311) | (101,065) | (112,634) |
| Total shareholders equity | 2,058,921 | 1,959,579 | 1,901,771 |
| Noncontrolling interest | 25,089 | 25,139 | 25,189 |
| Total equity | 2,084,010 | 1,984,718 | 1,926,960 |
| Total liabilities and equity | $ 22,526,089 | $ 21,353,118 | $ 21,231,447 |

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 June 30, 2011 | For the three months ended June 30, 2010 | For the six months ended June 30, 2011 | For the six months ended June 30, 2010 |
|---|---|---|---|---|
| **Interest Income** | | | | |
| Loans and leases | $ 169,992 | $ 174,354 | $ 332,931 | $ 343,904 |
| Securities available-for-sale | 39,406 | 32,866 | 76,739 | 65,066 |
| Trading securities | 233 | 24 | 319 | (28) |
| Due from banks - interest-bearing | 407 | 424 | 705 | 770 |
| Federal funds sold and securities purchased under resale agreements | 98 | 135 | 252 | 157 |
| Total interest income | 210,136 | 207,803 | 410,946 | 409,869 |
| **Interest Expense** | | | | |
| Deposits | 10,016 | 12,584 | 20,206 | 25,748 |
| Federal funds purchased and securities sold under repurchase agreements | 2 | 1,704 | 2 | 3,639 |
| Subordinated debt | 4,635 | 4,664 | 9,283 | 9,304 |
| Other long-term debt | 4,655 | 6,845 | 9,337 | 13,666 |
| Other short-term borrowings | 1 | 8 | 1 | 9 |
| Total interest expense | 19,309 | 25,805 | 38,829 | 52,366 |
| **Net interest income** | 190,827 | 181,998 | 372,117 | 357,503 |
| Provision for credit losses on loans and leases, excluding covered loans | | 32,000 | | 87,000 |
| Provision for losses on covered loans | 1,716 | 46,516 | 20,832 | 46,516 |
| Net interest income after provision | 189,111 | 103,482 | 351,285 | 223,987 |
| **Noninterest Income** | | | | |
| Trust and investment fees | 36,687 | 33,976 | 72,325 | 67,485 |
| Brokerage and mutual fund fees | 4,864 | 5,461 | 10,525 | 10,742 |
| Cash management and deposit transaction charges | 10,905 | 12,008 | 22,630 | 24,584 |
| International services | 9,015 | 8,374 | 17,331 | 14,882 |
| FDIC loss sharing (expense) income, net | (10,684) | 28,339 | (2,079) | 37,425 |
| Gain (loss) on disposal of assets | 8,422 | (2,814) | 10,846 | (1,423) |
| Gain on sale of securities | 1,689 | 355 | 1,819 | 2,489 |
| Gain on acquisition | 8,164 | 25,228 | 8,164 | 25,228 |
| Other | 23,169 | 12,215 | 44,727 | 19,606 |
| Impairment loss on securities: | | | | |
| Total other-than-temporary impairment loss on securities | (4,132) | (13,992) | (4,296) | (14,995) |
| Less: Portion of loss recognized in other comprehensive income | 3,838 | 13,486 | 3,838 | 13,486 |
| Net impairment loss recognized in earnings | (294) | (506) | (458) | (1,509) |
| Total noninterest income | 91,937 | 122,636 | 185,830 | 199,509 |
| **Noninterest Expense** | | | | |
| Salaries and employee benefits | 112,139 | 99,110 | 223,151 | 194,569 |
| Net occupancy of premises | 13,665 | 13,347 | 27,011 | 26,252 |
| Legal and professional fees | 14,790 | 13,754 | 24,867 | 22,937 |
| Information services | 8,335 | 7,538 | 15,832 | 15,054 |
| Depreciation and amortization | 6,904 | 6,363 | 13,652 | 12,710 |
| Amortization of intangibles | 2,104 | 2,128 | 4,272 | 4,575 |

| | | | | |
|---|---|---|---|---|
| Marketing and advertising | 7,626 | 5,798 | 14,144 | 11,046 |
| Office services and equipment | 4,672 | 4,272 | 9,278 | 8,070 |
| Other real estate owned | 22,162 | 16,892 | 36,651 | 34,089 |
| FDIC assessments | 8,524 | 7,662 | 18,330 | 14,183 |
| Other operating | 10,911 | 9,823 | 22,041 | 19,136 |
| Total noninterest expense | 211,832 | 186,687 | 409,229 | 362,621 |
| Income before income taxes | 69,216 | 39,431 | 127,886 | 60,875 |
| Income taxes | 20,650 | (2,859) | 38,536 | 1,559 |
| **Net income** | $ 48,566 | $ 42,290 | $ 89,350 | $ 59,316 |
| Less: Net income attributable to noncontrolling interest | 1,095 | 972 | 2,187 | 2,300 |
| **Net income attributable to City National Corporation** | $ 47,471 | $ 41,318 | $ 87,163 | $ 57,016 |
| Less: Dividends and accretion on preferred stock | | | | 5,702 |
| **Net income available to common shareholders** | $ 47,471 | $ 41,318 | $ 87,163 | $ 51,314 |
| Net income per share, basic | $ 0.89 | $ 0.78 | $ 1.64 | $ 0.98 |
| Net income per share, diluted | $ 0.88 | $ 0.78 | $ 1.62 | $ 0.97 |
| Shares used to compute net income per share, basic | 52,462 | 52,012 | 52,392 | 51,852 |
| Shares used to compute net income per share, diluted | 52,977 | 52,542 | 52,931 | 52,336 |
| Dividends per share | $ 0.20 | $ 0.10 | $ 0.40 | $ 0.20 |

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 June 30, 2011** | **2010** |
|---|---|---|
| **Cash Flows From Operating Activities** | | |
| Net income | $ 89,350 | $ 59,316 |
| Adjustments to net income: | | |
| Provision for credit losses on loans and leases, excluding covered loans | | 87,000 |
| Provision for losses on covered loans | 20,832 | 46,516 |
| Amortization of intangibles | 4,272 | 4,575 |
| Depreciation and amortization | 13,652 | 12,710 |
| Share-based employee compensation expense | 9,468 | 8,109 |
| Deferred income tax benefit | 2,686 | 17,813 |
| (Gain) loss on disposal of assets | (10,846) | 1,423 |
| Gain on sale of securities | (1,819) | (2,489) |
| Gain on acquisition | (8,164) | (25,228) |
| Impairment loss on securities | 458 | 1,509 |
| Other, net | (9,418) | (15,184) |
| Net change in: | | |
| Trading securities | 129,818 | 25,015 |
| Other assets and other liabilities, net | 51,709 | 154,439 |
| Net cash provided by operating activities | 291,998 | 375,524 |
| **Cash Flows From Investing Activities** | | |
| Purchase of securities available-for-sale | (2,017,983) | (1,684,200) |
| Sales of securities available-for-sale | 53,304 | 432,021 |
| Maturities and paydowns of securities available-for-sale | 1,367,512 | 907,157 |
| Loan originations, net of principal collections | (108,530) | 629,454 |
| Net payments for premises and equipment | (19,637) | (10,361) |
| Net cash acquired in acquisitions | 28,066 | 94,706 |
| Other investing activities, net | 59,628 | 10,235 |
| Net cash (used in) provided by investing activities | (637,640) | 379,012 |
| **Cash Flows From Financing Activities** | | |
| Net increase in deposits | 961,463 | 51,966 |
| Net decrease in federal funds purchased and securities sold under repurchase agreements | | (449,079) |
| Net decrease in short-term borrowings, net of transfers from long-term debt | (3,105) | (30,529) |
| Net decrease in long-term debt | (757) | (353) |
| Proceeds from exercise of stock options | 4,507 | 17,761 |
| Tax benefit from exercise of stock options | 992 | 3,281 |
| Redemption of preferred stock | | (200,000) |
| Repurchase of common stock warrants | | (18,500) |
| Cash dividends paid | (21,211) | (13,467) |
| Other financing activities, net | (1,429) | (3,261) |
| Net cash provided by (used in) financing activities | 940,460 | (642,181) |
| Net increase in cash and cash equivalents | 594,818 | 112,355 |
| Cash and cash equivalents at beginning of year | 434,689 | 812,926 |
| Cash and cash equivalents at end of period | $ 1,029,507 | $ 925,281 |
| **Supplemental Disclosures of Cash Flow Information:** | | |
| Cash paid during the period for: | | |
| Interest | $ 40,129 | $ 39,413 |

| | | | | |
|---|---|---|---|---|
| Income taxes | | 26,072 | | |
| Non-cash investing activities: | | | | |
| Transfer of loans to other real estate owned | $ | 64,191 | $ | 66,653 |
| Assets acquired (liabilities assumed) in acquisitions: | | | | |
| Securities available-for-sale | $ | 10,441 | $ | 17,183 |
| Covered loans | | 55,313 | | 330,566 |
| Covered other real estate owned | | 7,463 | | 15,161 |
| Deposits | | (126,795) | | (541,499) |
| Other borrowings | | (3,165) | | (30,539) |

See accompanying Notes to the Unaudited Consolidated Financial Statements.

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**CITY NATIONAL CORPORATION**

**CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY**

**AND COMPREHENSIVE INCOME**

**(Unaudited)**

| | City National Corporation Shareholders Equity | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| **(in thousands, except share amounts)** | **Common shares issued** | **Preferred stock** | **Common stock** | **Additional paid-in capital** | **Accumulated other comprehensive income (loss)** | **Retained earnings** | **Treasury shares** | **Non-controlling interest** | **Total equity** |
| Balance, January 1, 2010 | 53,885,886 | $ 196,048 | $ 53,886 | $ 513,550 | $ (3,049) | $ 1,377,639 | $ (151,751) | $ 26,441 | $ 2,012,764 |
| Comprehensive income: | | | | | | | | | |
| Net income (1) | | | | | | 57,016 | | 1,070 | 58,086 |
| Other comprehensive income, net of tax (2) | | | | | 61,099 | | | | 61,099 |
| Total comprehensive income | | | | | | | | 1,070 | 119,185 |
| Dividends and distributions to noncontrolling interest | | | | | | | | (1,070) | (1,070) |
| Issuance of shares under share-based compensation plans | | | | (22,687) | | | 39,109 | | 16,422 |
| Preferred stock accretion | | 3,952 | | | | (3,952) | | | |
| Redemption of preferred stock | | (200,000) | | | | | | | (200,000) |
| Repurchase of common stock warrants | | | | (18,500) | | | | | (18,500) |
| Share-based employee compensation expense | | | | 8,090 | | | | | 8,090 |
| Tax benefit from share-based compensation plans | | | | 2,181 | | | | | 2,181 |
| Cash dividends: | | | | | | | | | |
| Preferred | | | | | | (1,750) | | | (1,750) |
| Common | | | | | | (10,467) | | | (10,467) |
| Net change in deferred compensation plans | | | | 425 | | | 8 | | 433 |
| Change in redeemable noncontrolling interest | | | | 924 | | | | | 924 |
| Other | | | | | | | | (1,252) | (1,252) |
| Balance, June 30, 2010 | 53,885,886 | $ | $ 53,886 | $ 483,983 | $ 58,050 | $ 1,418,486 | $ (112,634) | $ 25,189 | $ 1,926,960 |
| | | | | | | | | | |
| Balance, January 1, 2011 | 53,885,886 | $ | $ 53,886 | $ 487,868 | $ 36,853 | $ 1,482,037 | $ (101,065) | $ 25,139 | $ 1,984,718 |
| Comprehensive income: | | | | | | | | | |
| Net income (1) | | | | | | 87,163 | | 1,067 | 88,230 |
| Other comprehensive income, net of tax (2) | | | | | 19,440 | | | | 19,440 |
| Total comprehensive income | | | | | | | | 1,067 | 107,670 |
| Dividends and distributions to noncontrolling interest | | | | | | | | (1,067) | (1,067) |
| Issuance of shares under share-based compensation plans | | | | (14,229) | | | 16,754 | | 2,525 |
| Share-based employee compensation expense | | | | 9,363 | | | | | 9,363 |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Tax benefit from share-based compensation plans | | | | 1,037 | | | | | 1,037 |
| Cash dividends: | | | | | | | | | |
| Common | | | | | | (21,211) | | | (21,211) |
| Net change in deferred compensation plans | | | | 600 | | | | | 600 |
| Change in redeemable noncontrolling interest | | | | 349 | | | | | 349 |
| Other | | | | 76 | | | | (50) | 26 |
| Balance, June 30, 2011 | 53,885,886 | $ | $ 53,886 | $ 485,064 | $ 56,293 | $ 1,547,989 | $ (84,311) | $ 25,089 | $ 2,084,010 |

(1) Net income excludes net income attributable to redeemable noncontrolling interest of $1,120 and $1,230 for the six-month periods ended June 30, 2011 and 2010, respectively. Redeemable noncontrolling interest is reflected in the mezzanine section of the consolidated balance sheets. See Note 17 of the Notes to the Unaudited Consolidated Financial Statements.

(2) See Note 9 for additional information on other comprehensive income.

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 79 offices in Southern California, the San Francisco Bay area, Nevada, New York City and Nashville, Tennessee. As of June 30, 2011, the Corporation had five consolidated investment advisory affiliates and a noncontrolling interest in two other firms. The Corporation also had 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. The Company has both redeemable and non-redeemable noncontrolling interest. A noncontrolling interest is the portion of equity in a subsidiary not attributable to a parent. Preferred stock of consolidated bank affiliates that is owned by third parties is reflected as Noncontrolling interest in the equity section of the consolidated balance sheets. Redeemable noncontrolling interest includes noncontrolling ownership interests that are redeemable at the option of the holder or outside the control of the issuer. The redeemable equity ownership interests of third parties in the Corporation s investment advisory affiliates are not considered to be permanent equity and are reflected as Redeemable noncontrolling interest in the mezzanine section between liabilities and equity in the consolidated balance sheets. Noncontrolling interests share of subsidiary earnings is reflected as Net income attributable to noncontrolling interest in the consolidated statements of income.

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

*Use of Estimates*

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

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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, 2010.

The results for the 2011 interim period are not necessarily indicative of the results expected for the full year. The Company has not made any significant changes in its critical accounting policies or in its estimates and assumptions from those disclosed in its 2010 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, 2011. Refer to *Accounting Pronouncements* for discussion of accounting pronouncements adopted in 2011.

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

*Accounting Pronouncements*

During the six months ended June 30, 2011, the following accounting pronouncements applicable to the Company were issued or became effective:

• In January 2010, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) 2010-06, *Fair Value Measurements (Topic 820), Improving Disclosures about Fair Value Measurements* ( ASU 2010-06 ). ASU 2010-06 enhances disclosure requirements under Accounting Standards Codification ( ASC ) Topic 820, *Fair Value Measurements and Disclosures* ( ASC 820 ), to include disclosure of transfers in and out of Level 1 and 2, and detail of activity in Level 3 fair value measurements. The ASU also provides clarification of existing disclosure requirements pertaining to the level of disaggregation used in fair value measurements, and disclosures about inputs and valuation techniques used for both recurring and nonrecurring fair value measurements. The new guidance, except for the requirement to provide the Level 3 activity on a gross basis, was adopted by the Company on January 1, 2010. The expanded disclosure requirements pertaining to Level 3 activity became effective for the Company on January 1, 2011. Adoption of the new guidance did not have a material effect on the Company s consolidated financial statements.

• In April 2011, the FASB issued ASU 2011-02, *Receivables (Topic 310): A Creditor s Determination of Whether a Restructuring is a Troubled Debt Restructurings* ( ASU 2011-02 ). In evaluating whether a restructuring constitutes a troubled debt restructuring ( TDR ), a creditor ( lender ) must separately conclude that both of the following exist: (1) the restructuring constitutes a concession and (2) the debtor ( borrower ) is experiencing financial difficulties. Determining whether a modification is a TDR requires significant judgment. ASU 2011-02 clarifies the guidance on whether a lender has granted a concession, and on the lender s evaluation of whether a borrower is experiencing financial difficulties. ASU 2011-02 is effective for interim and annual periods beginning on or after June 15, 2011, and applies retrospectively to restructurings occurring on or after the beginning of the annual period of adoption. Thus, an entity will be required to apply the guidance to determine whether modifications that were not previously considered TDRs and that have occurred since the beginning of the year would now be considered TDRs. Adoption of the new guidance is not expected to have a significant effect on the Company s financial statements.

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

• In April 2011, the FASB issued ASU 2011-03, *Transfers and Servicing (Topic 860): Reconsideration of Effective Control for Repurchase Agreements* ( ASU 2011-03 ). ASC 860, *Transfers and Servicing*, provides the criteria for determining whether a transfer of financial assets is accounted for as a secured borrowing or as a sale. Under the guidance, an entity that maintains effective control over transferred assets must account for the transfer as a secured borrowing. ASU 2011-03 eliminates the requirement for entities to consider whether a transferor has the ability to repurchase the financial assets in a repurchase agreement for purposes of determining whether the transferor has maintained effective control. The ASU does not change the other criteria applicable to the assessment of effective control. ASU 2011-03 is effective for transactions, or modification of existing transactions, that occur on or after the first interim or annual period beginning on or after December 15, 2011. The new guidance is not expected to have a material effect on the Company s consolidated financial statements.

• In May 2011, the FASB issued ASU 2011-04, *Fair Value Measurements (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs* ( ASU 2011-04 ). ASU 2011-04 represents the converged guidance of the FASB and International Accounting Standards Board on fair value. The new guidance establishes a common framework for measuring fair value and for disclosing information about fair value measurements. While ASU 2011-04 is largely consistent with existing fair value measurement principles, it does expand disclosure requirements and amends certain guidance. ASU 2011-04 clarifies existing guidance pertaining to the applicability of the concepts of highest and best use and valuation premise in a fair value measurement, and on measuring the fair value of an instrument classified in shareholders equity. The ASU provides a framework for considering whether a premium or discount can be applied in a fair value measurement, and provides additional guidance on the application of fair value measurements to financial assets and liabilities with offsetting positions in market risk or counterparty credit risks. The expanded disclosure requirements include more detailed disclosures about the valuation processes used in fair value measurements within Level 3 of the fair value hierarchy, and categorization by level of the fair value hierarchy for items that are not measured at fair value in the statement of financial position but for which fair value is required to be disclosed in accordance with ASC Topic 825, *Financial Instruments*. The ASU is effective for interim and annual periods beginning after December 15, 2011. Adoption of ASU 2011-04, when effective, will result in expanded fair value disclosures in the Company s consolidated financial statements.

• In June 2011, the FASB issued ASU 2011-05, *Comprehensive Income (Topic 220), Presentation of Comprehensive Income* ( ASU 2011-05 ). ASU 2011-05 revises the manner in which entities present comprehensive income in their financial statements. The new guidance requires entities to report components of comprehensive income in either (1) a continuous statement of comprehensive income or (2) two separate but consecutive statements. Under the two-statement approach, the first statement would include components of net income, which is consistent with the income statement format used today, and the second statement would include components of other comprehensive income ( OCI ). Under either method, entities must display adjustments for items that are reclassified from OCI to net income in both net income and OCI. The ASU does not change the items that must be reported in OCI. ASU 2011-05 is effective for interim and annual periods beginning after December 15, 2011. After adoption, the guidance must be applied retrospectively for all periods presented in the financial statements. The new guidance is not expected to have a material effect on the Company s consolidated financial statements.

**Note 2. Business Combinations**

*Nevada Commerce Bank*

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

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**Note 2. Business Combinations (Continued)**

The Bank did not immediately acquire banking facilities, furniture or equipment as part of the purchase and assumption agreement, but had a 90 day option to purchase any or all owned bank premises including furniture, fixtures and equipment and to assume any or all leases for leased bank premises from the FDIC.

In connection with the acquisition of NCB, the Bank entered into loss-sharing agreements with the FDIC under which the FDIC will reimburse the Bank for 80 percent of eligible losses with respect to covered assets. Covered assets include acquired loans ( covered loans ) and OREO ( covered OREO ) that are covered under loss-sharing agreements with the FDIC. The term of the loss-sharing agreements is 10 years for single-family residential loans and eight years for all other loans. The expected reimbursements under the loss-sharing agreements were recorded as an indemnification asset at their estimated fair value of $33.8 million. The difference between the fair value of the FDIC indemnification asset and the undiscounted cash flow the Bank expects to collect from the FDIC is accreted into noninterest income.

The Bank recognized a gain of $8.2 million on the acquisition of NCB. The gain represents the amount by which the fair value of the assets acquired and consideration received from the FDIC exceeds the liabilities assumed. The gain is reported in Gain on acquisition in the consolidated statements of income. The Bank recognized approximately $0.3 million of acquisition-related expense. This expense is included in Legal and professional fees in the consolidated statements of income.

The consolidated statement of income for 2011 includes the operating results produced by the acquired assets and assumed liabilities of NCB from its acquisition date through June 30, 2011, which are not material to total operating results for the three and six month periods ended June 30, 2011. Due primarily to the Bank acquiring certain assets and liabilities of NCB which are not material to the Company s consolidated balance sheet, the significant amount of fair value adjustments, and the FDIC loss-sharing agreements, the historical results of the acquired bank is not material to the Company s results, and consequently, no pro forma information is presented.

*San Jose, California Branch*

On February 11, 2011, the Company purchased a branch banking office in San Jose, California from another financial institution. The Company acquired approximately $8.4 million in deposits. The Company recorded $0.3 million of goodwill and a core deposit intangible of $0.1 million with its acquisition of the branch.

*Datafaction, Inc.*

On November 15, 2010, the Corporation acquired Datafaction Inc. ( Datafaction ), a provider of accounting and imaging software for business managers and professional services firms, in an all-cash transaction. Datafaction s product and service offerings are expected to complement the cash management solutions available to the Company s business clients. The Company recognized goodwill of approximately $6.2 million and a customer contract intangible of approximately $2.2 million related to the acquisition.

*Sun West Bank and 1st Pacific Bank of California*

On May 28, 2010, the Bank acquired the banking operations of Sun West Bank ( SWB ) in Las Vegas, Nevada in a purchase and assumption agreement with the FDIC. Excluding the effects of acquisition accounting adjustments, the Bank acquired approximately $340.0 million in assets and assumed $310.1 million in liabilities. The Bank acquired most of SWB s assets, including loans and OREO with a fair value of $127.6 million and $12.1 million, respectively, and assumed deposits with a fair value of $304.3 million. The Bank received approximately $29.2 million in cash from the FDIC at acquisition and recognized a gain of $24.7 million on the acquisition of SWB in the second quarter of 2010.

On May 7, 2010, the Bank acquired the banking operations of 1st Pacific Bank of California ( FPB ) in a purchase and assumption agreement with the FDIC. Excluding the effects of acquisition accounting adjustments, the Bank acquired approximately $318.6 million in assets and assumed $264.2 million in liabilities. The Bank acquired most of FPB s assets, including loans with a fair value of $202.8 million and assumed deposits with a fair value of $237.2 million. The Bank paid $12.3 million in cash to the FDIC at acquisition. During the second quarter of 2010, the Bank recognized a gain of $0.5 million on the acquisition of FPB. During the third quarter of 2010, the Bank recognized an additional gain of $2.1 million when the first loss tranche under the FPB loss-sharing agreement was amended by the FDIC.

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**Note 2. Business Combinations (Continued)**

In connection with the acquisitions of SWB and FPB, the Bank entered into loss-sharing agreements with the FDIC under which the FDIC reimburses the Bank for 80 percent of eligible losses with respect to covered assets. The term of the loss-sharing agreements is 10 years for single-family residential loans and eight years for all other loans. The expected reimbursements under the loss-sharing agreements were recorded as indemnification assets at their estimated fair value of $104.6 million for SWB and $36.5 million for FPB at acquisition date. The difference between the fair value of the FDIC indemnification asset and the undiscounted cash flows that the Bank expects to collect from the FDIC is accreted into noninterest income.

The Bank recognized a $3.6 million liability in the acquisition of FPB relating to a requirement that the Bank reimburse the FDIC if actual cumulative losses are lower than the cumulative losses originally estimated by the FDIC at the time of acquisition. There was no similar liability recognized in the acquisition of SWB.

**Note 3. Fair Value Measurements**

Accounting guidance defines fair value for financial reporting purposes as the price that would be received to sell an asset or paid to transfer a liability in an orderly market transaction between market participants at the measurement date (reporting date). Fair value is based on an exit price in the principal market or most advantageous market in which the reporting entity could transact.

For each asset and liability required to be reported at fair value, management has identified the unit of account and valuation premise to be applied for purposes of measuring fair value. The unit of account is the level at which an asset or liability is aggregated or disaggregated for purposes of applying fair value measurement. The valuation premise is a concept that determines whether an asset is measured on a standalone basis or in combination with other assets. The Company measures its assets and liabilities on a standalone basis then aggregates assets and liabilities with similar characteristics for disclosure purposes.

*Fair Value Hierarchy*

Management employs market standard valuation techniques in determining the fair value of assets and liabilities. Inputs used in valuation techniques are based on assumptions that market participants would use in pricing an asset or liability. The inputs used in valuation techniques are prioritized as follows:

**Level 1** Quoted market prices in an active market for identical assets and liabilities.

**Level 2** Observable inputs including quoted prices (other than Level 1) in active markets for similar assets or liabilities, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability such as interest rates, yield curves,

volatilities and default rates, and inputs that are derived principally from or corroborated by observable market data.

**Level 3** Unobservable inputs reflect the reporting entity s own assumptions about the assumptions market participants would use in pricing the asset or liability based on the best information available.

If the determination of fair value measurement for a particular asset or liability is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety. Management s assessment of the significance of a particular input to the fair value measurement requires judgment and considers factors specific to the asset or liability measured.

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

The Company records securities available-for-sale, trading securities and derivative contracts at fair value on a recurring basis. Certain other assets such as impaired loans, OREO, goodwill, customer-relationship intangibles and investments carried at cost are recorded at fair value on a nonrecurring basis. Nonrecurring fair value measurements typically involve assets that are periodically evaluated for impairment and for which any impairment is recorded in the period in which the remeasurement is performed.

The following tables summarize assets and liabilities measured at fair value as of June 30, 2011, December 31, 2010 and June 30, 2010 by level in the fair value hierarchy:

| | | Fair Value Measurements at Reporting Date Using | | |
|---|---|---|---|---|
| **(in thousands)** | **Balance as of June 30, 2011** | **Quoted Prices in Active Markets Level 1** | **Significant Other Observable Inputs Level 2** | **Significant Unobservable Inputs Level 3** |
| **Measured on a Recurring Basis** | | | | |
| **Assets** | | | | |
| Securities available-for-sale | | | | |
| U.S. Treasury | $ 13,076 | $ 13,076 | $ | $ |
| Federal agency - Debt | 1,847,232 | | 1,847,232 | |
| Federal agency - MBS | 534,726 | | 534,726 | |
| CMOs - Federal agency | 3,453,901 | | 3,453,901 | |
| CMOs - Non-agency | 91,083 | | 91,083 | |
| State and municipal | 357,804 | | 357,804 | |
| Other debt securities | 44,121 | | 23,315 | 20,806 |
| Equity securities and mutual funds | 6,112 | 6,112 | | |
| Trading securities | 125,829 | 121,141 | 4,688 | |
| Mark-to-market derivatives (1) | 44,488 | 3,308 | 41,180 | |
| **Total assets at fair value** | $ 6,518,372 | $ 143,637 | $ 6,353,929 | $ 20,806 |
| | | | | |
| **Liabilities** | | | | |
| Mark-to-market derivatives (2) | $ 29,501 | $ 1,226 | $ 28,275 | $ |
| Other liabilities | 161 | | 161 | |
| **Total liabilities at fair value** | $ 29,662 | $ 1,226 | $ 28,436 | $ |
| | | | | |
| **Measured on a Nonrecurring Basis** | | | | |
| **Assets** | | | | |
| Collateral dependent impaired loans (3) | | | | |
| Commercial (4) | $ 3,822 | $ | $ 3,822 | $ |
| Commercial real estate mortgages | 2,505 | | 2,505 | |
| Residential mortgages | 4,656 | | 4,175 | 481 |
| Real estate construction | 10,136 | | 1,610 | 8,526 |
| Equity lines of credit | 2,064 | | 1,178 | 886 |
| Other real estate owned (5) | 61,103 | | 41,264 | 19,839 |
| Private equity investments | 7,293 | | | 7,293 |
| **Total assets at fair value** | $ 91,579 | $ | $ 54,554 | $ 37,025 |

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

(2) Reported in Other liabilities in the consolidated balance sheets.
(3) Impaired loans for which fair value was calculated using the collateral valuation method.
(4) Includes lease financing.
(5) Other real estate owned balance of $162.5 million in the consolidated balance sheets includes $114.9 million of covered OREO and is net of estimated disposal costs.

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

| (in thousands) | Balance as of December 31, 2010 | Fair Value Measurements at Reporting Date Using: Quoted Prices in Active Markets Level 1 | Significant Other Observable Inputs Level 2 | Significant Unobservable Inputs Level 3 |
|---|---|---|---|---|
| **Measured on a Recurring Basis** | | | | |
| **Assets** | | | | |
| Securities available-for-sale | | | | |
| U.S. Treasury | $ 14,113 | $ 14,113 | $ | $ |
| Federal agency - Debt | 1,142,328 | | 1,142,328 | |
| Federal agency - MBS | 551,346 | | 551,346 | |
| CMOs - Federal agency | 3,497,147 | | 3,497,147 | |
| CMOs - Non-agency | 118,295 | | 118,295 | |
| State and municipal | 343,380 | | 343,380 | |
| Other debt securities | 43,630 | | 22,648 | 20,982 |
| Equity securities and mutual funds | 10,436 | 10,436 | | |
| Trading securities | 255,397 | 249,861 | 5,536 | |
| Mark-to-market derivatives (1) | 46,712 | 3,258 | 43,454 | |
| **Total assets at fair value** | $ 6,022,784 | $ 277,668 | $ 5,724,134 | $ 20,982 |
| | | | | |
| **Liabilities** | | | | |
| Mark-to-market derivatives (2) | $ 26,437 | $ 1,215 | $ 25,222 | $ |
| Other liabilities | 160 | | 160 | |
| **Total liabilities at fair value** | $ 26,597 | $ 1,215 | $ 25,382 | $ |
| | | | | |
| **Measured on a Nonrecurring Basis** | | | | |
| **Assets** | | | | |
| Collateral dependent impaired loans (3) | | | | |
| Commercial (4) | $ 1,528 | $ | $ 1,528 | $ |
| Commercial real estate mortgages | 31,684 | | 21,236 | 10,448 |
| Residential mortgages | 9,061 | | 8,210 | 851 |
| Real estate construction | 98,059 | | 98,059 | |
| Equity lines of credit | 3,092 | | 2,224 | 868 |
| Collateral dependent impaired covered loans (3) | | | | |
| Commercial | 2,557 | | | 2,557 |
| Other real estate owned (5) | 88,993 | | 65,605 | 23,388 |
| Private equity investments | 10,804 | | | 10,804 |
| **Total assets at fair value** | $ 245,778 | $ | $ 196,862 | $ 48,916 |

(1) Reported in Other assets in the consolidated balance sheets.
(2) Reported in Other liabilities in the consolidated balance sheets.
(3) Impaired loans for which fair value was calculated using the collateral valuation method.
(4) Includes lease financing.
(5) Other real estate owned balance of $178.2 million in the consolidated balance sheets includes $120.9 million of covered OREO and is net of estimated disposal costs.

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

| (in thousands) | Balance as of June 30, 2010 | Fair Value Measurements at Reporting Date Using<br>Quoted Prices in Active Markets Level 1 | Significant Other Observable Inputs Level 2 | Significant Unobservable Inputs Level 3 |
|---|---|---|---|---|
| **Measured on a Recurring Basis** | | | | |
| **Assets** | | | | |
| Securities available-for-sale | | | | |
| U.S. Treasury | $ 19,145 | $ 19,145 | $ | $ |
| Federal agency - Debt | 1,090,846 | | 1,090,846 | |
| Federal agency - MBS | 466,713 | | 466,713 | |
| CMOs - Federal agency | 2,528,237 | | 2,528,237 | |
| CMOs - Non-agency | 217,078 | | 217,078 | |
| State and municipal | 360,422 | | 360,422 | |
| Other debt securities | 67,147 | | 42,003 | 25,144 |
| Equity securities and mutual funds | 11,555 | 11,555 | | |
| Trading securities | 129,287 | 113,483 | 15,804 | |
| Mark-to-market derivatives (1) | 60,619 | 4,976 | 55,643 | |
| **Total assets at fair value** | $ 4,951,049 | $ 149,159 | $ 4,776,746 | $ 25,144 |
| | | | | |
| **Liabilities** | | | | |
| Mark-to-market derivatives (2) | $ 31,736 | $ 1,629 | $ 30,107 | $ |
| **Total liabilities at fair value** | $ 31,736 | $ 1,629 | $ 30,107 | $ |
| | | | | |
| **Measured on a Nonrecurring Basis** | | | | |
| **Assets** | | | | |
| Collateral dependent impaired loans (3) | | | | |
| Commercial (4) | $ 2,996 | $ | $ 2,746 | $ 250 |
| Commercial real estate mortgages | 35,656 | | 21,243 | 14,413 |
| Residential mortgages | 7,364 | | 6,985 | 379 |
| Real estate construction | 111,339 | | 85,460 | 25,879 |
| Other real estate owned (5) | 50,797 | | 43,592 | 7,205 |
| Private equity investments | 4,427 | | | 4,427 |
| **Total assets at fair value** | | | | |