

ROYAL CARIBBEAN CRUISES LTD
Form 10-K
February 24, 2009
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2008

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: 1-11884

ROYAL CARIBBEAN CRUISES LTD.

(Exact name of registrant as specified in its charter)

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Republic of Liberia
(State or other jurisdiction of
incorporation or organization) **98-0081645**
(I.R.S. Employer
Identification No.)
1050 Caribbean Way, Miami, Florida 33132
(Address of principal executive offices) (zip code)
(305) 539-6000
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, par value \$.01 per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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).

large accelerated filer 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 Act). Yes No

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold was \$3.0 billion as of the last business day of the registrant's most recently completed second fiscal quarter.

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There were 213,676,131 shares of common stock outstanding as of February 12, 2009.

DOCUMENTS INCORPORATED BY REFERENCE

The information required under Part III of this report is incorporated herein by reference to registrant's definitive proxy statement for the 2009 Annual Meeting of Shareholders.

Table of Contents

ROYAL CARIBBEAN CRUISES LTD.

TABLE OF CONTENTS

	Page
<u>PART I</u>	
Item 1. <u>Business</u>	1
Item 1A. <u>Risk Factors</u>	21
Item 1B. <u>Unresolved Staff Comments</u>	26
Item 2. <u>Properties</u>	26
Item 3. <u>Legal Proceedings</u>	26
Item 4. <u>Submission of Matters to a Vote of Security Holders</u>	27
<u>PART II</u>	
Item 5. <u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	28
Item 6. <u>Selected Financial Data</u>	30
Item 7. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	31
Item 7A. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	48
Item 8. <u>Financial Statements and Supplementary Data</u>	49
Item 9. <u>Changes In and Disagreements With Accountants on Accounting and Financial Disclosure</u>	49
Item 9A. <u>Controls and Procedures</u>	49
Item 9B. <u>Other Information</u>	50
<u>PART III</u>	
Item 10. <u>Directors, Executive Officers and Corporate Governance</u>	51
Item 11. <u>Executive Compensation</u>	51
Item 12. <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	51
Item 13. <u>Certain Relationships and Related Transactions, and Director Independence</u>	51
Item 14. <u>Principal Accountant Fees and Services</u>	51
<u>PART IV</u>	
Item 15. <u>Exhibits and Financial Statement Schedules</u>	52
<u>Signatures</u>	53

Table of Contents

PART I

As used in this Annual Report on Form 10-K, the terms Royal Caribbean, the Company, we, our and us refer to Royal Caribbean Cruises Ltd. and the terms Royal Caribbean International, Celebrity Cruises, Pullmantur, Azamara Cruises, and CDF Croisières de France refer to our cruise brands. In accordance with cruise vacation industry practice, the term berths is determined based on double occupancy per cabin even though many cabins can accommodate three or more passengers.

Item 1. Business
General

Royal Caribbean International was founded in 1968. The current parent corporation, Royal Caribbean Cruises Ltd., was incorporated on July 23, 1985 in the Republic of Liberia under the Business Corporation Act of Liberia.

We are the world's second largest cruise company operating 38 ships in the cruise vacation industry with approximately 78,650 berths as of December 31, 2008. We own five cruise brands, Royal Caribbean International, Celebrity Cruises, Pullmantur, Azamara Cruises, and CDF Croisières de France. In addition, we have a 50% investment in a joint venture with TUI AG which operates the brand TUI Cruises. Our cruise brands primarily serve the contemporary, premium and deluxe segments of the cruise vacation industry, which also includes the budget and luxury segments. Our ships operate on a selection of worldwide itineraries that call on approximately 425 destinations. We compete principally on the basis of quality of ships, quality of service, variety of itineraries and price.

Historically, our primary focus has been to serve the North American cruise market through our two main global cruise brands, Royal Caribbean International and Celebrity Cruises. Throughout the years, we have expanded our focus to increase international passenger sourcing by opening offices in the United Kingdom, Germany, Norway, Italy, Spain, Singapore, China, Brazil, and Australia. We also expanded our global base through the strategic acquisition of Pullmantur in 2006, which provides us with a brand to serve the cruise markets in Spain and Latin America. Our launch of CDF Croisières de France in 2007 provides us with a custom tailored product targeted at the cruise market in France and our joint venture with TUI AG will provide us with a custom tailored product targeted at the cruise market in Germany beginning in 2009.

In addition to increasing our international passenger sourcing, the launch of Azamara Cruises in 2007 provides us with a new global cruise brand designed to serve the emerging deluxe cruise segment between the premium and luxury segments, primarily in the North American, U.K. and German cruise markets.

Our commitment to acquire state-of-the-art ships, along with our maintenance programs and revitalizations to incorporate our current signature brand elements provides us with the flexibility to deploy our ships among our brand portfolio and expand into growing international markets.

We believe cruising has become a more widely accepted vacation alternative over the years due to its perceived value, expanded itineraries, shipboard innovation, and variety of shore-side activities. In addition, we believe that our products appeal to a large consumer base and are not dependent on a single market or demographic. Further, we believe our global brands possess the versatility to enter multiple cruise market segments within the cruise vacation industry.

Table of Contents

Royal Caribbean International

Royal Caribbean International is positioned at the upper end of the contemporary segment of the cruise vacation industry, although its quality enables it to attract consumers from the premium segment as well. This allows Royal Caribbean International to achieve one of the broadest market coverages of any of the major cruise brands in the vacation industry. The contemporary segment is served by cruises that are generally seven nights or shorter and feature a casual ambiance. The premium segment is served by cruises that are generally seven to 14 nights and appeal to the more experienced guest who is usually more affluent. Royal Caribbean International operates 20 ships with approximately 51,200 berths, offering cruise itineraries that range from two to 18 nights. Royal Caribbean International offers a variety of itineraries to destinations worldwide, including Alaska, Asia, Australia, Bermuda, Canada, the Caribbean, Europe, Hawaii, Latin America and New Zealand.

Royal Caribbean International's strategy is to attract an array of vacationing consumers by providing a wide variety of itineraries and cruise lengths with multiple innovative options for onboard dining, entertainment and other onboard activities. Royal Caribbean International offers a wide array of onboard services, amenities and activities. It has introduced many product innovations such as ice skating rinks, rock climbing walls, surf simulators, bungee jumping trampolines, an interactive waterpark called the H2O Zone, and Royal Promenades which are boulevards with shopping, dining and entertainment venues. Additionally, Royal Caribbean International offers a variety of shore excursions at each port of call. We believe that the variety and quality of Royal Caribbean International's product offerings represent excellent value to consumers, especially to couples and families traveling with children. Because of the brand's extensive product offerings, we believe Royal Caribbean International is well positioned to attract new consumers to the cruise vacation industry and to continue to bring guests back for their next vacation.

Celebrity Cruises

Celebrity Cruises primarily serves the premium segment of the cruise vacation industry. Celebrity Cruises operates nine ships with approximately 16,650 berths, offering various cruise itineraries that range from two to 16 nights. Celebrity Cruises' fleet and service has been consistently recognized with numerous awards from cruise traveler polls, travel agents and travel industry publications.

Celebrity Cruises' strategy is to attract experienced cruise guests who appreciate and value the high quality, service-focused experience the brand offers. Celebrity Cruises offers a global cruise experience by providing a variety of cruise lengths and itineraries to premium destinations throughout the world and has deployed a high proportion of its fleet in seasonal markets, e.g., Alaska, Australia, Europe, Hawaii, New Zealand, the Panama Canal, the Caribbean and South America. Celebrity Cruises is also the only major cruise line to operate a ship in the Galapagos Islands, *Celebrity Xpedition*. *Celebrity Xpedition* has approximately 100 berths and provides this unique experience on seven day cruises with pre-cruise tours in Ecuador.

Celebrity Cruises' products and service have broad appeal for a global audience. Celebrity Cruises delivers an intimate experience onboard upscale ships that offer a high staff-to-passenger ratio, extensive spa facilities, fine dining, personalized service, and on *Celebrity Solstice*, unique onboard attractions such as the Lawn Club, a half acre venue featuring live grass and the Hot Glass Show, a fully functional glass blowing studio.

Pullmantur

Pullmantur serves the contemporary segment of the Spanish and Latin American cruise markets. Pullmantur operates six ships with approximately 8,650 berths, offering various seven-night cruise itineraries. In addition, Pullmantur has tour operations, and owns a 49% interest in a small air business that operates three Boeing 747 aircraft in support of its cruise and tour operations.

Pullmantur's strategy is to attract cruise guests by providing a variety of cruising options and land-based travel packages. Pullmantur offers a range of cruise itineraries to the Caribbean, the Mediterranean, Brazil and the Baltic. Pullmantur offers a wide array of onboard activities and services to guests, including exercise facilities, swimming pools, beauty salons, gaming facilities, shopping, and dining and entertainment venues. Pullmantur's tour operations sell land-based travel packages to Spanish guests including hotels and flights primarily to Caribbean resorts, and sell land-based tour packages to Europe aimed at Latin American guests.

Table of Contents

Empress of the Seas and *Sovereign of the Seas* were redeployed from Royal Caribbean International to Pullmantur in March 2008 and November 2008, respectively. The ships currently sail under the names of *Empress* and *Sovereign*, respectively. Before redeployment to Pullmantur, each ship underwent renovations including the expansion of public areas and restaurants, the redesign of the Atrium and incorporation of Pullmantur's signature elements.

Azamara Cruises

Azamara Cruises is designed to serve the emerging deluxe cruise segment between the premium and luxury segments of the North American cruise markets, along with the U.K. and German markets. Azamara Cruises operates two ships with a total of approximately 1,400 berths, offering various cruise itineraries that range from seven to 24 nights and appeal to the more experienced guest who is usually more affluent.

Azamara Cruises' strategy is to attract experienced travelers who enjoy cruising and who seek a more intimate onboard experience, a high level of service and itineraries to a variety of unique destinations. Azamara Cruises completed its first full year of operation offering global itineraries to many ports not accessible by larger ships. Europe, South America, the Caribbean, Asia, and the Panama Canal were all visited by either *Azamara Journey* or *Azamara Quest* in 2008.

Azamara Cruises offers a wide array of onboard services, amenities and activities, including gaming facilities, fine dining and interactive entertainment venues.

CDF Croisières de France

CDF Croisières de France is designed to serve the contemporary segment of the French cruise market and increases our global presence by providing us with a brand custom-tailored for French cruise guests. In April 2008, *Holiday Dream*, a 750-berth ship, was redeployed from Pullmantur to CDF Croisières de France and is currently sailing under the name *Bleu de France* as the brand's only ship. Before redeployment to CDF Croisières de France, *Bleu de France* underwent renovations to customize the ship for French guests.

CDF Croisières de France offers seasonal seven to ten night itineraries to the Mediterranean and the Caribbean. CDF Croisières de France offers a variety of onboard services, amenities and activities, including entertainment venues, exercise and spa facilities, fine dining, and gaming facilities.

TUI Cruises

In April 2008, we closed on our joint venture agreement with TUI AG, a European tourism and shipping company which owns 51% of TUI Travel. The joint venture operates TUI Cruises, designed to serve the contemporary and premium segments of the German cruise market by offering a custom-tailored product for German guests. *Celebrity Galaxy*, a 1,850-berth ship currently part of Celebrity Cruises, will be sold to TUI Cruises to serve as its first ship and will sail under a new name beginning in May 2009.

Other

In November 2008, we sold our 50% investment in a joint venture with TUI Travel PLC (TUI Travel), formerly First Choice Holidays PLC, which operates the brand Island Cruises. As part of this transaction, we agreed to an early termination of the charter of *Island Star* to Island Cruises. We anticipate the return of *Island Star* in April 2009 and intend to redeploy the ship to Pullmantur. The ship will sail under the name *Pacific Dream*. Before redeployment to Pullmantur, the ship will undergo renovations to incorporate Pullmantur's signature elements. This ship will be dedicated to the Latin American market in support of Pullmantur's Latin American expansion.

Table of Contents**Industry**

Over the past several years, cruising has represented a small but growing sector of the overall vacation market. Industry data indicates that a significant portion of cruise guests carried are first-time cruisers. We believe this could present an opportunity for long-term growth and a potential for increased market share through the expansion of our fleet.

We estimate that the global cruise industry carried 17.2 million cruise passengers in 2008 compared to 16.6 million cruise passengers carried in 2007. We estimate that the global cruise fleet was served by approximately 354,000 berths on approximately 240 ships by the end of 2008. There are approximately 34 ships with an estimated 86,000 berths that are expected to be placed in service in the global cruise market between 2009 and 2012.

North America represents the primary source of our cruise passengers and has experienced a compound annual growth rate of approximately 8.7% since 1970. From 2004 to 2008 North America has experienced a compound annual growth rate in cruise passengers of approximately 4.4%. We estimate that North America was served by 132 ships with approximately 194,000 berths at the beginning of 2004 and by 150 ships with approximately 257,000 berths by the end of 2008. There are approximately 27 ships with an estimated 68,000 berths that are expected to be placed in service in the North American cruise market between 2009 and 2012.

The following table details the growth in the global and North American cruise markets in terms of cruise passengers and estimated weighted-average berths over the past five years:

Year	Global Cruise Passengers(1)	Weighted-Average Supply of Berths		North American Cruise Passengers(2)	Weighted-Average Supply of Berths Marketed in North America(1)
		Marketed Globally(1)	Marketed in North America(1)		
2004	13,757,000	265,000	9,108,000	207,000	
2005	14,818,000	282,000	9,909,000	216,000	
2006	15,309,000	299,000	10,080,000	227,000	
2007	16,586,000	323,000	10,330,000	242,000	
2008	17,184,000	345,000	10,815,000	254,000	

(1) Source: Our estimates.

(2) Source: Cruise Line International Association based on cruise passengers carried for at least two consecutive nights.

In an effort to penetrate untapped markets and diversify our customer base, we have redeployed some of the ships in our Royal Caribbean International and Celebrity Cruises brands from the North American market to Europe, Latin America and Asia. This redeployment has contributed to an increase in the growth of our global cruise brands outside of the North American market.

Although the global and North American cruise markets have grown steadily over the past several years, the recent weakening of the United States and other economies has significantly deteriorated consumer confidence and discretionary spending. This has caused a global drop in demand for cruises and a resulting drop in cruise prices. The long-term impact of these conditions on the continued growth of the cruise market will depend on the depth and duration of this worldwide economic downturn. In addition, the projected increase in capacity within the cruise industry from new cruise ships currently on order could produce additional pricing pressures within the industry. See Item 1A. *Risk Factors*.

We compete with a number of cruise lines; however, our principal competitors are Carnival Corporation & plc, which owns, among others, Aida Cruises, Carnival Cruise Lines, Costa Cruises, Cunard Line, Holland America Line, P&O Cruises and Princess Cruises and has a joint venture with Orizonia Corporation under which they operate Iberocrueros; Disney Cruise Line; MSC Cruises; Norwegian Cruise Line and Oceania Cruises. Cruise lines compete with other vacation alternatives such as land-based resort hotels and sightseeing destinations for consumers' leisure time. Demand for such activities is influenced by political and general economic conditions. Companies within the vacation market are dependent on consumer discretionary spending. Although vacation spending is likely to be curtailed significantly in the midst of the current worldwide economic downturn, we believe that cruising is perceived by consumers as a good value when compared to other vacation alternatives.

Table of Contents

Our ships operate worldwide and have itineraries that call on destinations in Alaska, Asia, Australia, the Bahamas, Bermuda, California, Canada, the Caribbean, Europe, the Galapagos Islands, Hawaii, Mexico, New England, New Zealand, the Panama Canal and South America.

Operating Strategies

Our principal operating strategies are to:

manage the efficiency of our operating expenditures and preserve cash and liquidity during the current worldwide economic downturn,

increase the awareness and market penetration of our brands,

expand our fleet with the new state-of-the-art cruise ships currently on order,

expand into new markets and itineraries,

continue to expand and diversify our passenger mix through passenger sourcing outside North America,

protect the health, safety and security of our passengers and employees and protect the environment in which our vessels and organization operate,

utilize sophisticated revenue management capabilities to optimize revenue based on demand for our products,

further improve our technological capabilities, and

maintain strong relationships with travel agencies, the principal industry distribution channel, while offering direct access for consumers.

Manage operating expenditures and preserve cash and liquidity

During the current worldwide economic downturn we are focused on maximizing the efficiency of our operating expenditures and preserving cash and liquidity. During 2008, we announced the reduction in our workforce of approximately 400 shoreside positions and implemented a number of cost-saving initiatives in an effort to reduce our operating costs. To preserve liquidity, we have discontinued our quarterly dividend commencing in the fourth quarter of 2008, curtailed our non-shipbuild capital expenditures, and currently do not have plans to place further newbuild orders. We believe these strategies will enhance our ability to fund our capital spending obligations and improve our balance sheet.

Brand Awareness and Market Penetration

We continue to increase the recognition and market penetration of our brands among consumers. Royal Caribbean International and Celebrity Cruises are established global brands in the contemporary and premium segments of the vacation industry. Pullmantur is a widely recognized brand in the Spanish and Latin American contemporary cruise markets. Azamara Cruises is designed to serve the emerging deluxe cruise segment. CDF Croisières de France which commenced operations in May 2008, is targeted to serve the contemporary segment of the French cruise market.

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We increase brand awareness and market penetration of our Royal Caribbean International brand through communication strategies designed to emphasize its high quality and excellent-value cruise vacations. For instance, in 2008, Royal Caribbean International launched a new brand campaign, *The Nation of Why Not*. This brand campaign highlights Royal Caribbean International's global destinations and innovative onboard amenities. Royal Caribbean International's communication strategies

Table of Contents

target adults and families who are vacation enthusiasts interested in exploring new destinations and seeking new experiences. These strategies are also designed to attract first-time cruisers to the cruise vacation industry and to the Royal Caribbean International brand. In order to attract the experienced cruiser who is seeking new experiences as well as first-time cruisers, Royal Caribbean International provides multiple choices to guests through a wide array of itineraries, accommodations, dining options, onboard activities and shore excursions. The hallmarks of the brand include friendly and engaging service, state-of-the-art ships, family programs, entertainment, health and fitness and energizing onboard and shoreside activities designed for guests of all ages.

We increase brand awareness and market penetration of our Celebrity Cruises brand through a series of consumer and trade campaigns designed to broaden the recognition of its high quality cruise vacations and drive loyalty and brand preference by emphasizing the personalized service and attention its guests receive. Celebrity Cruises' communications target cruisers who seek upscale experiences and appreciate a high staff-to-passenger ratio, spacious accommodations, fine dining and spa services.

We increase brand awareness and market penetration of our Pullmantur brand primarily through advertising campaigns targeted to Spanish-speaking guests in both Spain and Latin America. All customer-facing crewmembers speak Spanish, and onboard activities, services, shore excursions and menu offerings are designed to suit the preferences of this target market.

We are increasing awareness and market penetration of our Azamara Cruises brand through trade advertising and education, public relations and direct communications, designed to target the emerging deluxe cruise segment of the North American and European cruise markets. Azamara Cruises' communications target experienced cruise guests who prefer a more upscale, intimate and destination-focused cruise experience on smaller ships with longer itineraries. We believe Azamara Cruises provides a more exclusive guest experience with its distinctive combination of personalized service, exceptional cuisine and exotic destinations, with unique excursions.

We are increasing the awareness and market penetration of our CDF Croisières de France brand through trade education, public relations and direct communications, designed to target the contemporary segment of the French cruise market. CDF Croisières de France's communications emphasizes that its cruise product is tailored specifically to French-speaking guests. All customer-facing crewmembers speak French, and the onboard activities and menu offerings are designed to suit their target guests' preferences.

In addition, we also increase brand awareness through our travel agencies who generate the majority of our bookings. We are committed to further developing and strengthening this very important distribution channel by facilitating their focus on the unique qualities of each of our brands.

Fleet Development and Maintenance

We currently have signed agreements with two shipyards providing for the construction of six new state-of-the-art cruise ships scheduled to enter service between the third quarter of 2009 and the fourth quarter of 2012. These additions are expected to result in an increase in our passenger capacity of approximately 22,200 berths by December 31, 2012, or approximately 28.0% as compared to our capacity as of December 31, 2008. It is possible that some of our older ships may be sold or retired during this time period, thus reducing the size of our fleet. We could also order new ships or purchase existing ships, thereby further increasing our fleet size; however, we do not believe that current economic conditions warrant buying or ordering new ships other than what is currently on order.

The acquisition of the state-of-the-art ships on order, along with our maintenance programs on our existing fleet will provide us with the flexibility to deploy our ships among our brand portfolio and expand into growing international markets. Since our first fleet expansion program in 1988, we have increased our average ship size and number of available berths, which has enabled us to achieve certain economies of scale.

In addition to our fleet development, we place a strong focus on product innovation to drive new demand for our products and stimulate repeat business from our guests. Innovation of our products is achieved by introducing new concepts on our new ships and continuously making improvements to our existing fleet. In order to offer guests a wider range of activities and amenities and to ensure consistency across our fleets, we have revitalized some of our older ships to update and refresh their interiors and to incorporate signature brand elements. Renovations have included the addition of new balconies, dining and entertainment options, as well as refurbishments to staterooms and public areas.

Table of Contents

Royal Caribbean International. Founded in 1968, Royal Caribbean International was the first cruise line to design ships for warm water year-round cruising. Royal Caribbean International operated a modern fleet in the 1970s and early 1980s, establishing a reputation for high quality. Between 1988 and 1992, the brand tripled its capacity by embarking on its first major capital expansion program and taking delivery of three Sovereign-class ships. In addition, Royal Caribbean International took delivery of *Empress of the Seas* in 1990 and from 1995 through 1998, took delivery of six Vision-class ships. Since delivery, several of these ships have undergone extensive renovations and refurbishments. This includes the addition of new dining and entertainment options, the upgrade of guest suites and staterooms, the expansion of day spa and fitness center facilities, and in one case, a new 73-foot midsection featuring 151 additional staterooms.

From 1999 through 2003, Royal Caribbean International introduced its five Voyager-class ships. Each Voyager-class ship is approximately 140,000 gross tons with approximately 3,100 berths. The Voyager-class ships introduced several product innovations to the marketplace, including the cruise vacation industry's first horizontal atrium, the Royal Promenade (which is four decks tall, longer than a football field and provides entertainment, shopping and dining experiences), recreational activities such as ice skating, in-line skating, rock climbing, miniature golf and full court basketball, enhanced staterooms, expanded dining venues and a variety of intimate spaces.

From 2001 through 2004, Royal Caribbean International introduced its four Radiance-class ships, a progression from the brand's Vision-class ships. Each Radiance-class ship is approximately 90,000 gross tons with approximately 2,100 berths. The Radiance-class ships incorporate many of the dining and entertainment options of the Voyager-class ships, as well as offer a wide array of unique features. These features include panoramic glass elevators facing outward to the sea, floor to ceiling glass windows offering sea views and a billiards club featuring gyroscopic billiard tables. Royal Caribbean International has adopted the product innovations of the Voyager and Radiance-class ships as signature elements of the brand.

In 2006, Royal Caribbean International launched the 3,600-berth *Freedom of the Seas*, the first of three Freedom-class ships. The Freedom-class ships are approximately 16% larger than the Voyager-class ships and have some of the largest staterooms and balconies in the industry, flat screen televisions, cell phone services and other amenities. The launch of the Freedom-class ships also introduced several new experiences to cruising, including a surf simulator and an interactive water park called the H2O Zone™. Royal Caribbean International took delivery of a second Freedom-class ship, *Liberty of the Seas*, in April 2007 and the third Freedom-class ship, *Independence of the Seas*, in April 2008.

Building upon the innovations of the Voyager and Freedom-class ships, Royal Caribbean International will introduce a new class of ships in 2009. This new class of ships, the Oasis-class, will be approximately 220,000 gross tons each with approximately 5,400 berths. Each ship will be 50% larger than the Freedom-class ships and will span 16 decks and 2,700 staterooms. The new Oasis-class ships will introduce several new experiences to cruising including the new neighborhood concept. The neighborhood concept consists of seven distinct themed areas which will include *Central Park*, a park open to the sky; *Boardwalk*, an outdoor family-friendly area featuring a handcrafted carousel; *AquaTheater*, the first amphitheater at sea; *Rising Tide*, a levitating bar; a sloped-beach entry pool and many other new features. The Oasis-class ships will also offer new categories in onboard accommodations including bi-level, urban-style two bedroom/two bathroom suites and balcony staterooms facing some of the distinct neighborhoods. Royal Caribbean International has contracts with a shipyard to build two Oasis-class ships, *Oasis of the Seas* and *Allure of the Seas*, expected to enter service in the fourth quarters of 2009 and 2010, respectively. See Item 1A. *Risk Factors* regarding shipyards.

Celebrity Cruises. Celebrity Cruises was founded in 1990 and operated three ships between 1992 and 1995. Between 1995 and 1997, Celebrity Cruises began its first capital expansion program, adding three Century-class ships, which range in size from approximately 1,750 to 1,850 berths. During this time, Celebrity Cruises also disposed of one of its original three ships.

From 2000 through 2002, Celebrity Cruises took delivery of four Millennium-class ships. Each Millennium-class ship is approximately 90,000 gross tons with approximately 2,050 berths. The Millennium-class ships are a progression from the Century-class ships and elevated Celebrity Cruises' position in the premium segment of the marketplace. The Millennium-class ships build on the brand's primary strengths, including gourmet dining, spacious staterooms and suites with verandas and spa facilities featuring a

Table of Contents

large hydro pool with neck massage, body jets and services including acupuncture at sea. On the Millennium-class ships, an entire deck is dedicated to health and fitness. To further enhance the onboard experience, Celebrity Cruises offers a more intimate setting in piano, champagne, and martini bars and lounges.

In 2004, Celebrity Cruises continued to expand its product offerings with the launch of *Celebrity Xpedition*, a 100-berth ship that offers a more intimate experience onboard a smaller ship with sailings to the Galapagos Islands.

From 2005 to 2008, Celebrity Cruises entered into contracts with a shipyard to build five Solstice-class ships. The Solstice-class ships are a new wide-body construction class of ships, and are approximately 122,000 gross tons each with approximately 2,850 berths. This new wide-body construction design provides for many intimate areas onboard the ship. The Solstice-class ships incorporate many new and improved design features including the industry's first ever Lawn Club. The Lawn Club is over a half acre venue featuring live grass for guest enjoyment. Celebrity Cruises also introduced the Hot Glass Show, a fully functional glass blowing studio which operates at the Lawn Club onboard Solstice-class ships. The Solstice-class ships are also equipped with solar foils and solar panels, another industry first. Approximately 90% of the ships' staterooms are outside and approximately 85% of the staterooms have verandas. In 2008, Celebrity Cruises took delivery of *Celebrity Solstice*, the first of the five Solstice-class ships. *Celebrity Equinox* and *Celebrity Eclipse* are expected to enter service in the third quarters of 2009 and 2010, respectively. Two unnamed ships are expected to enter service in the third quarter of 2011 and the fourth quarter of 2012, respectively.

In 2009, *Celebrity Galaxy*, a 1,850-berth ship currently part of Celebrity Cruises, will be sold to TUI Cruises to serve as its first ship and will sail under a new name beginning in May 2009.

Pullmantur. Pullmantur was founded in 1971 and currently operates six ships which range in size from approximately 1,000 to 2,300 berths. As a result of the acquisition of Pullmantur in November 2006, we expanded our overall fleet by five ships and approximately 4,500 berths. Furthermore, Pullmantur purchased a 1,000-berth ship which is currently sailing under the name *Ocean Dream*.

In May 2007, *Zenith* was redeployed from Celebrity Cruises to Pullmantur. Before redeployment to Pullmantur, *Zenith* underwent renovations to incorporate Pullmantur's signature elements, while adding approximately 38 new verandas and 25 staterooms. *Empress of the Seas* and *Sovereign of the Seas* were redeployed from Royal Caribbean International to Pullmantur in March 2008 and November 2008, respectively. Before redeployment to Pullmantur, each ship underwent renovations to incorporate Pullmantur's signature elements. Upon the return of *Island Star* in April 2009 from Island Cruises, the ship will be redeployed to Pullmantur and will sail under the name *Pacific Dream*. Before redeployment to Pullmantur, the ship will undergo renovations to incorporate Pullmantur's signature elements. This ship will be dedicated to the Latin American market in support of Pullmantur's Latin American expansion.

Azamara Cruises. In May 2007, *Blue Dream* was redeployed from Pullmantur to Azamara Cruises, and is sailing under the name *Azamara Journey*. In September 2007, *Blue Moon* was also redeployed from Pullmantur to Azamara Cruises and is sailing under the name *Azamara Quest*. Before redeployment to the Azamara Cruises brand, each ship underwent renovations to incorporate Azamara Cruises' signature elements, while upgrading guest suites and staterooms, and adding two new specialty restaurants.

CDF Croisières de France. In April 2008, *Holiday Dream* was redeployed from Pullmantur to CDF Croisières de France and sails as its first ship under the name *Bleu de France*. Before redeployment to CDF Croisières de France, *Holiday Dream* underwent renovations, including the addition of a French bistro and a spa with a sea water center, to customize the ship for French guests.

New Markets and Itineraries

Our ships operate worldwide with a selection of itineraries that call on approximately 425 ports. New ships, including both newly constructed ships and those we acquire, allow us to expand into new markets and itineraries. Our brands have expanded their mix of itineraries, while strengthening our ability to penetrate the European, Latin American and Caribbean markets further.

Table of Contents

In April 2008, *Independence of the Seas* was introduced in the United Kingdom and began offering itineraries from the United Kingdom to the Mediterranean, Ireland and the Canary Islands. *Navigator of the Seas*, which had offered the U.K. program in 2007, offered cruises sailing out of Spain and Italy during the summer of 2008. In the fall, both Royal Caribbean International and Celebrity Cruises expanded in Australia, New Zealand and the South Pacific with Royal Caribbean International's *Rhapsody of the Seas* and *Celebrity Millennium*. In December 2008, Royal Caribbean International introduced new Southern Caribbean itineraries from Panama on *Enchantment of the Seas*. Also in late 2008, *Legend of the Seas* began offering sailings throughout Asia from Singapore and Shanghai, and *Radiance of the Seas* began offering cruises in South America around Cape Horn.

In 2009, we will continue to focus on the acceleration of Royal Caribbean International's and Celebrity Cruise's strategic positioning as global cruise brands while expanding Pullmantur. An unprecedented 22 ships will be sailing in Europe for the Company and Royal Caribbean International will have the most European capacity of any non-European brand as it increases its capacity to eight ships: *Independence of the Seas*, *Voyager of the Seas*, *Navigator of the Seas*, *Brilliance of the Seas*, *Jewel of the Seas*, *Legend of the Seas*, *Splendour of the Seas*, and *Vision of the Seas*. *Brilliance of the Seas* will remain in Europe year round throughout 2009, and then will begin offering sailings from Dubai starting in January 2010. In late 2009, *Legend of the Seas* will return to Asia and commence year round deployment throughout 2010.

Celebrity Cruises will also increase its capacity in Europe in 2009. With five ships, the brand will have its greatest presence ever in Europe, with sailings being offered on *Celebrity Solstice*, *Celebrity Equinox*, *Celebrity Century*, *Celebrity Summit* and *Celebrity Constellation*. The 2009 season will also mark the debut of *Celebrity Equinox* with Holy Land sailings from Rome, which will be a first for the brand. The Royal Caribbean International brand will return to Israel in 2009, having last visited Israel in 2000. Azamara Cruises will offer European sailings on both *Azamara Journey* and *Azamara Quest*. Also, Pullmantur and CDF Croisières de France will continue to offer European itineraries on all ships.

In January 2009, *Mariner of the Seas* began year round cruises to Mexico from Los Angeles, California. Also in January, *Vision of the Seas* began offering seasonal Caribbean itineraries from the Dominican Republic. Starting in the fall of 2009, both the Celebrity Cruises and Royal Caribbean International brands are expanding into new North American markets. *Celebrity Mercury* will operate Caribbean cruises from Baltimore, Maryland and Charleston, South Carolina and Royal Caribbean International will operate Mexico cruises from San Diego, California with the *Radiance of the Seas*. Royal Caribbean International will debut *Oasis of the Seas* in the Eastern Caribbean in December 2009. Also starting in December, Royal Caribbean International will increase its capacity in Brazil, deploying both *Splendour of the Seas* and *Vision of the Seas*.

In an effort to secure desirable berthing facilities for our ships, and to provide new or enhanced cruise destinations for our passengers, we actively assist or invest in the development or enhancement of certain port facilities and infrastructure, including mixed-use commercial properties, located in strategic ports of call. Generally, we collaborate with local, private or governmental entities by providing management and/or financial assistance and often enter into long-term port usage arrangements. In exchange for our involvement, we generally secure preferential berthing rights for our ships.

International Passengers

Passenger ticket revenues generated by sales originating in countries outside of the United States were approximately 40%, 37%, and 24% of total passenger ticket revenues in 2008, 2007 and 2006, respectively. International passengers have grown from approximately 511,000 in 2004 to approximately 1.3 million in 2008.

We sell and market our global brands, Royal Caribbean International, Celebrity Cruises and Azamara Cruises, to passengers outside of North America through our offices in the United Kingdom, Germany, Norway, Italy, Spain, Singapore, China, Brazil, and Australia. We believe that having a local presence in these markets provides us with the ability to react faster to local market conditions as well as providing us with the ability to better understand our customer base in each respective market. We further extend our reach with a network of 48 independent international representatives located throughout the world. Historically, our focus has been to primarily source our passengers for our global brands from North America. Currently, we are expanding our focus to sell and market our cruise brands to countries outside of North America through fleet innovation and by responding to cultural characteristics of our global passengers.

Table of Contents

In 2008, we continued our strategy of acquiring or developing brands custom-tailored to specific markets when we closed on our joint venture agreement with TUI AG, a European tourism and shipping company that owns 51% of TUI Travel. This joint venture operates TUI Cruises, a new cruise brand targeted at the cruise market in Germany. TUI Cruises will complement two of our existing brands custom-tailored to specific markets, Pullmantur, which is targeted at passengers primarily in Spain and Latin America and CDF Croisières de France, which is targeted at passengers primarily in France.

Health, Safety, Security and Environmental Policies

We are committed to protecting the health, safety and security of our passengers, employees and others working on our behalf. We are also committed to protecting the marine environment in which our vessels sail and the communities in which we operate by minimizing adverse environmental consequences and using resources efficiently. To this end, we established a unified department to oversee Global Security, Maritime Safety, Medical and Public Health areas, and Environmental Stewardship. The organization is comprised of technical experts in each area focused on improving our systems for prevention and response.

Revenue Management

We believe we have some of the most advanced revenue management capabilities in the industry, which enables us to make more advantageous decisions about pricing, inventory management and marketing actions. We are continuously working to improve our systems and tools through increased forecasting capabilities, ongoing improvements to our understanding of price/demand relationships, and greater automation of the decision processes. We believe these revenue management capabilities allow us to make more advantageous decisions to enhance revenue, especially during these uncertain economic times.

Technological Capabilities

We continue to invest in information technology to align with our business strategies. In 2008, we completed the integration of Pullmantur and CDF Croisières de France into our reservations and accounting platforms, enabling additional synergies across brands. Also in 2008, we completed major upgrades to the reservations platform to support future needs. The most significant changes enabled the selling of *Oasis of the Seas* with expanded pricing options and key enhancements. We also invested in our shoreside and shipboard systems integration, most notably the Advanced Shipboard Revenue platform, where we enabled the sale of specialty dining on our websites, prior to guests boarding the vessel. This capability allows our guests to pre-arrange not only shore excursions in advance of their cruise vacation, but also allows guests to make reservations for one of our specialty restaurants.

To further align with our business strategy, we completed a major web globalization initiative, launching our full Royal Caribbean International website with localized content in a number of major international markets, including the U.K., Spain, Latin America, and Brazil.

This year also marked the completion of a major Customer Relationship Management initiative, an enhanced Marketing Datamart, which allows us to better target marketing campaigns based on a wide array of customer touch points, including web, call centers, and onboard.

Our fleet expansion was also a major focus for IT this year, with the launch of *Celebrity Solstice*, our first ship with a converged data/voice network and an enhanced in-stateroom entertainment system. This will serve as a model for future ships and opens the door to a number of exciting opportunities to enhance the guest experience.

Finally, we have implemented a number of key technologies across the enterprise to further enhance our guest experience and reduce operating costs. This includes enhancing the guest internet and telecommunications capabilities onboard. These technologies also include a consolidation strategy across systems, providing higher service levels and at the same time reducing operating expenses.

Table of Contents

Travel Agency Support and Direct Business

Travel agencies generate the majority of bookings for our ships. We are committed to further developing and strengthening this very important distribution channel. Our sales teams focus on the unique qualities of each brand and provide support to the travel agency community. The Trade Support & Service department, with branded call center operations, further supports the travel agency community in delivering the cruise vacation experience. *Cruisingpower.com* continues to be an industry-leading website exclusive to the travel agency community. Over the past two years, the website launched a number of new online tools designed to increase travel agent productivity and the focus in 2008 has been on increasing travel agents adoption of these tools. This includes *VIP CruisePass*, a desktop alert designed to give travel agents alerts to special offers, weather updates, itinerary changes and latest news. *EMarketing* provides travel agents with a personalized link that directs customers to a video magazine or cruise planner interactive experience. *EConnect* is an online quoting tool that enables travel agents to send up to five online quotes to their database with real-time pricing and web-based functionality. In addition, Royal Caribbean International continues to enhance its online training certification program, *University of Wow*, where travel agents can now achieve up to an expert-plus graduate level certification. In 2008 Celebrity Cruises launched *Five Star Academy*, a travel partner learning suite featuring five sequential modules. The modules cover from brand basics to accommodations, amenities, and destinations.

In 2008, we completed several key enhancements to simplify the online booking process via our new *CruiseMatch* trade booking tool based on feedback from our travel agent partners. The second phase of this investment will be launched in 2009 to offer additional functionality such as enabling travel agents to make bookings in an existing group block, as well as provide group insurance. Pullmantur and Azamara Cruises were also incorporated into the online tool in 2008.

In 2008, we also launched a program directed to help support our travel agents during the current economic downturn. The program, *Agent Support Action Plan (ASAP)*, includes multiple components to help the agency community during this period. These components include a one percent commission supplement on any cruise bookings made between January 1 and February 28, 2009 for sailings from January 2009 through March 2010, increased co-op funding for qualifying agencies undertaking significant marketing plans, relaxed requirements to qualify for tour conductor credits which will help agents earn more money while encouraging group bookings, and an individual agent booking incentive through which agents can earn a complimentary cruise.

We have customer service representatives that are trained to assist travel agents in providing a higher level of service and *Insight*, the first service tool of its kind in the industry, assists agencies with productivity and enhances customer service. We currently operate reservation call centers to support our travel agent community in the United States, Canada, France, Spain and the United Kingdom offering flexibility and extended hours of operations.

We have certified vacation planners in our call centers in Miramar, Wichita and Addlestone offering cruise planning expertise and personal attention for direct bookings. In addition, direct booking channels for Royal Caribbean International, Celebrity Cruises and Azamara Cruises are available through our internet sites at *www.royalcaribbean.com*, *www.celebrity.com* and *www.azamaracruises.com*. We continue to experience an increase in the use of our internet sites and other direct booking channels as a source of our overall bookings.

Passenger Services

We offer to handle virtually all travel aspects related to passenger reservations and transportation, including arranging passenger pre- and post-hotel stay arrangements and air transportation. We offer our passengers the ability to check-in online in order to alleviate boarding time during embarkation. Our air/sea program offers passengers the choice of our standard air or custom air programs. Our standard air program allows our passengers to benefit from comprehensive relationships that we maintain with many major airlines ranging from fare negotiation and space handling to baggage transfer. Our custom air program enables passengers to customize their flight arrangements, including selection of airline, specific flights and class of service.

The Royal Caribbean International passenger loyalty program, *Crown & Anchor Society*, has over five million members worldwide and includes benefits such as a secured dedicated section in the *www.royalcaribbean.com* internet site with special cruise

Table of Contents

offers and onboard amenities. The Celebrity Cruises and Azamara Cruises passenger loyalty program, Captain's Club, has over one million members. Captain's Club members enjoy exclusive members-only onboard programs and amenities, and are provided with a secured area on the Celebrity Cruises website, which communicates select products.

Operations*Cruise Ships and Itineraries*

As of December 31, 2008, we operate 38 ships under five cruise brands, with a selection of worldwide itineraries ranging from two to 24 nights that call on approximately 425 destinations. *Celebrity Equinox* and *Oasis of the Seas* are expected to enter revenue service in the third and fourth quarters of 2009, respectively. The following table represents summary information concerning our ships and their areas of operation based on 2009 itineraries (subject to change):

Ship	Year Ship	Approximate	
	Entered Service ¹	Berths	Primary Areas of Operation
Royal Caribbean International			
<i>Oasis of the Seas</i>	2009	5,400	Eastern Caribbean
<i>Independence of the Seas</i>	2008	3,600	Europe, Eastern/Western Caribbean
<i>Liberty of the Seas</i>	2007	3,600	Eastern/Western Caribbean
<i>Freedom of the Seas</i>	2006	3,600	Eastern/Western Caribbean
<i>Jewel of the Seas</i>	2004	2,100	Caribbean, Panama Canal, Canada/New England, Europe
<i>Mariner of the Seas</i>	2003	3,100	South America, Mexican Riviera
<i>Serenade of the Seas</i>	2003	2,100	Alaska, Southern Caribbean, Panama Canal
<i>Navigator of the Seas</i>	2002	3,100	Western Caribbean, Europe
<i>Brilliance of the Seas</i>	2002	2,100	Europe
<i>Adventure of the Seas</i>	2001	3,100	Southern Caribbean
<i>Radiance of the Seas</i>	2001	2,100	South America, Mexican Riviera, Alaska
<i>Explorer of the Seas</i>	2000	3,100	Eastern/Southern Caribbean, Bermuda, Canada/New England
<i>Voyager of the Seas</i>	1999	3,100	Western Caribbean, Europe
<i>Vision of the Seas</i>	1998	2,000	Southern Caribbean, Europe, Brazil
<i>Enchantment of the Seas</i>	1997	2,250	Western/Southern Caribbean
<i>Rhapsody of the Seas</i>	1997	2,000	Australia/NZ, Alaska
<i>Grandeur of the Seas</i>	1996	1,950	Eastern/Western Caribbean, Bermuda, Canada/New England
<i>Splendour of the Seas</i>	1996	1,800	Europe, Brazil
<i>Legend of the Seas</i>	1995	1,800	Asia, Europe
<i>Majesty of the Seas</i>	1992	2,350	Bahamas
<i>Monarch of the Seas</i>	1991	2,350	Bahamas
Celebrity Cruises			
<i>Celebrity Equinox</i>	2009	2,850	Europe, Caribbean
<i>Celebrity Solstice</i>	2008	2,850	Europe, Eastern Caribbean
<i>Celebrity Constellation</i>	2002	2,050	Caribbean, Europe, Canada/New England, Panama Canal
<i>Celebrity Summit</i>	2001	2,050	Europe, Southern Caribbean
<i>Celebrity Infinity</i>	2001	2,050	Alaska, Panama Canal, South America
<i>Celebrity Millennium</i>	2000	2,050	Southern Caribbean, Panama Canal, Hawaii, Alaska, Australia/NZ
<i>Celebrity Mercury</i>	1997	1,850	

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			Alaska, Pacific Northwest, Panama Canal, Hawaii, Bahamas, Eastern Caribbean
<i>Celebrity Galaxy</i> ³	1996	1,850	Southern Caribbean
<i>Celebrity Century</i>	1995	1,800	Western Caribbean, Bahamas, Europe
<i>Celebrity Xpedition</i> ⁴	2004	100	Galapagos Islands

Table of Contents**Pullmantur**

<i>Ocean Dream</i> ⁵	2008	1,000	Southern Caribbean
<i>Sky Wonder</i> ¹¹	2006	1,200	Eastern Mediterranean
<i>Oceanic</i> ⁵	2001	1,150	Western Mediterranean
<i>Zenith</i> ⁷	1992	1,400	Western Europe, Baltic
<i>Empress</i> ²	1990	1,600	Eastern Mediterranean
<i>Sovereign</i> ²	1988	2,300	Western Mediterranean
<i>Pacific Dream</i> ¹⁰	1990	1,350	Mexico

Azamara Cruises

<i>Azamara Journey</i> ⁸	2004	700	Europe, Caribbean, Panama Canal
<i>Azamara Quest</i> ⁹	2006	700	Europe, Asia

CDF Croisières de France

<i>Bleu de France</i> ⁶	2005	750	Mediterranean, Caribbean
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Total 88,250

¹ The year a ship entered service refers to the year in which the ship commenced cruise revenue operations for the Company, which is the same as the year the ship was built, unless otherwise noted.

² *Empress* (formerly *Empress of the Seas*) and *Sovereign* (formerly *Sovereign of the Seas*) were redeployed from Royal Caribbean International to Pullmantur in March 2008 and November 2008, respectively.

³ *Celebrity Galaxy* will be sold to TUI Cruises to serve as its first ship and will sail under a new name beginning in May 2009.

⁴ *Celebrity Xpedition* was built in 2001.

⁵ *Ocean Dream* and *Oceanic* were built in 1981 and 1965, respectively.

⁶ *Bleu de France* (formerly *Holiday Dream*) was built in 1981 and was redeployed from Pullmantur to CDF Croisières de France in April 2008.

⁷ *Zenith* was revitalized in 2007 and redeployed to Pullmantur in May 2007.

⁸ *Azamara Journey* (formerly *Blue Dream*) was built in 2000 and was redeployed from Pullmantur to Azamara Cruises in May 2007.

⁹ *Azamara Quest* (formerly *Blue Moon*) was built in 2000 and was redeployed from Pullmantur to Azamara Cruises in September 2007.

¹⁰ Celebrity Cruises' *Horizon* was built in 1990 and is currently chartered to Island Cruises. We anticipate the return of the ship in April 2009 and intend to redeploy the ship to Pullmantur. The ship will sail under the name *Pacific Dream*.

¹¹ *Sky Wonder* was built in 1984 and will begin sailing under the name *Atlantic Star* in March 2009.

We have two Oasis-class ships on order for Royal Caribbean International. These ships are being built in Finland by STX Finland Cruise Oy (formerly Aker Yards Oy). We have four Solstice-class ships on order for Celebrity Cruises. These ships are being built in Germany by Meyer Werft GmbH. See Item 1A. *Risk Factors* regarding shipyards. The expected dates these ships will enter service and their planned number of berths are as follows:

Ship	Expected to Enter Service	Approximate Berths
Royal Caribbean International:		
Oasis-class:		
<i>Oasis of the Seas</i>	4th Quarter 2009	5,400
<i>Allure of the Seas</i>	4th Quarter 2010	5,400
Celebrity Cruises:		
Solstice-class:		
<i>Celebrity Equinox</i>	3rd Quarter 2009	2,850
<i>Celebrity Eclipse</i>	3rd Quarter 2010	2,850
<i>Unnamed</i>	3rd Quarter 2011	2,850
<i>Unnamed</i>	4th Quarter 2012	2,850
Total Berths		22,200

Table of Contents*Seasonality*

Our revenues are seasonal based on the demand for cruises. Demand is strongest for cruises during the Northern Hemisphere summer months and holidays.

Passengers and Capacity

Selected statistical information is shown in the following table (see Terminology and Non-GAAP Financial Measures under Item 7. *Management's Discussion and Analysis of Financial Condition and Results of Operations*, for definitions). (Amounts include Pullmantur effective January 1, 2007):

	Year Ended December 31,				
	2008	2007	2006	2005	2004
Passengers Carried	4,017,554	3,905,384	3,600,807	3,476,287	3,405,227
Passenger Cruise Days	27,657,578	26,594,515	23,849,606	23,178,560	22,661,965
Available Passenger Cruise Days (APCD)	26,463,637	25,155,768	22,392,478	21,733,724	21,439,288
Occupancy	104.5%	105.7%	106.5%	106.6%	105.7%

Cruise Pricing

Our cruise ticket prices include accommodations and a wide variety of activities and amenities, including meals and entertainment. Prices vary depending on the destination, cruise length, cabin category selected and the time of year the cruise takes place. Although we grant credit terms to certain travel agencies and tour operators outside of the United States, our payment terms generally require an upfront deposit to confirm a reservation with the balance due prior to the sailing. During the selling period of a cruise, we continually monitor and adjust our cruise ticket prices for available passenger cabins based on demand, with the objective of maximizing net yields. Historically, we have opened cruises for sale at least one year in advance, and often as much as two years in advance. Additionally, we offer air transportation as a service for guests that elect to utilize our transportation program. Our air transportation program is available from major cities in the United States and Canada, and from select cities in Europe, mainly in the United Kingdom. Prices vary by gateway and destination. Generally, air tickets are sold to guests at prices close to cost. Passenger ticket revenues accounted for 72.4%, 72.0% and 73.4% of total revenues in 2008, 2007 and 2006, respectively.

Onboard Activities and Other Revenues

Our cruise brands offer modern fleets with a wide array of onboard services, amenities and activities, including swimming pools, sun decks, lawn decks, spa facilities (which include massage and exercise facilities), beauty salons, bungee jumping trampolines, gaming facilities, lounges, bars, a wide variety of dining options and venues, Las Vegas-style entertainment, hot glass shows, retail shopping, libraries, dedicated recreational areas for youth of all ages, cinemas, conference centers, internet cafes and shore excursions at each port of call. Royal Caribbean International offers rock climbing walls on its ships, additional activities including ice skating rinks and in-line skating on its Voyager-class and Freedom-class ships, sports courts, a surf simulator and an interactive water park called the H2O Zone on its Freedom-class ships. While many onboard activities are included in the base price of a cruise, we realize additional revenues from, among other things, gaming, the sale of alcoholic and other beverages, specialty restaurants, gift shop items, shore excursions, photography, spa/salon and fitness services and art auctions. Royal Caribbean International, Celebrity Cruises and Azamara Cruises offer enhanced functionality on our internet sites for selecting shore excursions, specialty dining and amenities prior to embarkation. Royal Caribbean International and Celebrity Cruises also offer a catalogue gift service, which is now offered via the internet to provide travel agents and others the opportunity to purchase gifts for guests.

In conjunction with our cruise vacations, we offer pre- and post-cruise hotel packages to our Royal Caribbean International, Celebrity Cruises and Azamara Cruises guests. We also offer escorted, premium land-tour vacation packages in Alaska, Asia, Australia, the Canadian Rockies, Europe, New Zealand and Latin America. These escorted, premium land-tour vacations are offered exclusively in conjunction with our cruises marketed to our Royal Caribbean International, Celebrity Cruises and Azamara Cruises guests through our cruise-tour operations, Royal Celebrity Tours. Pullmantur also offers land-based tour packages to Spanish and European vacation travelers including hotels and flights to Caribbean resorts and sells land based packages to Europe aimed at Latin

Table of Contents

American guests. In addition, we sell cruise vacation protection coverage, which provides guests with coverage for trip cancellation, medical protection and baggage protection. Onboard and other revenues accounted for 27.6%, 28.0% and 26.6% of total revenues in 2008, 2007 and 2006, respectively.

Segment Reporting

We operate five cruise brands, Royal Caribbean International, Celebrity Cruises, Pullmantur, Azamara Cruises and CDF Croisières de France. The brands have been aggregated as a single reportable segment based on the similarity of their economic characteristics as well as products and services provided. (For financial information see Item 8. *Financial Statements and Supplementary Data*.)

Employees

As of December 31, 2008, we employed approximately 4,400 full-time and 650 part-time employees worldwide in our shoreside operations. We also employed approximately 44,600 shipboard employees. As of December 31, 2008, approximately 80% of our shipboard employees were covered by collective bargaining agreements. We believe that our relationship with our employees is good.

Insurance

We maintain insurance on the hull and machinery of our ships, which includes additional coverage for disbursements, earnings and increased value, which are maintained in amounts related to the value of each ship. The coverage for each of the hull policies is maintained with syndicates of insurance underwriters from the British, Scandinavian, French, United States and other international insurance markets.

We maintain liability protection and indemnity insurance for each of our ships through either the United Kingdom Mutual Steam Ship Assurance Association (Bermuda) Limited or Steamship Mutual Underwriting Association (Bermuda) Limited. Our protection and indemnity liability insurance is done on a mutual basis and we are subject to additional premium calls in amounts based on claim records of all members of the mutual protection and indemnity association. We are also subject to additional premium calls based on investment shortfalls experienced by the insurer.

We maintain war risk insurance for our ships, including terrorist risk insurance, on each ship through a Norwegian war risk insurance organization. This coverage includes coverage for physical damage to the ship which is not covered under the hull policies as a result of war exclusion clauses in such hull policies. We also maintain protection and indemnity war risk coverage for risks that would be excluded by the rules of the indemnity insurance organizations, subject to certain limitations. Consistent with most marine war risk policies, under the terms of our war risk insurance coverage, underwriters can give seven days notice to us that the policy will be canceled and reinstated at higher premium rates.

We also maintain insurance coverage for certain events, which would result in a delayed delivery of our contracted new ships, which we normally place starting approximately two years prior to the scheduled delivery dates.

Insurance coverage for shoreside property, shipboard inventory, and general liability risks are maintained with insurance underwriters in the United States and the United Kingdom.

We do not carry business interruption insurance for our ships nor our shoreside operations based on our evaluation of the risks involved and protective measures already in place, as compared to the cost of insurance.

All insurance coverage is subject to certain limitations, exclusions and deductible levels. In addition, in certain circumstances, we co-insure a portion of these risks. Premiums charged by insurance carriers, including carriers in the maritime insurance industry, increase or decrease from time to time and tend to be cyclical in nature. These cycles are impacted both by our own loss experience and by losses incurred in direct and reinsurance markets. We historically have been able to obtain insurance coverage in amounts and at premiums we have deemed to be commercially acceptable. No assurance can be given that affordable and secure insurance markets will be available to us in the future, particularly for war risk insurance.

Table of Contents

The Athens Convention relating to the Carriage of Passengers and their Luggage by Sea (1974) and the 1976 Protocol to the Athens Convention are generally applicable to passenger ships. The United States has not ratified the Athens Convention; however, with limited exceptions, the 1976 Athens Convention Protocol may be contractually enforced with respect to those of our cruises that do not call at a United States port. The International Maritime Organization Diplomatic Conference agreed upon a new Protocol to the Athens Convention on November 1, 2002. The 2002 Protocol, which is not yet in force, substantially increases the level of compulsory insurance, which must be maintained by passenger ship operators. No assurance can be given as to if or when the 2002 Protocol will come into force. If in force, no assurance can be given that affordable and secure insurance markets will be available to provide the level of coverage required under the 2002 Protocol.

Trademarks

We own a number of registered trademarks related to the Royal Caribbean International, Celebrity Cruises, Pullmantur, Azamara Cruises and CDF Croisières de France cruise brands. The registered trademarks include the name Royal Caribbean and its crown and anchor logo, the name Celebrity Cruises and its X logo, the names Pullmantur Cruises and Pullmantur and their logos, the name Azamara Cruises and its logo, the name CDF Croisières de France and its logo, and the names of various cruise ships. We believe trademarks related to the Royal Caribbean International, Celebrity Cruises and Pullmantur Cruises brands are widely recognized throughout the world and have considerable value. We also believe trademarks related to our new brands, Azamara Cruises and CDF Croisières de France, have received recent recognition throughout the world and have significant value.

Regulation

Our ships are regulated by various international, national, state and local laws, regulations and treaties in force in the jurisdictions in which they operate. In addition, our ships are registered in the Bahamas, Malta or in the case of *Celebrity Xpedition*, Ecuador. Each ship is subject to regulations issued by its country of registry, including regulations issued pursuant to international treaties governing the safety of the ship and its passengers. Each country of registry conducts periodic inspections to verify compliance with these regulations. Ships operating out of United States ports are subject to inspection by the United States Coast Guard for compliance with international treaties and by the United States Public Health Service for sanitary conditions. Our ships are also subject to similar inspections pursuant to the laws and regulations of various other countries our ships visit.

Our ships are required to comply with international safety standards defined in the Safety of Life at Sea Convention. The Safety of Life at Sea Convention standards are revised from time to time and the most recent modifications are being phased in through 2010. We do not anticipate that we will be required to make any material expenditures in order to comply with these rules.

We are required to obtain certificates from the United States Federal Maritime Commission relating to our ability to satisfy liability in cases of non-performance of obligations to passengers, as well as casualty and personal injury. Pursuant to the United States Federal Maritime Commission regulations, we arrange through our insurers for the provision of guarantees aggregating \$45.0 million for our ship-operating companies as a condition to obtaining the required certificates. The United States Federal Maritime Commission has proposed various revisions to the financial responsibility regulations, which could require us to significantly increase the amount of our bonds and accordingly increase our costs of compliance.

We are also required by the United Kingdom and other jurisdictions to establish our financial responsibility for any liability resulting from the non-performance of our obligations to passengers from these jurisdictions. In the United Kingdom, we are currently required by the United Kingdom Passenger Shipping Association to provide performance bonds totaling approximately £42.0 million. We are also required to pay to the United Kingdom Civil Aviation Authority a non-refundable tax of £1 per passenger.

We are subject to various United States and international laws and regulations relating to environmental protection. Under such laws and regulations, we are prohibited from, among other things, discharging certain materials, such as petrochemicals and plastics, into the waterways. We have made, and will continue to make, capital and other expenditures to comply with environmental laws and

Table of Contents

regulations. From time to time, environmental and other regulators consider more stringent regulations, which may affect our operations and increase our compliance costs. We believe that the impact of cruise ships on the global environment will continue to be an area of focus by the relevant authorities throughout the world and, accordingly, this will likely subject us to increasing compliance costs in the future.

Our ships are subject to the International Maritime Organization's regulations under the International Convention for the Prevention of Pollution from Ships (the MARPOL Regulations), which impose limitations on the sulfur content of fuel used by ships operating worldwide. The MARPOL Regulations also provide for special Emission Control Areas (ECAs) to be established with more stringent limitations on sulfur emissions.

In 2008, the MARPOL Regulations were amended (the Amendment) to require reductions in sulfur emissions by reducing the maximum sulfur content in fuel oil that may be used in ECAs to 1.0% by 2010. The Amendment also introduced progressive reductions in nitrogen oxide emissions from both existing and new marine diesel engines by 2011.

Compliance with the MARPOL Regulations will increase our fuel and operating costs, due to the higher cost of purchasing low sulfur fuel. In addition, compliance with the new standards under the Amendment may require the development of new engine designs or exhaust gas treatment systems, which may result in significant additional costs.

In 2010, a European Union directive also regarding the use of low sulfur fuels for passenger ships becomes effective. The directive places a 0.1% sulfur content limit on all marine fuels used by such ships while alongside in European Union ports. Compliance with this directive will require us to use distillate fuels such as marine gas oil, which will increase our fuel costs.

The International Labour Organization, an agency of the United Nations that develops worldwide employment standards, has adopted a new Consolidated Maritime Labour Convention (the Convention). The Convention reflects standards and conditions to govern all aspects of crew management for all ships in international commerce, including additional requirements not previously in effect. The Convention may be ratified in 2010, in which case it would enter into force in 2011. If ratified, our crew costs may increase in order to comply with the Convention.

We are required to obtain certificates from the United States Coast Guard relating to our ability to satisfy liability in cases of water pollution. Pursuant to United States Coast Guard regulations, we arrange through our insurers for the provision of guarantees aggregating \$348.0 million as a condition to obtaining the required certificates.

We believe that we are in material compliance with all the regulations applicable to our ships and that we have all licenses necessary to conduct our business. Health, safety, security and financial responsibility issues are, and we believe will continue to be, an area of focus by the relevant government authorities in the United States and internationally. From time to time, various regulatory and legislative changes may be proposed that could impact our operations and would likely subject us to increasing compliance costs in the future.

Taxation of the Company

United States Federal Income Tax

The following discussion of the application of the United States federal income tax laws to us and our subsidiaries is based on the current provisions of the United States Internal Revenue Code, Treasury Department regulations, administrative rulings, and court decisions. All of the foregoing is subject to change, and any such change could affect the accuracy of this discussion.

Application of Section 883 of the Internal Revenue Code

We and our subsidiary, Celebrity Cruises Inc., the operator of Celebrity Cruises and Azamara Cruises, are foreign corporations engaged in a trade or business in the United States, and our ship-owning subsidiaries are foreign corporations that, in many cases, depending upon the itineraries of their ships, receive income from sources within the United States. Under Section 883 of the Internal Revenue Code, certain foreign corporations are not subject to United States income or branch profits tax on United States source income derived from or incidental to the international operation of a ship or ships, including income from the leasing of such ships.

Table of Contents

A foreign corporation will qualify for the benefits of Section 883 if, in relevant part: (1) the foreign country in which the foreign corporation is organized grants an equivalent exemption to corporations organized in the United States; and (2)(A) more than 50% of the value of the corporation's capital stock is owned, directly or indirectly, by individuals who are residents of a foreign country that grants such an equivalent exemption to corporations organized in the United States, or (B) the stock of the corporation (or the direct or indirect corporate parent thereof) is primarily and regularly traded on an established securities market in the United States or another qualifying country such as Norway. In the opinion of our United States tax counsel, Drinker Biddle & Reath LLP, based on the representations and assumptions set forth in that opinion, we, Celebrity Cruises Inc. and our ship-owning subsidiaries qualify for the benefits of Section 883 because we and each of those subsidiaries are incorporated in Liberia or Malta, which are qualifying countries, and our common stock is primarily and regularly traded on an established securities market in the United States or Norway. If, in the future, (1) Liberia no longer qualifies as an equivalent exemption jurisdiction, and we do not reincorporate in a jurisdiction that does qualify for the exemption, or (2) we fail to qualify as a publicly traded corporation, we and all of our ship-owning or operating subsidiaries that rely on Section 883 for tax exemption on qualifying income would be subject to United States federal income tax on their United States source shipping income and income from activities incidental thereto.

We believe that most of our income and the income of our ship-owning subsidiaries is derived from or incidental to the international operation of a ship or ships and, therefore, is exempt from taxation under Section 883. In 2005, final regulations became effective under Section 883, which, among other things, narrow somewhat the scope of activities that are considered by the Internal Revenue Service to be incidental to the international operation of ships. The activities listed in the regulations as not being incidental to the international operation of ships include income from the sale of air and land transportation, shore excursions and pre- and post-cruise tours. To the extent the income from these activities is earned from sources within the United States, that income will be subject to United States taxation; but the determination of the precise amount of such United States source income involves some uncertainties.

Under certain circumstances, changes in the identity, residence or holdings of our direct or indirect shareholders could cause our common stock not to be regularly traded on an established securities market within the meaning of the regulations under Section 883. To substantially reduce any such risk, in May 2000, our Articles of Incorporation were amended to prohibit any person, other than our two existing largest shareholders, from owning, directly or constructively as determined for purposes of Section 883(c)(3) of the Internal Revenue Code and the regulations promulgated under it, more than 4.9% of the relevant class or classes of our shares. Under Liberian law, this amendment may not be enforceable with respect to shares of common stock that were voted against the amendment or that were recorded as abstaining from the vote.

Also, it should be noted that Section 883 has been the subject of legislative modifications in past years that have had the effect of limiting its availability to certain taxpayers, and there can be no assurance that future legislation will not preclude us from obtaining the benefits of Section 883.

Taxation in the Absence of an Exemption under Section 883 of the Internal Revenue Code

If we, Celebrity Cruises Inc., or our ship-owning subsidiaries were to fail to meet the requirements of Section 883 of the Internal Revenue Code, or if the provision was repealed, then, as explained below, such companies would be subject to United States income taxation on a portion of their income derived from or incidental to the international operation of our ships.

Because we and Celebrity Cruises Inc. conduct a trade or business in the United States, we and Celebrity Cruises Inc. would be taxable at regular corporate rates on our separate company taxable income (i.e., without regard to the income of our ship-owning subsidiaries), from United States sources, which includes 100% of income, if any, from transportation that begins and ends in the United States (not including possessions of the United States), 50% of income from transportation that either begins or ends in the United States, and no income from transportation that neither begins nor ends in the United States. The legislative history of the transportation income source rules suggests that a cruise that begins and ends in a United States port, but that calls on more than one foreign port, will derive United States source income only from the first and last legs of such cruise. This conclusion is not free from doubt, however, because there are no regulations or other Internal Revenue Service interpretations of the above rules. In addition, if any of our earnings and profits effectively connected with our United States trade or business were withdrawn, or were deemed to have been withdrawn, from our United States trade or business, those withdrawn amounts would be subject to a branch profits tax.

Table of Contents

at the rate of 30%. The amount of such earnings and profits would be equal to the aforesaid United States source income, with certain generally minor adjustments, less income taxes. We and Celebrity Cruises Inc. would also be potentially subject to tax on portions of certain interest paid by us at rates of up to 30%.

If Section 883 were not available to our ship-owning subsidiaries, each such subsidiary would be subject to a special 4% tax on its United States source gross transportation income, if any, each year because it does not have a fixed place of business in the United States and its income is derived from the leasing of a ship. Such United States source gross transportation income may be determined under any reasonable method, including ratios of days traveling directly to or from United States ports to total days traveling, or of the lessee's United States source gross income from the ship (as determined under the source rules discussed in the preceding paragraph, and subject to the assumptions and qualifications set forth therein) to the lessee's total gross income from the ship.

Maltese Income Tax

Our Pullmantur ship owner-operator subsidiaries qualify as licensed shipping organizations in Malta. No Maltese income tax is charged on the income derived from shipping activities of a licensed shipping organization. Instead, a licensed shipping organization is liable to pay a tonnage tax based on the net tonnage of the ship or ships registered under the relevant provisions of the Merchant Shipping Act. A company qualifies as a shipping organization if it engages in qualifying activities and it obtains a license from the Registrar-General to enable it to carry on such activities. Qualifying activities include, but are not limited to, the ownership, operation (under charter or otherwise), administration and management of a ship or ships registered as a Maltese ship in terms of the Merchant Shipping Act and the carrying on of all ancillary financial, security and commercial activities in connection therewith.

Our Maltese operations that do not qualify as licensed shipping organizations, which are not considered significant, remain subject to normal Maltese corporate income tax.

United Kingdom Income Tax

The *Brilliance of the Seas* is operated by a company that is strategically and commercially managed in the United Kingdom, which has elected to be subject to the United Kingdom tonnage tax regime (U.K. tonnage tax). Companies subject to U.K. tonnage tax pay a corporate tax on a notional profit determined with reference to the net tonnage of qualifying vessels. Normal United Kingdom corporate income tax is not chargeable on the relevant shipping profits of a qualifying U.K. tonnage tax company. The requirements for a company to qualify for the U.K. tonnage tax regime include being subject to United Kingdom corporate income tax, operating qualifying ships, which are strategically and commercially managed in the United Kingdom, and fulfilling a seafarer training requirement.

Relevant shipping profits include income from the operation of qualifying ships and from shipping related activities. Our United Kingdom income from non-shipping activities which do not qualify under the U.K. tonnage tax regime and which are not considered significant, remain subject to United Kingdom corporate income tax.

State Taxation

We, Celebrity Cruises Inc. and certain of our subsidiaries are subject to various United States state income taxes which are generally imposed on each state's portion of the United States source income subject to federal income taxes. Additionally, the state of Alaska subjects an allocated portion of the total income of companies doing business in Alaska and certain other affiliated companies to Alaska corporate state income taxes and also imposes a 33% tax on income from onboard gambling activities conducted in Alaska waters. This did not have a material impact to our results of operations for all years presented.

Table of Contents**Other Taxation**

We and certain of our subsidiaries are subject to income tax in the United States or other jurisdictions on income that does not qualify for exemption under Section 883 or tonnage tax regimes. The tax on such income was not material to our results of operations for all years presented.

Website Access to Reports

We make available, free of charge, access to our Annual Reports, all quarterly and current reports and all amendments to those reports, as soon as reasonably practicable after such reports are electronically filed with or furnished to the Securities and Exchange Commission through our website at www.rclinvestor.com. The information contained on our website is not a part of any of these reports and is not incorporated by reference herein.

Executive Officers of the Company

Our executive officers are:

Name	Age	Position
Richard D. Fain	61	Chairman, Chief Executive Officer and Director
Adam M. Goldstein	49	President and Chief Executive Officer, Royal Caribbean International
Daniel J. Hanrahan	51	President and Chief Executive Officer, Celebrity Cruises and Azamara Cruises
Brian J. Rice	50	Executive Vice President and Chief Financial Officer
Harri U. Kulovaara	56	Executive Vice President, Maritime
Gonzalo Chico Barbier	48	President and Chief Executive Officer, Pullmantur

Richard D. Fain has served as a director since 1979 and as our Chairman and Chief Executive Officer since 1988. Mr. Fain has been involved in the shipping industry for over 25 years.

Adam M. Goldstein has served as President of Royal Caribbean International since February 2005 and as its President and Chief Executive Officer since September 2007. Mr. Goldstein has been employed with Royal Caribbean since 1988 in a variety of positions, including Executive Vice President, Brand Operations of Royal Caribbean International, Senior Vice President, Total Guest Satisfaction and Senior Vice President, Marketing. Mr. Goldstein served as National Chair of the United States Travel Association (formerly, Travel Industry Association of America) in 2001.

Daniel J. Hanrahan has served as President of Celebrity Cruises since February 2005 and as its President and Chief Executive Officer since September 2007. Mr. Hanrahan also serves as President and Chief Executive Officer of Azamara Cruises. From 1999 until February 2005, Mr. Hanrahan served in a variety of positions with the Royal Caribbean International brand, including Senior Vice President, Sales and Marketing.

Brian J. Rice has served as Executive Vice President and Chief Financial Officer since November 2006. Mr. Rice has been employed with Royal Caribbean since 1989 in a variety of positions including Executive Vice President, Revenue Performance. In such capacity, Mr. Rice was responsible for revenue management, air/sea, groups, international operations, decision support, reservations and customer service for both Royal Caribbean International and Celebrity Cruises. As part of his responsibilities, Mr. Rice oversees revenue performance.

Harri U. Kulovaara has served as Executive Vice President, Maritime, since January 2005. Mr. Kulovaara is responsible for fleet design and newbuild operations. Mr. Kulovaara also chairs our Maritime Safety Advisory Board. Mr. Kulovaara has been employed with Royal Caribbean since 1995 in a variety of positions, including Senior Vice President, Marine Operations, and Senior Vice President, Quality Assurance. Mr. Kulovaara is a naval architect and engineer.

Gonzalo Chico Barbier has served as President and Chief Executive Officer of Pullmantur since June 2008. From 1995 to June 2008, Mr. Chico served as Executive President of TNT Spain, a division of TNT, a global distribution, logistics and international mail service company. From 1986 until 1995, Mr. Chico was employed in a variety of positions with Ford Motor Company in Spain and in the United Kingdom, including Pan-European Fleet Business Manager of Ford of Europe, Ltd.

Table of Contents

Item 1A. Risk Factors

The risk factors set forth below and elsewhere in this Annual Report on Form 10-K are important factors, among others, that could cause actual results to differ from expected or historical results. It is not possible to predict or identify all such factors. Consequently, this list should not be considered a complete statement of all potential risks or uncertainties. (See Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations for a cautionary note regarding forward-looking statements.)

The adverse impact of the continuing worldwide economic downturn on the demand for cruises could adversely impact our operating results, cash flows and financial condition.

The demand for cruises is affected by international, national and local economic conditions. The current worldwide economic downturn has had an adverse effect on vacationers' discretionary income and consumer confidence which has resulted in cruise booking slowdowns, decreased cruise prices and lower onboard revenues for us and for the others in the cruise industry. We cannot predict the extent or duration of this downturn or the timing or strength of a subsequent economic recovery. However, if the downturn continues for an extended period of time or worsens, we could experience a prolonged period of booking slowdowns, depressed cruise prices and reduced onboard revenues. This could adversely impact our operating results, cash flows and financial condition including the impairment of the value of our ships, goodwill and other intangible assets.

We may not be able to obtain sufficient financing or capital for our needs or may not be able to do so on terms that are acceptable or consistent with our expectations.

To fund our capital expenditures and scheduled debt payments, we have historically relied on a combination of cash flows provided by operations, drawdowns under available credit facilities, the incurrence of additional indebtedness and the sale of equity or debt securities in private or public securities markets. The decrease in consumer cruise spending as a result of the current economic environment is adversely impacting our cash flows from operations. The disruption in the credit markets has resulted in a lack of liquidity worldwide which may affect our ability to successfully raise capital or to do so on acceptable terms. These factors may prevent us from having sufficient available capital or financing to meet our needs or to do so on acceptable terms. During 2008, our credit rating was lowered from BBB- with a negative outlook to BB with a negative outlook by Standard and Poor's. In January 2009, Standard and Poor's placed our credit rating on credit watch with negative implications. In addition, our credit rating was lowered from Ba1 with a stable outlook to Ba2 with a negative outlook by Moody's. There is no assurance that our credit ratings will not be lowered further. The lowering of our credit ratings may increase our cost of financing and can make it more difficult for us to access the financial markets. See Item 7. *Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources.*

As of December 31, 2008, we had two ships of a new Oasis-class designated for Royal Caribbean International and four Solstice-class ships designated for Celebrity Cruises on order. We expect to take delivery of *Celebrity Equinox* and *Oasis of the Seas* in July 2009 and November 2009, respectively. We have committed financing for all of the Solstice-class ships and have commitments for government financing guarantees from Finnvera, the export credit agency of Finland for 80% of the financed amount of the Oasis-class ships. We must still secure financing for *Oasis of the Seas* and *Allure of the Seas*, and, although we believe that we will be able to do so, there can be no assurance that we will be able to do so or that we will be able to do so on acceptable terms.

The impact of disruptions in the global financial markets may affect the ability of our counterparties and others to perform their obligations to us.

The economic events over the past several months, including recent failures of financial service companies and the related liquidity crisis, have disrupted the capital and credit markets. These disruptions could cause our counterparties and others to breach their obligations to us under our contracts with them. This could include failures of banks or other financial service companies to fund required borrowings under our loan agreements or to pay us amounts that may become due under our derivative contracts for hedging of fuel prices, interest rates and foreign currencies or other agreements. If this occurs it may have a negative impact on our cash flows including our ability to meet our obligations, results of operations and financial condition.

Table of Contents

The increase in capacity resulting from delivery of newbuilds currently on order within the cruise industry could further adversely impact the demand for cruises or cruise pricing.

A total of 34 new ships are on order for delivery through 2012 in the cruise industry, six of which are ours. The current worldwide economic downturn and tighter credit markets have already resulted in a weaker demand environment which has led to lower cruise prices and lower onboard purchases, all of which have adversely affected our revenues. The further growth in capacity from these new ships, without an increase in the cruise industry's share of the vacation market, could further depress cruise prices, compounding with the current adverse economic environment to hinder our ability for a quick recovery.

We may lose business to competitors throughout the vacation market.

We operate in the vacation market and cruising is one of many alternatives for people choosing a vacation. We therefore risk losing business not only to other cruise lines, but also to other vacation operators, which provide other leisure options including hotels, resorts and package holidays and tours.

We face significant competition from other cruise lines, both on the basis of cruise pricing and also in terms of the nature of ships and services we offer to passengers. Our principal competitors within the cruise vacation industry include Carnival Corporation & plc, which owns, among others, Aida Cruises, Carnival Cruise Lines, Costa Cruises, Cunard Line, Holland America Line, P&O Cruises and Princess Cruises and has a joint venture with Orizonia Corporation under which they operate Iberocruceiros; Disney Cruise Line; MSC Cruises; Norwegian Cruise Line and Oceania Cruises.

In the event that we do not compete effectively with other vacation alternatives and cruise companies, our results of operations and financial position could be adversely affected.

Fears of terrorist and pirate attacks, war, and other hostilities and the spread of contagious diseases could have a negative impact on our results of operations.

Events such as terrorist and pirate attacks, war, and other hostilities and the resulting political instability, travel restrictions, the spread of contagious diseases and concerns over safety, health and security aspects of traveling have had, and could have in the future, a significant adverse impact on demand and pricing in the travel and vacation industry. These events could also impact our ability to source qualified crew from throughout the world at competitive costs and, therefore, increase our shipboard employee costs.

Incidents or adverse publicity concerning the cruise vacation industry or unusual weather conditions could affect our reputation and harm our future sales and results of operations.

The operation of cruise ships involves the risk of accidents, illnesses and other incidents which may bring into question passenger safety, health, security and vacation satisfaction and create a perception that cruising is more dangerous than other vacation alternatives. Incidents involving cruise ships, adverse media publicity concerning the cruise vacation industry or unusual weather patterns or natural disasters, such as hurricanes and earthquakes, could impact demand and consequently have an adverse impact on our results of operations and on future industry performance.

Environmental, health and safety, financial responsibility and other maritime regulations could affect operations and increase operating costs.

The United States and various state and foreign government or regulatory agencies have enacted or are considering new environmental regulations or policies, such as requiring the use of low sulfur fuels, increasing fuel efficiency requirements or further restricting emissions, that could adversely impact the cruise vacation industry. Some environmental groups have also lobbied for more stringent regulation of cruise ships and have generated negative publicity about the cruise vacation industry and its environmental impact. In addition, we are subject to various international, national, state and local laws, regulations and treaties that govern, among

Table of Contents

other things, safety standards applicable to our ships, health and sanitary standards applicable to our passengers, security standards on board our ships and at the ship/port interface areas, and financial responsibilities to our passengers. These issues are, and we believe will continue to be, an area of focus by the relevant authorities throughout the world. This could result in the enactment of more stringent regulation of cruise ships that would subject us to increasing compliance costs in the future.

Conducting business internationally may result in increased costs and other risks.

We operate our business internationally and plan to continue to develop our international presence. Operating internationally exposes us to a number of risks. Examples include unstable local political or economic conditions and risk of increases in duties and taxes as well as changes in laws and policies affecting cruising, vacation or maritime businesses, or governing the operations of foreign-based companies. Additional risks include currency fluctuations, interest rate movements, imposition of trade barriers and restrictions on repatriation of earnings. If we are unable to address these risks adequately, our financial position and results of operations could be adversely affected.

We have ship construction contracts, which are denominated in euros. While we have entered into euro-denominated forward contracts to manage a portion of the currency risk associated with these ship construction contracts, we are exposed to fluctuations in the euro exchange rate for the portion of the ship construction contracts that has not been hedged. If the shipyard is unable to perform under the related ship construction contract, any foreign currency hedges that were entered into to manage the currency risk would need to be terminated. Termination of these contracts could result in a significant loss.

Our attempts to expand our business into new markets may not be successful.

Historically our focus has been to serve the North American cruise market, which continues to be our primary source of cruise passengers. We have expanded our focus to increase our international passenger sourcing, most recently, in the Brazilian and Australian markets. Expansion into new markets requires significant levels of investment. There can be no assurance that these markets will develop as anticipated or that we will have success in these markets, and if we do not, we may be unable to recover our investment, which could adversely impact our business, financial condition and results of operations.

Ship construction delays or mechanical faults may result in cancellation of cruises or unscheduled drydocks and repairs and thus adversely affect our results of operations.

We depend on shipyards to construct and deliver our cruise ships on a timely basis and in good working order. The sophisticated nature of building a ship involves risks. Delays or mechanical faults in ship construction have in the past and may in the future result in delays or cancellation of cruises or necessitate unscheduled drydocks and repairs of ships. We have, for example, experienced mechanical problems with the pod propulsion units on certain ships and there can be no assurance that we will not experience such problems in the future. These events and any related adverse publicity could result in lost revenue, increased operating expenses, or both, and thus adversely affect our results of operations.

The current worldwide economic downturn is resulting in financial difficulties for shipyards and their subcontractors. This may cause or result in delivery delays, ship cancellations or increases in shipbuilding costs that could adversely affect our results of operations.

The current downturn in the worldwide economy is causing a loss of business for shipyards and their subcontractors which could result in financial difficulties, liquidations or closures. These events could adversely affect the timely delivery or costs of new ships or the ability of shipyards to repair and refurbish our existing fleet in accordance with our needs or expectations. Delivery delays and cancelled deliveries can adversely affect our results of operations, as can any constraints on our ability to repair and maintain our ships on a timely basis. In addition, the cruise shipyard industry is undergoing consolidation, which could result in stronger bargaining power on the part of the shipyards, and thus higher prices for our future ship orders.

Table of Contents

Our operating costs and taxes could increase due to market forces and economic or geo- political factors beyond our control.

Our operating costs, including fuel, food, payroll, airfare for our shipboard personnel, insurance and security costs are subject to increases due to market forces and economic or political instability or other factors beyond our control. Increases in these operating costs could adversely affect our profitability. In addition, the recent volatility in the price of fuel is making our ability to predict fuel prices extremely difficult. United States, state and local authorities as well as foreign authorities periodically consider increases in taxes. Any such tax increases could also cause an increase in our costs.

Unavailability of ports of call may adversely affect our results of operations.

We believe that port destinations are a major reason why passengers choose to go on a particular cruise or on a cruise vacation. The availability of ports is affected by a number of factors, including, but not limited to, existing capacity constraints, security concerns, adverse weather conditions and natural disasters, financial limitations on port development, exclusivity arrangements that ports may have with our competitors, local governmental regulations and local community concerns about port development and other adverse impacts on their communities from additional tourists. Any limitations on the availability of our ports of call or on the availability of shore excursion and other service providers at such ports could adversely affect our results of operations.

Price increases for commercial airline service for our passengers or major changes or reduction in commercial airline service could adversely impact the demand for cruises and undermine our ability to provide reasonably priced vacation packages to our passengers.

Many of our passengers depend on scheduled commercial airline services to transport them to or from the ports where our cruises embark or disembark. Increases in the price of airfare would increase the overall price of the cruise vacation to our passengers which may adversely impact demand for our cruises. In addition, changes in the availability of commercial airline services could adversely affect our passenger's ability to obtain airfare as well as our ability to fly our passengers to or from our cruise ships which could adversely affect our results of operations.

Changes or disruptions to external distribution channels for our guest bookings could adversely affect our results of operations.

We rely on travel agencies to generate the majority of bookings for our ships. If the current worldwide economic downturn continues for an extended period of time or worsens, these agencies could be adversely impacted and significant disruptions or contractions could occur to these businesses. This could reduce the distribution channels available for us to market and sell our cruises. If this were to occur, it could have an adverse impact on our financial condition and results of operations.

The loss of key personnel or our inability to recruit or retain qualified personnel could adversely affect our results of operations.

Our success depends, in large part, on the skills and contributions of key executives and other employees, and on our ability to recruit and retain high quality employees. We must continue to recruit, retain and motivate management and other employees sufficient to maintain our current business and support our projected growth. A loss of key employees could adversely affect our results of operations.

A change in our tax status under the United States Internal Revenue Code, or other jurisdictions, may have adverse effects on our income.

We and a number of our subsidiaries are foreign corporations that derive income from a United States trade or business and/or from sources within the United States. Drinker Biddle & Reath LLP, our United States tax counsel, has delivered to us an opinion, based on certain representations and assumptions set forth in it, to the effect that this income, to the extent derived from or incidental to the international operation of a ship or ships, is exempt from United States income tax pursuant to Section 883 of the Internal Revenue Code. We believe that most of our income (including that of our subsidiaries) is derived from or incidental to the international operation of a ship or ships.

Table of Contents

It should also be noted that the provisions of Section 883 are subject to change at any time by legislation. Moreover, changes could occur in the future with respect to the identity, residence or holdings of our direct or indirect shareholders, or relevant foreign tax laws, that could affect our eligibility for the Section 883 exemption. Accordingly, there can be no assurance that we will continue to be exempt from United States income tax on United States source shipping income in the future. If we were not entitled to the benefit of Section 883, we and our subsidiaries would be subject to United States taxation on a portion of the income derived from or incidental to the international operation of our ships, which would reduce our net income. See *Taxation of the Company* above for a discussion of such taxation in the absence of an exemption under Section 883.

Finally, changes in the income tax laws affecting our operations in Malta, the United Kingdom or elsewhere could result in higher income taxes being charged against our operations, resulting in lower net income.

We are controlled by principal shareholders that have the power to determine our policies, management and actions requiring shareholder approval.

As of February 12, 2009, A. Wilhelmsen AS., a Norwegian corporation indirectly owned by members of the Wilhelmsen family of Norway, owned approximately 20.1% of our common stock and Cruise Associates, a Bahamian general partnership indirectly owned by various trusts primarily for the benefit of certain members of the Pritzker family and a trust primarily for the benefit of certain members of the Ofer family, owned approximately 15.6% of our common stock. A sale of shares by A. Wilhelmsen AS. or Cruise Associates could cause a drop in our share prices.

A. Wilhelmsen AS. and Cruise Associates are parties to a shareholders' agreement and have the power to determine, among other things our policies, the persons who will be our directors and officers, and actions requiring shareholder approval. The shareholders' agreement provides that our board of directors will consist of four nominees of A. Wilhelmsen AS., four nominees of Cruise Associates and our Chief Executive Officer.

During the term of the shareholders' agreement, certain corporate actions require the approval of at least one director nominated by A. Wilhelmsen AS. and one director nominated by Cruise Associates. Our principal shareholders are not prohibited from engaging in a business that may compete with our business, subject to certain exceptions. If any person other than A. Wilhelmsen AS. and Cruise Associates, our two principal shareholders, acquires ownership of more than 30% of our common stock and our two principal shareholders, in the aggregate, own less of our common stock than such person and do not collectively have the right to elect, or to designate for election, at least a majority of the board of directors, we may be obligated to prepay indebtedness outstanding under the majority of our credit facilities, which we may be unable to replace on similar terms. If this were to occur, it could have an adverse impact on our liquidity and operations.

We are not a United States corporation and our shareholders may be subject to the uncertainties of a foreign legal system in protecting their interests.

Our corporate affairs are governed by our Restated Articles of Incorporation and By-Laws and by the Business Corporation Act of Liberia. The provisions of the Business Corporation Act of Liberia resemble provisions of the corporation laws of a number of states in the United States. However, while most states have a fairly well developed body of case law interpreting their respective corporate statutes, there are very few judicial cases in Liberia interpreting the Business Corporation Act of Liberia. As such, the rights and fiduciary responsibilities of directors under Liberian law are not as clearly established as the rights and fiduciary responsibilities of directors under statutes or judicial precedent in existence in certain United States jurisdictions. For example, the right of shareholders to bring a derivative action in Liberian courts may be more limited than in United States jurisdictions. There may also be practical difficulties for shareholders attempting to bring suit in Liberia and Liberian courts may or may not recognize and enforce foreign judgments. Thus, our public shareholders may have more difficulty in protecting their interests with respect to actions by management, directors or controlling shareholders than would shareholders of a corporation incorporated in a United States jurisdiction.

Table of Contents

Litigation, enforcement actions, fines or penalties could adversely impact our financial condition or results of operations and/or damage our reputation.

Our business is subject to various United States and international laws and regulations that could lead to enforcement actions, fines, civil or criminal penalties or the assertion of litigation claims and damages. In addition, improper conduct by our employees or agents could damage our reputation and/or lead to litigation or legal proceedings that could result in civil or criminal penalties, including substantial monetary fines. In certain circumstances it may not be economical to defend against such matters and/or a legal strategy may not ultimately result in us prevailing in a matter. Such events could lead to an adverse impact on our financial condition or results of operations.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

Information about our cruise ships, including their size and primary areas of operation, may be found within the *Operating Strategies Fleet Development and Maintenance* section and the *Operations Cruise Ships and Itineraries* section in Item 1. *Business*. Information regarding our cruise ships under construction, estimated expenditures and financing may be found within the *Future Capital Commitments and Funding Sources* sections of Item 7. *Management's Discussion and Analysis of Financial Condition and Results of Operations*.

Our principal executive office and shoreside operations are located at the Port of Miami, Florida where we lease three office buildings totaling approximately 359,000 square feet from Miami-Dade County, Florida, under long-term leases with initial terms expiring in various years on and after 2011. We also lease offices to administer our Royal Caribbean International and Celebrity Cruises operations internationally, including an office in Addlestone, England, for our Europe operations, offices in Singapore and Shanghai for our Asia/Pacific operations and an office in Sydney for our Australia operations. We lease an office in Madrid, Spain and in Mexico City, Mexico to administer our Pullmantur operations.

We lease an office building in Springfield, Oregon totaling approximately 163,000 square feet, which is used as a call center for reservations. In addition, we lease an office building in Wichita, Kansas totaling approximately 95,000 square feet, which is used as a call center for reservations and customer service.

We lease two buildings in Miramar, Florida totaling approximately 178,000 square feet. One building is used primarily as additional office space and the other building is used as a call center for reservations.

We lease our logistics center in Pembroke Park, Florida totaling approximately 154,000 square feet through December 2009. We also lease a building in Weston, Florida totaling approximately 267,000 square feet which is currently used as additional office space. This facility will be used as our logistics center in the future.

Royal Caribbean International operates two private destinations: (i) an island we own in the Bahamas which we call CocoCay; and (ii) Labadee, a secluded peninsula which we lease and is located on the north coast of Haiti.

Item 3. Legal Proceedings

In January 2006, a purported class action lawsuit was filed in the United States District Court for the Southern District of New York alleging that we infringed rights in copyrighted works and other intellectual property by presenting performances on our cruise ships without securing the necessary licenses. The suit seeks payment of damages, disgorgement of profits and a permanent injunction against future infringement. In April 2006, we filed a motion to sever and transfer the case to the United States District Court for the Southern District of Florida. The motion is pending. We are not able at this time to estimate the impact of this proceeding.

We have a lawsuit pending in the Circuit Court for Miami-Dade County, Florida against Rolls Royce, co-producer of the Mermaid pod-propulsion system on Millennium-class ships, for the recurring Mermaid pod failures. Alstom Power Conversion, the

Table of Contents

other co-producer of the pod-propulsion system, settled out of this suit in January 2006 for \$38.0 million. In December 2008, Rolls Royce filed its answer to our lawsuit denying the allegations and asserting various affirmative defenses. At the same time, Rolls Royce counterclaimed that we engaged in a civil conspiracy with Alstom Power Conversion and its various affiliates (Alstom), that we tortiously interfered with Rolls Royce's joint venture agreement with Alstom and that we caused Alstom to breach its fiduciary obligations owing to Rolls Royce under the joint venture agreement. Rolls Royce alleges damages against us in excess of \$100.0 million for these claims. They also brought a third-party complaint against Alstom and are seeking indemnification and contribution from them. We have moved to dismiss Rolls Royce's counterclaims on the basis that they are frivolous, unfounded and untimely. We are not able at this time to estimate the outcome of the Rolls Royce proceeding although we believe we have meritorious claims against Rolls Royce and meritorious defenses to the counterclaims, both of which we intend to vigorously pursue.

In July 2006, a purported class action lawsuit was filed in the United States District Court for the Central District of California alleging that we failed to timely pay crew wages and failed to pay proper crew overtime. The suit seeks payment of damages, including penalty wages under the United States Seaman's Wage Act and equitable relief damages under the California Unfair Competition Law. In December 2006, the District Court granted our motion to dismiss the claim and held that it should be arbitrated pursuant to the arbitration provision in Royal Caribbean's collective bargaining agreement. In November 2008, the United States Ninth Circuit Court of Appeals affirmed the District Court's finding and plaintiffs subsequent request for rehearing and rehearing en banc was denied. We are not able at this time to estimate the impact of this proceeding.

The Miami District Office of the United States Equal Employment Opportunity Commission (EEOC) has alleged that certain of our shipboard employment practices do not comply with United States employment laws. In June 2007, the EEOC proposed payment of monetary sanctions and certain remedial actions. Following discussions with the EEOC regarding this matter, the EEOC informed us that they transferred the matter to its legal unit for litigation review. To date, no legal proceedings have been initiated. We do not believe that this matter will have a material adverse impact on our financial condition or results of operations.

The Florida Attorney General's office is investigating whether there is or has been a violation of state or federal anti-trust laws in connection with the setting by us and other cruise line operators of fuel supplements in 2007. We are cooperating with the Attorney General's office in connection with this investigation and are not able at this time to estimate the impact of this investigation.

In October 2008, we were named as a defendant in a purported class action filed in the United States District Court, Western District of Washington against Park West Galleries, Inc. (Park West), Fine Arts Sales, Inc., HSBC Bank Nevada, NA, HSBC Finance Corporation, Holland America Line Inc., Holland America Line USA Inc. and other unnamed parties on behalf of purchasers of artwork from Park West. The suit alleges that Park West sold art pieces that Park West falsely claimed were authored by certain artists. The suit seeks damages and equitable relief on behalf of the class members and alleges claims for violation of the Racketeer Influenced and Corrupt Organizations Act (RICO), breach of contract, statutory fraud and other similar claims. Park West has a concession to sell artwork onboard Royal Caribbean International and Celebrity Cruises ships. In January 2009, we were dismissed without prejudice from the case.

We are routinely involved in other claims typical within the cruise vacation industry. The majority of these claims are covered by insurance. We believe the outcome of such claims, net of expected insurance recoveries, will not have a material adverse impact on our financial condition or results of operations.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Table of Contents**PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**
Market Information

Our common stock is listed on the New York Stock Exchange (NYSE) and the Oslo Stock Exchange (OSE) under the symbol RCL . The table below sets forth the high and low prices of our common stock as reported by the NYSE and the OSE for the two most recent years by quarter:

	NYSE		OSE	
	Common Stock High	Common Stock Low	Common Stock(1) High	Common Stock(1) Low
2008				
Fourth Quarter	\$ 21.26	\$ 6.64	133.50	54.50
Third Quarter	29.35	19.54	164.00	97.50
Second Quarter	35.47	22.33	181.50	113.50
First Quarter	41.22	30.23	229.00	160.00
2007				
Fourth Quarter	\$ 43.45	\$ 37.52	243.50	205.00
Third Quarter	42.53	36.03	251.00	203.50
Second Quarter	44.62	40.43	268.00	244.00
First Quarter	45.34	38.68	290.00	243.00

(1) Denominated in Norwegian kroner.

 Holders

As of February 12, 2009 there were 1,254 record holders of our common stock. Since certain of our shares are held indirectly, the foregoing number is not representative of the number of beneficial owners.

 Dividends

We declared cash dividends on our common stock of \$0.15 per share in the each of the first three quarters of 2008 and each of the quarters of 2007. Commencing in the fourth quarter 2008 our board of directors discontinued the quarterly dividends.

Holders of our common stock have an equal right to share in our profits in the form of dividends when declared by our board of directors out of funds legally available for the distribution of dividends. Holders of our common stock have no rights to any sinking fund.

There are no exchange control restrictions on remittances of dividends on our common stock. Since (1) we are and intend to maintain our status as a nonresident Liberian entity under the Revenue Code of Liberia (2000) and the regulations thereunder, and (2) our ship-owning subsidiaries are not now engaged, and are not in the future expected to engage, in any business in Liberia, including voyages exclusively within the territorial waters of the Republic of Liberia, under current Liberian law, no Liberian taxes or withholding will be imposed on payments to holders of our securities other than to a holder that is a resident Liberian entity or a resident individual or an individual or entity subject to taxation in Liberia as a result of having a permanent establishment within the meaning of the Revenue Code of Liberia (2000) in Liberia.

The declaration of dividends shall at all times be subject to the final determination of our board of directors that a dividend is prudent at that time in consideration of the needs of the business. The shareholders agreement provides that A. Wilhelmsen AS. and Cruise Associates will from time to time consider our dividend policy with due regard for the interests of the shareholders in

Table of Contents

maximizing the return on their investment and our ability to pay such dividends. The shareholders agreement also provides that payment of dividends will depend, among other factors, upon our earnings, financial position and capital requirements and the income and other tax liabilities of A. Wilhelmsen AS., Cruise Associates and their respective affiliates relating to their ownership of common stock.

Issuer Purchases of Equity Securities

None.

Performance Graph

The following graph compares the total return, assuming reinvestment of dividends, on an investment in the Company, based on performance of the Company's common stock with the performance of the Standard & Poor's 500 Composite Stock Index and the Dow Jones United States Travel and Leisure Index for a five year period by measuring the changes in common stock prices from December 31, 2003 to December 31, 2008.

	12/03	12/04	12/05	12/06	12/07	12/08
Royal Caribbean Cruises Ltd.	\$ 100.00	\$ 158.32	\$ 132.66	\$ 123.67	\$ 128.70	\$ 42.33
S&P 500	\$ 100.00	\$ 110.88	\$ 116.33	\$ 134.70	\$ 142.10	\$ 89.53
Dow Jones United States Travel & Leisure	\$ 100.00	\$ 128.53	\$ 130.64	\$ 159.96	\$ 157.71	\$ 102.30

The stock performance graph assumes for comparison that the value of the Company's common stock and of each index was \$100 on December 31, 2003 and that all dividends were reinvested. Past performance is not necessarily an indicator of future results.

Table of Contents**Item 6. Selected Financial Data**

The selected consolidated financial data presented below for the years 2004 through 2008 and as of the end of each such year, are derived from our audited financial statements and should be read in conjunction with those financial statements and the related notes.

	2008	Year Ended December 31,			2004
		2007	2006	2005	
	(in thousands, except per share data)				
Operating Data:					
Total revenues	\$ 6,532,525	\$ 6,149,139	\$ 5,229,584	\$ 4,903,174	\$ 4,555,375
Operating income	831,984	901,335	858,446	871,565	753,589
Income before cumulative effect of a change in accounting principle	573,722	603,405	633,922	663,465	474,691
Cumulative effect of a change in accounting principle ¹				52,491	
Net income	573,722	603,405	633,922	715,956	474,691
Per Share Data Basic:					
Income before cumulative effect of a change in accounting principle	\$ 2.69	\$ 2.84	\$ 3.01	\$ 3.22	\$ 2.39
Cumulative effect of a change in accounting principle ¹	\$	\$	\$	\$ 0.25	\$
Net income	\$ 2.69	\$ 2.84	\$ 3.01	\$ 3.47	\$ 2.39
Weighted-average shares	213,477	212,784	210,703	206,217	198,946
Per Share Data Diluted:					
Income before cumulative effect of a change in accounting principle	\$ 2.68	\$ 2.82	\$ 2.94	\$ 3.03	\$ 2.26
Cumulative effect of a change in accounting principle ¹	\$	\$	\$	\$ 0.22	\$
Net income	\$ 2.68	\$ 2.82	\$ 2.94	\$ 3.26	\$ 2.26
Weighted-average shares and potentially dilutive shares	214,195	214,255	221,485	234,714	234,580
Dividends declared per common share	\$ 0.45	\$ 0.60	\$ 0.60	\$ 0.56	\$ 0.52
Balance Sheet Data:					
Total assets	\$ 16,463,310	\$ 14,982,281	\$ 13,393,088	\$ 11,255,771	\$ 11,964,084
Total debt, including capital leases	7,011,403	5,698,272	5,413,744	4,154,775	5,731,944
Common stock	2,239	2,235	2,225	2,165	2,012
Total shareholders' equity	6,803,012	6,757,343	6,091,575	5,554,465	4,804,520

¹ In the third quarter of 2005, we changed our method of accounting for drydocking costs from the accrual in advance to the deferral method. Under the accrual in advance method, estimated drydocking costs are accrued evenly over the period to the next scheduled drydock. Under the deferral method, drydocking costs incurred are deferred and charged to expense on a straight-line basis over the period to the next scheduled drydock. The deferral method is preferable because it only recognizes the liability when incurred and does not require the use of estimates inherent in the accrual in advance method.

Table of Contents

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations
Cautionary Note Concerning Factors That May Affect Future Results**

Certain statements under this caption Management's Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in this document constitute forward-looking statements under the Private Securities Litigation Reform Act of 1995. Words such as anticipate, believe, could, estimate, expect, goal, intend, may, plan, project, seek, should, will, and similar expressions are intended to identify forward-looking statements. Forward-looking statements do not guarantee future performance and may involve risks, uncertainties and other factors, which could cause our actual results, performance or achievements to differ materially from the future results, performance or achievements expressed or implied in those forward-looking statements. Examples of these risks, uncertainties and other factors include, but are not limited to those discussed under Item 1A. *Risk Factors* as well as the following:

the adverse impact of the continuing worldwide economic downturn on the demand for cruises,

the impact of the economic downturn on the availability of our credit facility and on our ability to generate cash flows from operations or obtain new borrowings from the credit or capital markets in amounts sufficient to satisfy our capital expenditures, debt repayments and other financing needs,

the impact of disruptions in the global financial markets on the ability of our counterparties and others to perform their obligations to us,

the uncertainties of conducting business internationally and expanding into new markets,

the volatility in fuel prices and foreign exchange rates,

the impact of changes in operating and financing costs, including changes in foreign currency, interest rates, fuel, food, payroll, airfare for our shipboard personnel, insurance and security costs,

the impact of problems encountered at shipyards and their subcontractors including insolvency or financial difficulties,

vacation industry competition and changes in industry capacity and overcapacity,

the impact of tax and environmental laws and regulations affecting our business or our principal shareholders,

the impact of changes in other laws and regulations affecting our business,

the impact of pending or threatened litigation, enforcement actions, fines or penalties,

the impact of delayed or cancelled ship orders,

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the impact of emergency ship repairs, including the related lost revenue,

the impact on prices of new ships due to shortages in available shipyard facilities, component parts and shipyard consolidations,

negative incidents involving cruise ships including those involving the health and safety of passengers,

reduced consumer demand for cruises as a result of any number of reasons, including geo-political and economic uncertainties and the unavailability or cost of air service,

the international political climate, fears of terrorist and pirate attacks, armed conflict and the resulting concerns over safety and security aspects of traveling,

Table of Contents

the impact of the spread of contagious diseases,

the impact of changes or disruptions to external distribution channels for our guest bookings,

the loss of key personnel or our inability to retain or recruit qualified personnel,

changes in our stock price or principal shareholders,

uncertainties of a foreign legal system as we are not incorporated in the United States,

the unavailability of ports of call,

weather.

The above examples are not exhaustive and new risks emerge from time to time. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Critical Accounting Policies

Our consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America. (See Note 1. *General* and Note 2. *Summary of Significant Accounting Policies* to our consolidated financial statements under Item 8. *Financial Statements and Supplementary Data*.) Certain of our accounting policies are deemed critical, as they require management's highest degree of judgment, estimates and assumptions. We have discussed these accounting policies and estimates with the audit committee of our board of directors. We believe our most critical accounting policies are as follows:

Ship Accounting

Our ships represent our most significant assets and are stated at cost less accumulated depreciation. Depreciation of ships is generally computed net of a 15% projected residual value using the straight-line method over estimated service lives of primarily 30 years. Improvement costs that we believe add value to our ships are capitalized as additions to the ship and depreciated over the improvements' estimated useful lives. The estimated cost and accumulated depreciation of replaced or refurbished ship components are written off and any resulting losses are recognized in cruise operating expenses. Repairs and maintenance activities are charged to expense as incurred. We use the deferral method to account for drydocking costs. Under the deferral method, drydocking costs incurred are deferred and charged to expense on a straight-line basis over the period to the next scheduled drydock. Deferred drydock costs consist of the costs to drydock the vessel and other costs incurred in connection with the drydock which are necessary to maintain the vessel's class certification. (See Note 2. *Summary of Significant Accounting Policies* to our consolidated financial statements under Item 8. *Financial Statements and Supplementary Data*).

Our service life and residual value estimates take into consideration the impact of anticipated technological changes, long-term cruise and vacation market conditions and historical useful lives of similarly-built ships. In addition, we take into consideration our estimates of the average useful lives of the ships' major component systems, such as hull, superstructure, main electric, engines and cabins. Given the very large and complex nature of our ships, our accounting estimates related to ships and determinations of ship improvement costs to be capitalized require considerable judgment and are inherently uncertain. We do not have cost segregation studies performed to specifically componentize our ship systems; therefore, we estimate the costs of component systems based principally on general and technical information known about major ship component systems and their lives and our knowledge of the cruise vacation industry. We do not identify and track depreciation by ship component systems, but instead utilize these estimates to determine the net cost basis of assets replaced or refurbished.

Table of Contents

We believe we have made reasonable estimates for ship accounting purposes. However, should certain factors or circumstances cause us to revise our estimates of ship service lives or projected residual values, depreciation expense could be materially higher or lower. If circumstances cause us to change our assumptions in making determinations as to whether ship improvements should be capitalized, the amounts we expense each year as repairs and maintenance costs could increase, partially offset by a decrease in depreciation expense. If we had reduced our estimated average 30-year ship service life by one year, depreciation expense for 2008 would have increased by approximately \$31.4 million. If our ships were estimated to have no residual value, depreciation expense for 2008 would have increased by approximately \$90.1 million.

Valuation of Long-Lived Assets, Goodwill and Indefinite-Lived Intangible Assets

We review our ships and other long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of these assets may not be fully recoverable. The assessment of possible impairment is based on our ability to recover the carrying value of these assets based on our estimate of their undiscounted future cash flows. If estimated future cash flows are less than the carrying value of an asset, an impairment charge is recognized for the difference between the asset's estimated fair value and its carrying value.

We determine fair value based on quoted market prices in active markets, if available. If active markets are not available we base fair value on independent appraisals, sales price negotiations and projected future cash flows discounted at a rate determined by management to be commensurate with the business risk. The estimation of fair value utilizing discounted forecasted cash flows includes numerous uncertainties which require significant judgment when making assumptions of revenues, operating costs, marketing, selling and administrative expenses, interest rates, cruise vacation industry competition and general economic and business conditions, among other factors.

We review goodwill, trademarks and tradenames, which are our most significant indefinite-lived intangible assets, for impairment whenever events or circumstances indicate but at least annually. The impairment review for goodwill consists of a two-step process of first determining the fair value of the reporting unit and comparing it to the carrying value of the net assets allocated to the reporting unit. If the fair value of the reporting unit exceeds the carrying value, no further analysis or write-down of goodwill is required. If the fair value of the reporting unit is less than the carrying value of its net assets, the implied fair value of the reporting unit is allocated to all its underlying assets and liabilities, including both recognized and unrecognized tangible and intangible assets, based on their fair value. If necessary, goodwill is then written down to its implied fair value. The impairment review for indefinite-life intangible assets consists of a comparison of the fair value of the asset with its carrying amount. If the carrying amount exceeds its fair value, an impairment loss is recognized in an amount equal to that excess. If the fair value exceeds its carrying amount, the indefinite-life intangible asset is not considered impaired.

The fair value of a reporting unit and an indefinite-life intangible asset is based on quoted market prices if available. Quoted market prices are often not available for individual reporting units and for indefinite-life intangible assets. Accordingly, we base the fair value of a reporting unit and an indefinite-life intangible asset on an expected present value technique.

We performed the annual impairment review for goodwill during the fourth quarter of 2008. We determined the fair value of our two reporting units which include goodwill, Royal Caribbean International and Pullmantur, using a probability-weighted discounted cash flow model. The principal assumptions used in the discounted cash flow model are projected operating results, weighted average cost of capital, and terminal value. Cash flows were calculated using our 2009 projected operating results as a base. To that base we added future years' cash flows assuming multiple revenue and expense scenarios that reflect the impact on each reporting unit of different global economic environments beyond 2009.

We discounted the projected cash flows using rates specific to each reporting unit based on their respective weighted average cost of capital. Based on the probability-weighted discounted cash flows of each reporting unit we determined the fair values of Royal Caribbean International and Pullmantur exceeded their carrying values. Therefore, we did not proceed to step two of the impairment analysis and we do not consider goodwill to be impaired.

We also performed the annual impairment review of our trademarks and trade names during the fourth quarter of 2008 using a discounted cash flow model and the relief-from-royalty method. The royalty rate used is based on comparable royalty agreements in

Table of Contents

the tourism and hospitality industry. We used the same discount rate used in valuing the Pullmantur reporting unit. Based on the discounted cash flow model we determined the fair value of our trademarks and trade names exceeded their carrying value.

In performing our asset impairment analysis, we considered the fact that at December 31, 2008, the book value of our shareholders' equity exceeded our market capitalization. However, we did not consider this to be determinative, especially in light of recent negative market conditions, the turmoil in the credit and capital markets and the resulting weakened demand environment.

The estimation of fair value utilizing discounted expected future cash flows includes numerous uncertainties which require our significant judgment when making assumptions of expected revenues, operating costs, marketing, selling and administrative expenses, interest rates, ship additions and retirements as well as assumptions regarding the cruise vacation industry competition and general economic and business conditions, among other factors. If there is a material change in the assumptions used in our determination of fair values or if there is a material change in the conditions or circumstances influencing fair value, we could be required to recognize a material impairment charge.

Contingencies Litigation

On an ongoing basis, we assess the potential liabilities related to any lawsuits or claims brought against us. While it is typically very difficult to determine the timing and ultimate outcome of such actions, we use our best judgment to determine if it is probable that we will incur an expense related to the settlement or final adjudication of such matters and whether a reasonable estimation of such probable loss, if any, can be made. In assessing probable losses, we take into consideration estimates of the amount of insurance recoveries, if any. We accrue a liability when we believe a loss is probable and the amount of loss can be reasonably estimated. Due to the inherent uncertainties related to the eventual outcome of litigation and potential insurance recoveries, it is possible that certain matters may be resolved for amounts materially different from any provisions or disclosures that we have previously made.

Terminology

Our revenues are seasonal based on demand for cruises. Demand is strongest for cruises during the Northern Hemisphere summer months and holidays.

Our revenues consist of the following:

Passenger ticket revenues consist of revenue recognized from the sale of passenger tickets and the sale of air transportation to and from our ships.

Onboard and other revenues consist primarily of revenues from the sale of goods and/or services onboard our ships not included in passenger ticket prices, cancellation fees, sales of vacation protection insurance, pre- and post-cruise tours, Pullmantur's land-based tours and hotel and air packages. Also included are revenues we receive from independent third party concessionaires that pay us a percentage of their revenues in exchange for the right to provide selected goods and/or services onboard our ships.

Our cruise operating expenses consist of the following:

Commissions, transportation and other expenses consist of those costs directly associated with passenger ticket revenues, including travel agent commissions, air and other transportation expenses, port costs that vary with passenger head counts and related credit card fees.

Onboard and other expenses consist of the direct costs associated with onboard and other revenues. These costs include the cost of products sold onboard our ships, vacation protection insurance premiums, costs associated with pre- and post-cruise tours and related credit card fees. These costs also include minimal costs associated with concession revenues, as the costs are mostly incurred by third-party concessionaires.

Payroll and related expenses consist of costs for shipboard personnel.

Table of Contents

Food expenses include food costs for both passengers and crew.

Fuel expenses include fuel and related delivery and storage costs, including the financial impact of fuel swap agreements.

Other operating expenses consist primarily of operating costs such as repairs and maintenance, port costs that do not vary with passenger head counts, vessel operating lease costs, costs associated with Pullmantur's land-based tours, vessel related insurance and entertainment.

We do not allocate payroll and related costs, food costs, fuel costs or other operating costs to the expense categories attributable to passenger ticket revenues or onboard and other revenues since they are incurred to provide the total cruise vacation experience.

Non-GAAP Financial Measures

Available Passenger Cruise Days (APCD) are our measurement of capacity and represent double occupancy per cabin multiplied by the number of cruise days for the period. We use this measure to perform capacity and rate analysis to identify our main non-capacity drivers which cause our cruise revenue and expenses to vary.

Gross Cruise Costs represent the sum of total cruise operating expenses plus marketing, selling and administrative expenses.

Gross Yields represent total revenues per APCD.

Net Cruise Costs represent Gross Cruise Costs excluding commissions, transportation and other expenses and onboard and other expenses (each of which is described above under the Terminology heading). In measuring our ability to control costs in a manner that positively impacts net income, we believe changes in Net Cruise Costs to be the most relevant indicator of our performance. A reconciliation of historical Gross Cruise Costs to Net Cruise Costs is provided below under *Summary of Historical Results of Operations*. We have not provided a quantitative reconciliation of projected Gross Cruise Costs to projected Net Cruise Costs due to the significant uncertainty in projecting the costs deducted to arrive at this measure. Accordingly, we do not believe that reconciling information for such projected figures would be meaningful.

Net Debt-to-Capital is a ratio which represents total long-term debt, including current portion of long-term debt, less cash and cash equivalents (Net Debt) divided by the sum of Net Debt and total shareholders' equity. We believe Net Debt and Net Debt-to-Capital, along with total long-term debt and shareholders' equity are useful measures of our capital structure. A reconciliation of historical Debt-to-Capital to Net Debt-to-Capital is provided below under *Summary of Historical Results of Operations*.

Net Revenues represent total revenues less commissions, transportation and other expenses and onboard and other expenses (each of which is described under the Terminology heading).

Net Yields represent Net Revenues per APCD. We utilize Net Revenues and Net Yields to manage our business on a day-to-day basis as we believe that it is the most relevant measure of our pricing performance because it reflects the cruise revenues earned by us net of our most significant variable costs, which are commissions, transportation and other expenses and onboard and other expenses. A reconciliation of historical Gross Yields to Net Yields is provided below under *Summary of Historical Results of Operations*. We have not provided a quantitative reconciliation of projected Gross Yields to projected Net Yields due to the significant uncertainty in projecting the costs deducted to arrive at this measure. Accordingly, we do not believe that reconciling information for such projected figures would be meaningful.

Occupancy, in accordance with cruise vacation industry practice, is calculated by dividing Passenger Cruise Days by APCD. A percentage in excess of 100% indicates that three or more passengers occupied some cabins.

Table of Contents

Passenger Cruise Days represent the number of passengers carried for the period multiplied by the number of days of their respective cruises.

The use of certain significant non-GAAP measures, such as Net Yields and Net Cruise Costs, allow us to perform capacity and rate analysis to separate the impact of known capacity changes from other less predictable changes which affect our business. We believe these non-GAAP measures provide expanded insight to measure revenue and cost performance in addition to the standard United States GAAP based financial measures. There are no specific rules or regulations for determining non-GAAP measures, and as such, there exists the possibility that they may not be comparable to other companies within the industry.

Executive Overview

We have seen a dramatic change in our operating environment during the past several months. The current worldwide economic downturn and the meltdown of the global credit and capital markets have resulted in significant deterioration in consumer confidence and spending. In addition, the current disruption and tightening of the credit and capital markets may make it more difficult for us to secure financing or to raise additional capital or to do so on acceptable terms. We are starting to experience significant compression in our booking window and forward bookings are lagging behind levels achieved during the last few years as consumers are delaying their purchase decisions. The extent and duration of this worldwide economic downturn is uncertain. Forecasting demand in 2009 is extremely difficult and we expect this difficult environment to continue at least through 2009. As a result, we expect 2009 Net Yields to decrease in the range of 9% to 13% compared to 2008.

The current economic environment has also led to more dramatic levels of volatility in fuel prices and foreign exchange rates which have become extremely volatile with significant daily or even hourly price fluctuations. For planning purposes, we do not forecast future fuel prices or exchange rates, but instead use current spot prices for calculation purposes.

In an effort to offset the impact of the weaker demand environment, we have increased our focus on cost reductions and on preserving cash and liquidity. The cost cutting initiatives we announced in July 2008 are on track to produce the anticipated savings and we have implemented a number of new initiatives including the targeting of synergies and capturing deflationary opportunities from our vendors. As a result of these initiatives, we expect a reduction in our 2009 Net Cruise Costs in the range of 7% to 9% per APCD compared to 2008. Approximately 2 percentage points of this decrease relates to reductions in the price of fuel in 2009.

We have also discontinued our quarterly dividend commencing in the fourth quarter of 2008, curtailed our non-shipbuild capital expenditures, and currently do not have plans to place further newbuild ship orders. We are also exploring other activities to improve our liquidity. We believe these strategies will enhance our ability to better fund our capital spending obligations and improve our balance sheet.

While cutting costs throughout the organization, we have not altered our strategy of substantially growing our sourcing of passengers outside of North America. We continue to increase our investments in growth outside of North America with the goal of diversifying our sources and increasing our opportunities for revenue growth.

We have four Solstice-class vessels under construction in Germany, all of which have committed bank financing arrangements and include financing guarantees from HERMES (Euler Hermes Kreditversicherungs AG), the export credit agency of the German government for 95% of the financed amount. We also have two Oasis-class vessels under construction in Finland each of which has commitments for financing guarantees from Finnvera, the export credit agency of Finland for 80% of the financed amount. We are working with the relevant export credit agencies and various financial institutions to obtain committed financing for *Oasis of the Seas*. This includes exploring opportunities to increase the guarantee level and obtain partial funding support from the relevant export credit agencies. Although we believe that we will secure committed financing for these ships before their delivery dates, there can be no assurance that we will be able to do so or that we will do so on acceptable terms.

Table of Contents

Summary of Historical Results of Operations

Although the operating environment has deteriorated since September 2008, total revenues increased 6.2% to \$6.5 billion from total revenues of \$6.1 billion for 2007 primarily due to a 5.2% increase in capacity and a 1.0% increase in Gross Yields. Net Yields increased by approximately 0.5% compared to 2007. The increase in Net Yields was primarily due to an increase in ticket prices partially offset by a decrease in onboard and other revenues. The increase in total revenues was partially offset by an increase in expenses primarily due to the increase in fuel and to a lesser extent, payroll and related expenses. In addition, we recorded a one-time litigation gain of approximately \$17.6 million related to the settlement of our pending case against Pentair Water Treatment (OH) Company (formerly known as Essef Corporation). As a result, our net income was \$573.7 million or \$2.68 per share on a diluted basis for 2008 compared to \$603.4 million or \$2.82 per share on a diluted basis for 2007.

Highlights for 2008 included:

Total revenues increased 6.2% to \$6.5 billion from total revenues of \$6.1 billion in 2007 primarily due to a 5.2% increase in capacity and a 1.0% increase in Gross Yields. Net Yields increased by approximately 0.5% compared to the same period in 2007.

Net Cruise Costs per APCD increased 3.7% compared to 2007.

Fuel expenses per APCD, net of the financial impact of fuel swap agreements, increased 25.7% per APCD as compared to the same period in 2007.

Our Net Debt-to-Capital ratio increased to 49.3% in 2008 from 44.7% in 2007. Similarly, our Debt-to-Capital ratio increased to 50.8% in 2008 from 45.7% in 2007.

As of December 31, 2008, liquidity was \$1.0 billion, including cash and the undrawn portion of our unsecured revolving credit facility.

We took delivery of *Independence of the Seas*, the third Freedom-class ship for Royal Caribbean International in the second quarter of 2008. To finance the purchase, we borrowed \$530.0 million under an unsecured term loan due through 2015. The loan bears interest at LIBOR plus an applicable margin. Currently, the rate is approximately 5.40%.

We took delivery of *Celebrity Solstice*, the first Solstice-class ship for Celebrity Cruises in the fourth quarter of 2008. To finance the purchase, we borrowed \$519.1 million under an unsecured term loan due through 2020. The loan bears interest at LIBOR plus 0.45%; the rate is currently 4.28%.

We implemented a cost savings initiative expected to save approximately \$125.0 million annually. As part of this initiative, we eliminated approximately 400 shore-side positions. In addition, we discontinued some non-core operations, including The Scholar Ship. As a result of this initiative, we incurred charges of approximately \$14.3 million, or \$0.07 per share.

We settled our pending case against Pentair Water Treatment (OH) Company (formerly known as Essef Corporation). Pursuant to the terms of the settlement agreement, we were paid, net of costs and payments to insurers, approximately \$17.6 million which we recognized during the third quarter.

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We finalized our contract with Meyer Werft GmbH to build a fifth Solstice-class ship for Celebrity Cruises, for an additional capacity of approximately 2,850 berths, which is expected to enter service in the fourth quarter of 2012. We signed a credit agreement to finance approximately 80% of the contract price at delivery.

We sold our interest in Island Cruises to TUI Travel PLC, the other 50% owner in the joint venture. We received proceeds of \$51.4 million and recognized a gain of approximately \$1.0 million on the transaction. As part of the transaction, we agreed to an early termination of the charter of *Island Star* to Island Cruises. We anticipate the return of *Island Star* in April 2009 and intend to redeploy the ship to Pullmantur at that time.

Table of Contents

We discontinued the Company's dividend beginning in the fourth quarter of 2008.

We reported historical total revenues, operating income, net income and earnings per share as shown in the following table (in thousands, except per share data):

	Year Ended December 31,		
	2008	2007	2006
Total revenues	\$ 6,532,525	\$ 6,149,139	\$ 5,229,584
Operating income	\$ 831,984	\$ 901,335	\$ 858,446
Net income	\$ 573,722	\$ 603,405	\$ 633,922
Basic earnings per share:			
Net income	\$ 2.69	\$ 2.84	\$ 3.01
Diluted earnings per share:			
Net income	\$ 2.68	\$ 2.82	\$ 2.94

The following table presents historical operating data as a percentage of total revenues for the last three years:

	Year Ended December 31,		
	2008	2007	2006
Passenger ticket revenues	72.4	72.0	73.4
Onboard and other revenues	27.6	28.0	26.6
Total revenues	100.0%	100.0%	100.0%
Cruise operating expenses			
Commissions, transportation and other	18.3	18.3	17.6
Onboard and other	7.0	6.6	6.3
Payroll and related	10.1	9.5	9.6
Food	5.2	5.3	5.3
Fuel	11.1	8.9	9.2
Other operating	15.8	16.2	14.1
Total cruise operating expenses	67.5	64.8	62.1
Marketing, selling and administrative expenses	11.9	12.7	13.4
Depreciation and amortization expenses	7.9	7.8	8.1
Operating income	12.7	14.7	16.4
Other expense	(3.9)	(4.9)	(4.3)
Net income	8.8%	9.8%	12.1%

Selected historical statistical information is shown in the following table:

	Year Ended December 31,		
	2008	2007	2006
Passengers Carried	4,017,554	3,905,384	3,600,807

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Passenger Cruise Days	27,657,578	26,594,515	23,849,606
APCD	26,463,637	25,155,768	22,392,478
Occupancy	104.5%	105.7%	106.5%

Table of Contents

Gross Yields and Net Yields were calculated as follows (in thousands, except APCD and Yields):

	Year Ended December 31,		
	2008	2007	2006
Passenger ticket revenues	\$ 4,730,289	\$ 4,427,384	\$ 3,838,648
Onboard and other revenues	1,802,236	1,721,755	1,390,936
Total revenues	6,532,525	6,149,139	5,229,584
Less:			
Commissions, transportation and other	1,192,316	1,124,022	917,929
Onboard and other	458,385	405,637	331,218
Net revenues	\$ 4,881,824	\$ 4,619,480	\$ 3,980,437
APCD	26,463,637	25,155,768	22,392,478
Gross Yields	\$ 246.85	\$ 244.44	\$ 233.54
Net Yields	\$ 184.47	\$ 183.64	\$ 177.76

Gross Cruise Costs and Net Cruise Costs were calculated as follows (in thousands, except APCD and costs per APCD):

	Year Ended December 31,		
	2008	2007	2006
Total cruise operating expenses	\$ 4,403,666	\$ 3,981,698	\$ 3,249,629
Marketing, selling and administrative expenses	776,522	783,040	699,864
Gross Cruise Costs	5,180,188	4,764,738	3,949,493
Less:			
Commissions, transportation and other	1,192,316	1,124,022	917,929
Onboard and other	458,385	405,637	331,218
Net Cruise Costs	\$ 3,529,487	\$ 3,235,079	\$ 2,700,346
APCD	26,463,637	25,155,768	22,392,478
Gross Cruise Costs per APCD	\$ 195.75	\$ 189.41	\$ 176.38
Net Cruise Costs per APCD	\$ 133.37	\$ 128.60	\$ 120.59

Net Debt-to-Capital was calculated as follows (in thousands):

	As of	
	December 31,	2007
	2008	2007
Long-term debt, net of current portion	\$ 6,539,510	\$ 5,346,547
Current portion of long-term debt	471,893	351,725
Total debt	7,011,403	5,698,272
Less: Cash and cash equivalents	402,878	230,784

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Net Debt	\$ 6,608,525	\$ 5,467,488
Total shareholders' equity	\$ 6,803,012	\$ 6,757,343
Total debt	7,011,403	5,698,272
Total debt and shareholders' equity	13,814,415	12,455,615
Debt-to-Capital	50.8%	45.7%
Net Debt	6,608,525	5,467,488
Net Debt and shareholders' equity	\$ 13,411,537	\$ 12,224,831
Net Debt-to-Capital	49.3%	44.7%

Table of Contents

Outlook

On January 29, 2009, we announced the following guidance for the full year and first quarter of 2009:

Full Year 2009

We expected Net Yields to decrease in the range of 9% to 13% compared to 2008.

We expected Net Cruise Costs per APCD to decrease in the range of 7% to 9% compared to 2008. Excluding fuel, we expected Net Cruise Costs per APCD to decrease in the range of 5% to 7% compared to 2008.

We do not forecast fuel prices and our cost calculation for fuel is based on current at-the-pump prices net of any hedging impacts. If fuel prices for the full year 2009 remain at the level of January 29, 2009, fuel expenses for the full year 2009 would be approximately \$580.0 million. For the full year 2009, our fuel expense is approximately 47% hedged. Assuming our fuel prices correlate with the movement in the price of WTI, a \$10 change in the WTI price per barrel would result in a change in our fuel costs of approximately \$46.0 million for the full year 2009, after taking into account existing hedges.

We expected a 6.7% increase in capacity in 2009, primarily driven by a full year of *Celebrity Solstice*, which entered service in November 2008, a full year of *Independence of the Seas*, which entered service in May 2008, the addition of *Celebrity Equinox*, which will enter service during the third quarter of 2009, and the addition of *Oasis of the Seas*, which will enter service in the fourth quarter of 2009.

Depreciation and amortization expenses were expected to be in the range of \$543.0 million to \$563.0 million, and interest expense was expected to be in the range of \$320.0 million to \$340.0 million.

Based on the expectations contained in this Outlook section, and assuming that fuel prices remain at the level of the January 29, 2009 at-the-pump prices, we expected full year 2009 earnings per share to be around \$1.40.

Our outlook has remained essentially unchanged since our announcement on January 29, 2009.

First Quarter 2009

As announced on January 29, 2009, we expected Net Yields will decrease in the range of 14% to 16% compared to 2008.

We expected Net Cruise Costs per APCD to decrease in the range of 4% to 6% compared to 2008. Excluding fuel, we expected Net Cruise Costs per APCD to decrease in the range of 5% to 7% compared to 2008.

We do not forecast fuel prices and our cost calculation for fuel is based on current at-the-pump prices net of any hedging impacts. If fuel prices for the first quarter of 2009 remain at the level of January 29, 2009, fuel expenses for the first quarter of 2009 would be approximately \$165.0 million. For the first quarter of 2009, our fuel expense is approximately 58% hedged. Assuming our fuel prices correlate with the movement in the price of WTI, a \$10 change in the WTI price per barrel would result in a change in our fuel costs of approximately \$8.0 million for the first quarter of 2009, after taking into account existing hedges.

We expected a 6.9% increase in capacity, primarily driven by the addition of *Independence of the Seas*, which entered service in May 2008, the addition of *Celebrity Solstice*, which entered service in November 2008, and the addition of *Ocean Dream*, which entered service in March 2008.

Depreciation and amortization expenses were expected to be in the range of \$135.0 million to \$140.0 million and interest expense was expected to be in the range of \$77.0 million to \$81.0 million.

Based on the expectations contained in this Outlook section, and assuming that fuel prices remain at the level of the January 29, 2009 at-the-pump prices, we expected a first quarter 2009 loss per share in the range of \$0.30 to \$0.35.

Table of Contents

Our outlook has remained essentially unchanged since our announcement on January 29, 2009.

Year Ended December 31, 2008 Compared to Year Ended December 31, 2007*Revenues*

Total revenues for 2008 increased \$383.4 million or 6.2% to \$6.5 billion from \$6.1 billion in 2007. Approximately \$319.7 million of this increase is attributable to an increase in capacity of 5.2%. The increase in capacity is primarily due to the addition of *Independence of the Seas*, which entered service in May 2008, a full year of *Liberty of the Seas*, which entered service in May 2007, the addition of *Ocean Dream*, which entered service in March 2008, and the addition of *Celebrity Solstice*, which entered service in November 2008. The remaining increase of \$63.7 million is due primarily to an increase in ticket prices partially offset by a decrease in onboard and other revenues. The decrease in onboard and other revenues is due primarily to a decrease in spending on a per passenger basis.

Onboard and other revenues included concession revenues of \$230.8 million in 2008 compared to \$239.3 million for the same period in 2007. The decrease in concession revenues was primarily due to a decrease in spending on a per passenger basis partially offset by the increase in capacity mentioned above.

Cruise Operating Expenses

Total cruise operating expenses for 2008 increased \$422.0 million or 10.6% to \$4.4 billion from \$4.0 billion for 2007. Approximately \$207.0 million of this increase is attributable to the 5.2% increase in capacity. The remaining increase of \$215.0 million was primarily driven by increases in fuel expenses, and to a lesser extent payroll and related expenses. Fuel expenses, which are net of the financial impact of fuel swap agreements, increased 30.0% per metric ton in 2008 as compared to 2007 primarily as a result of increasing fuel prices. As a percentage of total revenues, fuel expenses were 11.1% and 8.9% in 2008 and 2007, respectively. The increase in payroll and related expenses was associated with benefits and higher staffing levels.

Marketing, Selling and Administrative Expenses

Marketing, selling and administrative expenses for 2008 decreased \$6.5 million or 0.8% to \$776.5 million from \$783.0 million for 2007. The decrease was primarily due to the cost savings initiative announced during the third quarter to reduce spending along with a change in the employee forfeiture rate assumption related to our stock-based employee compensation plans that resulted in a benefit of approximately \$8.2 million in the second quarter of 2008. As part of the cost savings initiative, we eliminated approximately 400 shore-side positions during the third quarter of 2008. The decrease due to the cost savings initiative was partially offset by termination benefits of \$9.0 million, related to the same initiative and increases in headcount and other costs associated with personnel during the first six months of 2008.

Depreciation and Amortization Expenses

Depreciation and amortization expenses for 2008 increased \$37.3 million or 7.7% to \$520.4 million from \$483.1 million for the same period in 2007. This increase is primarily due to the addition of *Independence of the Seas*, which entered service in May 2008, a full year of *Liberty of the Seas*, which entered service in May 2007, and the addition of *Ocean Dream*, which entered service in March 2008.

Other Income (Expense)

Interest expense, net of interest capitalized, decreased to \$327.3 million in 2008 from \$333.8 million in 2007. Gross interest expense decreased to \$371.7 million in 2008 from \$373.7 million in 2007. The decrease was primarily due to lower interest rates, partially offset by a higher average debt level. Interest capitalized increased to \$44.4 million in 2008 from \$39.9 million in 2007 primarily due to a higher average level of investment in ships under construction.

Other income increased to \$54.9 million in 2008 from \$15.8 million in 2007. The increase was due to \$23.0 million in foreign currency exchange gains in 2008 as compared to \$6.7 million in foreign currency exchange losses in 2007, for a net change of \$29.7

Table of Contents

million when comparing these periods. The increase was also due to a \$17.6 million settlement received in the case against Pentair Water Treatment (OH) Company (formerly known as Essef Corporation). These increases were partially offset by a gain of \$18.5 million in 2007 related to certain derivatives instruments associated with our ship construction firm commitments denominated in euros that did not qualify for hedge accounting treatment which did not recur in 2008.

Net Yields

Net Yields increased 0.5% in 2008 compared to the same period in 2007 primarily due to increases in ticket prices as mentioned above. Occupancy in 2008 was 104.5% compared to 105.7% in 2007.

Net Cruise Costs

Net Cruise Costs increased 9.1% in 2008 compared to 2007 due to the 5.2% increase in capacity mentioned above and a 3.7% increase in Net Cruise Costs per APCD. The increase in Net Cruise Costs per APCD was primarily driven by increases in fuel expenses, and to a lesser extent, payroll and related expenses related to shipboard employees. These increases were partially offset by the decrease in marketing, selling and administrative expenses as mentioned above. Fuel expenses represented 4.3 percentage points of the overall increase in Net Cruise Costs per APCD.

Restructuring Initiatives

On July 21, 2008, we announced a cost savings initiative expected to save approximately \$125.0 million of general and administrative expenses annually. This initiative was a response to the reduction in our profitability. As part of this initiative, we eliminated approximately 400 shore-side positions. In addition, we discontinued some non-core operations, including The Scholar Ship. The elimination of the shore-side positions and the discontinuation of non-core operations were concluded by the end of the third quarter of 2008.

As a result of this initiative, we incurred charges, all of which were cash charges, of \$14.3 million, or \$0.07 per share in 2008, comprised of \$9.0 million in termination benefits and \$5.3 million in contract termination costs. Expenses related to termination benefits were included in marketing, selling and administrative expenses and contract termination costs were included in other operating expenses in the consolidated statements of operations. As of December 31, 2008, we paid approximately \$6.9 million of the termination benefits and all of the contract termination costs. We anticipate paying the remaining termination benefits during 2009.

Year Ended December 31, 2007 Compared to Year Ended December 31, 2006

Revenues

Total revenues for 2007 increased \$919.6 million or 17.6% to \$6.1 billion from \$5.2 billion in 2006. Approximately \$645.3 million of this increase is attributable to an increase in capacity of 12.3%. The increase in capacity is primarily due to the addition of Pullmantur's fleet, the addition of *Liberty of the Seas*, which entered service in May 2007 and a full year of *Freedom of the Seas*. This increase was partially offset by the revitalization of *Majesty of the Seas* during the first quarter of 2007 which was out of service for 28 days and an increase in the number of days ships were in drydock during 2007 as compared to 2006. The remaining increase of \$274.3 million is due to the addition of Pullmantur's tour business and, to a lesser extent, an increase in ticket prices. This increase was partially offset by a decrease in onboard revenues primarily due to an expanded cruise season in certain markets and itinerary changes for certain ships where passengers spend less onboard our ships.

Onboard and other revenues included concession revenues of \$239.3 million in 2007 compared to \$234.5 million in 2006. The increase in concession revenues was primarily due to the increase in capacity mentioned above.

Table of Contents

Cruise Operating Expenses

Total cruise operating expenses for 2007 increased \$732.1 million or 22.5% to \$4.0 billion from \$3.2 billion in 2006. Approximately \$401.0 million of this increase is attributable to the 12.3% increase in capacity. The remaining increase of \$331.1 million was primarily driven by the addition of Pullmantur's tour business which adds costs without corresponding capacity.

Marketing, Selling and Administrative Expenses

Marketing, selling and administrative expenses for 2007 increased 11.9% to \$783.0 million from \$699.9 million for 2006. The increase was primarily due to the addition of Pullmantur and other increases in headcount and other costs associated with personnel.

Depreciation and Amortization expenses

Depreciation and amortization expenses for 2007 increased \$61.5 million or 14.6% to \$483.1 million from \$421.6 million for 2006. This increase is primarily due to the addition of the Pullmantur fleet and the addition of *Liberty of the Seas*, which entered service in May 2007. The increase was also due to the incremental depreciation as a result of the addition of *Freedom of the Seas*, which entered service in June 2006, shore-side additions and ship improvements.

Other Income (Expense)

Interest expense, net of interest capitalized, increased to \$333.8 million in 2007 from \$267.9 million in 2006. Gross interest expense increased to \$373.7 million in 2007 from \$295.7 million in 2006. The increase was primarily due to a higher average debt level. Interest capitalized increased to \$39.9 million in 2007 from \$27.8 million in 2006 primarily due to a higher average level of investment in ships under construction. These amounts are recorded in interest expense, net of interest capitalized.

Other income decreased to \$15.8 million in 2007 from \$28.1 million in 2006. The decrease was primarily due to a \$36.0 million gain on the settlement of a lawsuit in 2006 that did not recur in 2007, partially offset by a gain of \$23.1 million related to certain derivative instruments associated with our ship construction firm commitments denominated in euros that did not qualify for hedge accounting treatment.

Net Yields

Net Yields increased 3.3% in 2007 compared to 2006 primarily due to, as mentioned above, the addition of Pullmantur's tour business and, to a lesser extent, an increase in ticket prices on a per passenger basis partially offset by a decrease in onboard revenues. Occupancy in 2007 was 105.7% compared to 106.5% in 2006.

Net Cruise Costs

Net Cruise Costs increased 19.8% in 2007 compared to 2006 due to the 12.3% increase in capacity mentioned above and a 6.6% increase in Net Cruise Costs per APCD. The increase in Net Cruise Costs per APCD was primarily driven by increases in other operating expenses. Other operating expenses increased primarily due to the addition of Pullmantur's tour business which adds costs without corresponding capacity.

Recently Adopted, and Future Application of, Accounting Standards

Refer to Note 2. *Summary of Significant Accounting Policies* to our consolidated financial statements for further information on *Recently Adopted Accounting Standards* and *Future Application of Accounting Standards*.

Table of Contents

Liquidity and Capital Resources

Sources and Uses of Cash

Cash flow generated from operations provides us with a significant source of liquidity. Net cash provided by operating activities decreased \$197.4 million to \$1.1 billion in 2008 compared to \$1.3 billion in 2007. This decrease was primarily a result of a \$118.5 million decrease in cash received from customer deposits. The decrease in customer deposits is a result of a compression in the booking window, forward bookings lagging behind the prior year and cruises being purchased for lower ticket prices compared to the prior year. The decrease in customer deposits was also attributable, to a lesser extent, to a decrease in the value of foreign denominated customer deposits due to the strengthening of the United States dollar during 2008 as compared to 2007.

Net cash used in investing activities increased to \$2.0 billion in 2008 from \$1.2 billion in 2007. The increase was primarily due to an increase in capital expenditures which were \$2.2 billion in 2008, compared to \$1.3 billion in 2007. Capital expenditures were primarily related to the delivery of *Independence of the Seas* and *Celebrity Solstice* in 2008 as compared to *Liberty of the Seas* and the purchase of *Pacific Star* in 2007. These expenditures were partially offset by settlements of approximately \$269.8 million and \$59.4 million on our foreign currency forward contracts in 2008 and 2007, respectively along with proceeds from the sale of our investment in Island Cruises of \$51.4 million in 2008.

Net cash provided by financing activities was \$1.1 billion in 2008 compared to \$36.6 million for the same period in 2007. The change was primarily due to a decrease in repayments of debt of approximately \$818.3 million and an increase in debt proceeds of approximately \$288.4 million, in 2008 compared to the same period in 2007. During 2008, we received \$530.0 million through an unsecured term loan due through 2015 to purchase *Independence of the Seas* and \$519.1 million, through an unsecured term loan due through 2020 to purchase *Celebrity Solstice*. We also borrowed approximately \$1.2 billion under our unsecured revolving credit facility of which we repaid approximately \$595.0 million. We made debt repayments on various loan facilities and capital leases, including a payment of approximately \$150.0 million to retire our 6.75% senior notes due March 2008. During 2008, we received \$3.8 million in connection with the exercise of common stock options and paid cash dividends pertaining to the fourth quarter of 2007 and the first, second and third quarters of 2008 on our common stock of \$128.0 million. Net Debt-to-Capital increased to 49.3% as of December 31, 2008 compared to 44.7% as of December 31, 2007. Similarly, our Debt-to-Capital ratio increased to 50.8% in 2008 from 45.7% in 2007.

Interest capitalized during 2008 increased to \$44.4 million from \$39.9 million for the same period in 2007 due to a higher average level of investment in ships under construction.

Future Capital Commitments

Our future capital commitments consist primarily of new ship orders. As of December 31, 2008, we had two ships of a new Oasis-class designated for Royal Caribbean International and four Solstice-class ships, designated for Celebrity Cruises, on order for an aggregate additional capacity of approximately 22,200 berths. The aggregate cost of the six ships is approximately \$6.5 billion, of which we have deposited \$540.1 million as of December 31, 2008. Approximately 13.9% of the aggregate cost of ships was exposed to fluctuations in the euro exchange rate at December 31, 2008.

As of December 31, 2008 we anticipated overall capital expenditures, including the six ships on order, will be approximately \$2.1 billion for 2009, \$2.2 billion for 2010, \$1.0 billion for 2011, and \$1.0 billion for 2012.

Table of Contents**Contractual Obligations and Off-Balance Sheet Arrangements**

As of December 31, 2008, our contractual obligations were as follows (in thousands):

	Total	Payments due by period			
		Less than 1 year	1-3 years	3-5 years	More than 5 years
Long-term debt obligations(1)	\$ 6,959,586	\$ 466,973	\$ 1,636,480	\$ 2,060,305	\$ 2,795,828
Capital lease obligations(1)	51,817	4,920	6,319	3,196	37,382
Operating lease obligations(2)(3)	390,639	48,459	88,187	219,637	34,356
Ship purchase obligations(4)	5,319,376	1,956,756	2,643,694	718,926	
Other(5)	647,870	132,841	174,638	154,962	185,429
Total	\$ 13,369,288	\$ 2,609,949	\$ 4,549,318	\$ 3,157,026	\$ 3,052,995

- (1) Amounts exclude interest as a significant portion of our debt is variable-rate.
- (2) We are obligated under noncancelable operating leases primarily for a ship, offices, warehouses and motor vehicles.
- (3) Under the *Brilliance of the Seas* lease agreement, we may be required to make a termination payment of approximately £126.0 million, or approximately \$183.9 million, based on the exchange rate at December 31, 2008, if the lease is canceled in 2012. This amount is included in the three to five years category. (See Note 16. *Commitments and Contingencies* to our consolidated financial statements under Item 8. *Financial Statements and Supplementary Data*.)
- (4) Amounts represent contractual obligations with initial terms in excess of one year.
- (5) Amounts represent future commitments with remaining terms in excess of one year to pay for our usage of certain port facilities, marine consumables, services and maintenance contracts.

As a normal part of our business, depending on market conditions, pricing and our overall growth strategy, we continuously consider opportunities to enter into contracts for the building of additional ships. We may also consider the sale of ships or the purchase of existing ships. We continuously consider potential acquisitions and strategic alliances. If any of these were to occur, they would be financed through the incurrence of additional indebtedness, the issuance of additional shares of equity securities or through cash flows from operations.

Under the *Brilliance of the Seas* operating lease, we have agreed to indemnify the lessor to the extent its after-tax return is negatively impacted by unfavorable changes in corporate tax rates, capital allowance deductions and certain unfavorable determinations which may be made by United Kingdom tax authorities. These indemnifications could result in an increase in our lease payments. We are unable to estimate the maximum potential increase in our lease payments due to the various circumstances, timing or a combination of events that could trigger such indemnifications. We have been advised by the lessor that the United Kingdom tax authorities are disputing the lessor's accounting treatment of the lease and that the parties are in discussions on the matter. If the characterization of the lease is ultimately determined to be incorrect, we could be required to indemnify the lessor under certain circumstances. The lessor has advised us that they believe their characterization of the lease is correct. Based on the foregoing and our review of available information, we do not believe an indemnification is probable. However, if the lessor loses its dispute and we are required to indemnify the lessor, we cannot at this time predict the impact that such an occurrence would have on our financial condition and results of operations.

Some of the contracts that we enter into include indemnification provisions that obligate us to make payments to the counterparty if certain events occur. These contingencies generally relate to changes in taxes, increased lender capital costs and other similar costs. The indemnification clauses are often standard contractual terms and are entered into in the normal course of business. There are no stated or notional amounts included in the indemnification clauses and we are not able to estimate the maximum potential amount of future payments, if any, under these indemnification clauses. We have not been required to make any payments under such indemnification clauses in the past and, under current circumstances, we do not believe an indemnification obligation is probable.

Other than the items described above, we are not party to any other off-balance sheet arrangements, including guarantee contracts, retained or contingent interest, certain derivative instruments and variable interest entities, that either have, or are reasonably likely to have, a current or future material effect on our financial position.

Table of Contents

Funding Sources

We have significant contractual obligations of which the capital expenditures associated with our ship purchases and our debt maturities represent our largest funding needs. We have \$2.6 billion in contractual obligations due in 2009 of which approximately \$2.0 billion relates to the acquisition of the *Celebrity Equinox* and *Oasis of the Seas* along with progress payments on other ship purchases. In addition, we have \$10.8 billion in contractual obligations due beyond 2009 of which debt maturities and ship purchase obligations represent \$6.5 billion and \$3.4 billion, respectively. We have historically relied on a combination of cash flows provided by operations, drawdowns under our available credit facilities and the incurrence of additional debt to fund these obligations.

As of December 31, 2008, our liquidity was \$1.0 billion consisting of approximately \$402.9 million in cash and cash equivalents and \$625.0 million available under our unsecured revolving credit facility. In addition, we had a working capital deficit of \$1.7 billion as of December 31, 2008 as compared to our working capital deficit of \$1.3 billion as of December 31, 2007. Our December 31, 2008 deficit included \$968.5 million of customer deposits received on sales of cruises collected in advance of sailing and initially recorded as customer deposit liabilities on our balance sheet compared to \$1.1 billion at December 31, 2007. Substantially all customer deposits represent deferred revenue rather than an actual current cash liability. We generate substantial cash flows from operations and our business model has historically allowed us to maintain this working capital deficit and still meet our operating, investing and financing needs. We expect that we will continue to have working capital deficits in the future.

We have four Solstice-class vessels under construction in Germany, all of which have committed bank financing arrangements and include financing guarantees from HERMES (Euler Hermes Kreditrisicherung AG), the export credit agency of the German government for 95% of the financed amount. The terms of the financing guarantees and bank commitments are similar to those established for the *Celebrity Solstice* and are executable at our option. During 2008, we signed a credit agreement for our fifth Solstice-class ship and have elected our option to finance *Celebrity Equinox*. We must elect to use the remaining commitments within six months of the relevant ship delivery and they are each subject to customary funding conditions.

We also have two Oasis-class vessels under construction in Finland. *Oasis of the Seas* is scheduled for delivery in the fourth quarter of 2009 and *Allure of the Seas* is scheduled for delivery in late 2010. We have commitments for financing guarantees from Finnvera, the export credit agency of Finland for 80% of the financed amount. We must elect to use these commitments within five months of the ship delivery and they are each subject to customary funding conditions. We are working with the relevant export credit agencies and various financial institutions to obtain committed financing for *Oasis of the Seas*. This includes exploring opportunities to increase the guarantee level and obtain partial funding support from the relevant export credit agencies. Although we believe that we will secure committed financing for these ships before their delivery dates, there can be no assurance that we will be able to do so or that we will do so on acceptable terms.

The current worldwide economic downturn has adversely impacted our cash flows from operations. In addition, the turmoil in the credit and capital markets may make it more difficult for us to secure new financing or to raise additional capital or to do so on acceptable terms. During 2008, our credit rating was lowered from BBB- with a negative outlook to BB with a negative outlook by Standard and Poor's. In January 2009, Standard and Poor's placed our credit rating on credit watch with negative implications. In addition, our credit rating was lowered from Ba1 with a stable outlook to Ba2 with a negative outlook by Moody's. There is no assurance that our credit ratings will not be lowered further. The lowering of our credit ratings may increase our cost of financing and can make it more difficult for us to access the credit and capital markets.

In response to the current environment and in light of our funding needs, we have increased our focus on preserving cash and improving our liquidity. We have discontinued our dividends, curtailed our non-shipbuild capital expenditures, currently do not have plans to place further newbuild orders, and are working with various financial institutions to secure financing for our Oasis-class ships. In addition, we may elect to fund our contractual obligations through other means if current conditions in the capital markets improve. While we anticipate that our cash flows from operations, our current available credit facilities, our current financing arrangements and those that we expect to obtain will be adequate to meet our capital expenditures and debt repayments over the next twelve-month period, there can be no assurance that this will be the case.

Table of Contents

If any person other than A. Wilhelmsen AS. and Cruise Associates, our two principal shareholders, acquires ownership of more than 30% of our common stock and our two principal shareholders, in the aggregate, own less of our common stock than such person and do not collectively have the right to elect, or to designate for election, at least a majority of the board of directors, we may be obligated to prepay indebtedness outstanding under the majority of our credit facilities, which we may be unable to replace on similar terms. If this were to occur, it could have an adverse impact on our liquidity and operations.

Debt Covenants

Our financing agreements contain covenants that require us, among other things, to maintain minimum net worth and fixed coverage ratio and limit our net debt-to-capital ratio. Our minimum net worth and maximum net debt-to-capital calculations exclude the impact of accumulated other comprehensive income (loss) on total shareholders' equity. The fixed coverage ratio is calculated by dividing net cash from operations by the sum of dividend payments plus scheduled principal debt payments in excess of any new financings. We are currently in compliance with all debt covenants. The specific covenants and related definitions can be found in the applicable debt agreements, the majority of which have been previously filed with the Securities and Exchange Commission. As of December 31, 2008, our net worth was \$7.1 billion compared with a minimum requirement of \$5.1 billion, our fixed coverage ratio was 8.37x compared with a minimum requirement of 1.25x and our net-debt-to-capital ratio was 48.1% compared to a maximum requirement of 62.5%.

Dividends

During fiscal year 2008, we paid out dividends totaling \$128.0 million.

In November 2008 our board of directors discontinued our quarterly dividend commencing with the fourth quarter of 2008. This decision is intended to enhance our liquidity during this period of heightened economic and financial market uncertainty.

Table of Contents**Item 7A. Quantitative and Qualitative Disclosures About Market Risk
Financial Instruments and Other***General*

We are exposed to market risk attributable to changes in interest rates, foreign currency exchange rates and fuel prices. We manage these risks through a combination of our normal operating and financing activities and through the use of derivative financial instruments pursuant to our hedging practices and policies. The financial impacts of these hedging instruments are primarily offset by corresponding changes in the underlying exposures being hedged. We achieve this by closely matching the amount, term and conditions of the derivative instrument with the underlying risk being hedged. We do not hold or issue derivative financial instruments for trading or other speculative purposes. We monitor our derivative positions using techniques including market valuations and sensitivity analyses. (See Note 15. *Fair Value Measurements* to our consolidated financial statements under Item 8. *Financial Statements and Supplementary Data*.)

The recent turmoil in the credit and capital markets has increased the volatility associated with interest rates, foreign currency exchange rates and fuel prices. However, we are taking steps to mitigate these risks.

Interest Rate Risk

Our exposure to market risk for changes in interest rates relates to our long-term debt obligations and our operating lease for *Brilliance of the Seas*. At December 31, 2008, approximately 43% of our long-term debt was effectively fixed and approximately 57% was floating. We enter into interest rate swap agreements to modify our exposure to interest rate movements and to manage our interest expense and rent expense.

Market risk associated with our long-term fixed rate debt is the potential increase in fair value resulting from a decrease in interest rates. At December 31, 2008, our interest rate swap agreements effectively changed \$350.0 million of fixed rate debt with a fixed rate of 7.25% to LIBOR-based floating rate debt, and 1.0 billion of fixed rate debt with a fixed rate of 5.625% to EURIBOR-based floating rate debt. We have cross currency swap agreements that effectively change 300.0 million of the 1.0 billion floating EURIBOR-based debt to floating LIBOR-based debt. (See *Foreign Currency Exchange Rate Risk* for further information). The estimated fair value of our long-term fixed rate debt at December 31, 2008, was \$3.2 billion using quoted market prices, where available, or using the present value of expected future cash flows. The fair value of our associated interest rate swap agreements was estimated to be an asset of \$165.5 million as of December 31, 2008 based on the present value of expected future cash flows. A hypothetical one percentage point decrease in interest rates at December 31, 2008 would increase the fair value of our long-term fixed rate debt by approximately \$12.1 million, net of an increase in the fair value of the associated interest rate swap agreements.

Market risk associated with our long-term floating rate debt is the potential increase in interest expense from an increase in interest rates. A hypothetical one percentage point increase in interest rates would increase our 2009 interest expense by approximately \$24.7 million, assuming no change in exchange rates.

Market risk associated with our operating lease for *Brilliance of the Seas* is the potential increase in rent expense from an increase in sterling LIBOR rates. As of January 2008, we have effectively changed 50% of the operating lease obligation from a floating rate to a fixed rate obligation with a weighted-average rate of 4.76% through rate fixings with the lessor. A hypothetical one percentage point increase in sterling LIBOR rates would increase our 2009 rent expense by approximately \$1.4 million, based on the exchange rate at December 31, 2008.

Foreign Currency Exchange Rate Risk

Our primary exposure to foreign currency exchange rate risk relates to our ship construction firm commitments denominated in euros. We enter into euro-denominated forward contracts to manage this risk. The estimated fair value of such euro-denominated forward contracts at December 31, 2008, was a net unrealized loss of approximately \$66.9 million, based on the present value of expected future cash flows. At December 31, 2008, approximately 13.9% of the aggregate cost of the ships was exposed to fluctuations in the euro exchange rate. A hypothetical 10% strengthening of the euro as of December 31, 2008, assuming no changes in comparative interest rates, would result in a \$588.5 million increase in the United States dollar cost of the foreign currency denominated ship construction contracts. This increase would be largely offset by an increase in the fair value of our euro-denominated forward contracts.

Table of Contents

As discussed above, we have cross currency swap agreements that effectively change 300 million of floating EURIBOR-based debt to \$389 million of floating LIBOR-based debt at December 31, 2008. (See *Interest Rate Risk* for further information). The estimated fair value of these cross currency swap agreements at December 31, 2008, was an asset of approximately \$44.4 million based on the present value of expected future cash flows. A hypothetical 10% strengthening of the euro as of December 31, 2008, assuming no changes in comparative interest rates, would result in an increase in the fair value of the 300 million of floating EURIBOR-based debt by \$42.8 million, offset by an increase in the fair value of the cross currency swap agreements of \$43.7 million.

Also, we consider our investments in foreign subsidiaries to be denominated in relatively stable currencies and of a long-term nature. We partially address the exposure of our investments in foreign subsidiaries by denominating a portion of our debt in our subsidiaries' functional currencies (generally euros). Specifically, we have assigned debt of approximately 393.0 million, or approximately \$549.1 million, as a hedge of our net investment in Pullmantur and, accordingly, have included approximately \$23.2 million of foreign-currency transaction gains in the foreign currency translation adjustment component of accumulated other comprehensive income (loss) at December 31, 2008. A hypothetical 10% increase or decrease in the December 31, 2008 foreign currency exchange rate would increase or decrease the fair value of our assigned debt by \$54.9 million, which would be offset by a corresponding decrease or increase in the United States dollar value of our net investment.

Fuel Price Risk

Our exposure to market risk for changes in fuel prices relates to the consumption of fuel on our ships. Fuel cost (net of the financial impact of fuel swap agreements), as a percentage of our total revenues, was approximately 11.1% in 2008, 8.9% in 2007 and 9.2% in 2006. We use a range of instruments including fuel swap agreements to mitigate the financial impact of fluctuations in fuel prices. As of December 31, 2008, we had fuel swap agreements to pay fixed prices for fuel with an aggregate notional amount of approximately \$367.2 million, maturing through 2010. The estimated fair value of these contracts at December 31, 2008 was an unrealized loss of \$191.3 million. We estimate that a hypothetical 10% increase in our weighted-average fuel price from that experienced during the year ended December 31, 2008 would increase our 2009 fuel cost by approximately \$76.7 million. This increase would be partially offset by an increase in the fair value of our fuel swap agreements maturing in 2009 of approximately \$28.9 million.

Item 8. Financial Statements and Supplementary Data

Our Consolidated Financial Statements and Quarterly Selected Financial Data are included beginning on page F-1 of this report.

Item 9. Changes In and Disagreements With Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our Chairman and Chief Executive Officer and Executive Vice President and Chief Financial Officer, we conducted an evaluation of the effectiveness of our disclosure controls and procedures, as such term is defined in Exchange Act Rule 13a-15(e), as of the end of the period covered by this report and concluded that those controls and procedures were effective.

Management's Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Under the supervision and with the participation of our management, including our

Table of Contents

Chairman and Chief Executive Officer and Executive Vice President and Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework in *Internal Control-Integrated Framework*, our management concluded that our internal control over financial reporting was effective as of December 31, 2008. The effectiveness of our internal control over financial reporting as of December 31, 2008 has been audited by PricewaterhouseCoopers LLP, the independent registered certified public accounting firm that audited our consolidated financial statements included in this Annual Report on Form 10-K, as stated in their report, which is included on page F-2.

Changes in Internal Controls Over Financial Reporting

There were no changes in our internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Exchange Act Rules 13a-15 and 15d-15 during the quarter ended December 31, 2008 that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

It should be noted that any system of controls, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the system will be met. In addition, the design of any control system is based in part upon certain assumptions about the likelihood of future events. Because of these and other inherent limitations of control systems, there is only the reasonable assurance that our controls will succeed in achieving their goals under all potential future conditions.

Item 9B. Other Information

None.

Table of Contents

PART III

Items 10, 11, 12, 13 and 14. Directors, Executive Officers and Corporate Governance, Executive Compensation, Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters, Certain Relationships and Related Transactions, and Director Independence and Principal Accountant Fees and Services.

The information required by Items 10, 11, 12, 13 and 14 is incorporated herein by reference to the Royal Caribbean Cruises Ltd. definitive proxy statement to be filed with the Securities and Exchange Commission not later than 120 days after the close of the fiscal year, except that the information concerning the executive officers called for by Item 401(b) of Regulation S-K is included in Part I of this Annual Report on Form 10-K.

We have adopted a Code of Ethics that applies to our Chief Executive Officer, Chief Financial Officer and other senior officers. This code of ethics is posted on our website at www.rclinvestor.com.

Table of Contents

PART IV

Item 15. Exhibits and Financial Statement Schedules

(a) (1) Financial Statements

Our Consolidated Financial Statements have been prepared in accordance with Item 8. *Financial Statements and Supplementary Data* and are included beginning on page F-1 of this report.

(2) Financial Statement Schedules

None.

(3) Exhibits

The exhibits listed on the accompanying Index to Exhibits are filed or incorporated by reference as part of this Annual Report on Form 10-K and such Index to Exhibits is hereby incorporated herein by reference.

Table of Contents

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ROYAL CARIBBEAN CRUISES LTD.
(Registrant)

By: /s/ BRIAN J. RICE
Brian J. Rice
Executive Vice President and Chief Financial Officer
(Principal Financial Officer)

February 23, 2009

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities indicated on February 23, 2009.

/s/ RICHARD D. FAIN
Richard D. Fain
Director, Chairman and Chief Executive Officer
(Principal Executive Officer)

/s/ BRIAN J. RICE
Brian J. Rice
Executive Vice President and Chief Financial
Officer
(Principal Financial Officer)

/s/ HENRY L. PUJOL
Henry L. Pujol
Vice President and Corporate Controller
(Principal Accounting Officer)

/s/ * MORTEN ARNTZEN
Morten Arntzen
Director

/s/ * BERNARD W. ARONSON
Bernard W. Aronson
Director

/s/ * WILLIAM L. KIMSEY
William L. Kimsey
Director

/s/ * LAURA LAVIADA
Laura Laviada
Director

/s/ * GERT W. MUNTHE
Gert W. Munthe

Table of Contents

/s/ * EYAL M. OFER
Eyal M. Ofer
Director

/s/ * THOMAS J. PRITZKER
Thomas J. Pritzker
Director

/s/ * WILLIAM K. REILLY
William K. Reilly
Director

/s/ * BERNT REITAN
Bernt Reitan
Director

/s/ * ARNE ALEXANDER WILHELMSSEN
Arne Alexander Wilhelmsen
Director

***By: /s/ BRIAN J. RICE**
Brian J. Rice, as Attorney-in-Fact

Table of Contents

INDEX TO EXHIBITS

Exhibits 10.15 through 10.41 represent management compensatory plans or arrangements.

Exhibit	Description
3.1	Restated Articles of Incorporation of the Company, as amended (composite) (incorporated by reference to Exhibit 3.1 to the Company's Registration Statement on Form S-3, File No. 333-136186, filed with the Securities and Exchange Commission (the Commission)).
3.2	Restated By-Laws of the Company, as amended (incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed with the Commission on May 31, 2006).
4.1	Indenture dated as of July 15, 1994 between the Company, as issuer, and The Bank of New York Trust Company, N.A., successor to NationsBank of Georgia, National Association, as Trustee (incorporated by reference to Exhibit 2.4 to the Company's 1994 Annual Report on Form 20-F filed with the Commission, File No. 1-11884).
4.2	Fourth Supplemental Indenture dated as of August 12, 1996 to Indenture dated as of July 15, 1994 between the Company, as issuer, and The Bank of New York Trust Company, N.A., as Trustee (incorporated by reference to Document No. 2 in the Company's Form 6-K filed with the Commission on February 10, 1997, File No. 1-11884).
4.3	Fifth Supplemental Indenture dated as of October 14, 1997 to Indenture dated as of July 15, 1994 between the Company, as issuer, and The Bank of New York Trust Company, N.A., as Trustee (incorporated by reference to Exhibit 2.10 to the Company's 1997 Annual Report on Form 20-F filed with the Commission, File No. 1-11884).
4.4	Sixth Supplemental Indenture dated as of October 14, 1997 to Indenture dated as of July 15, 1994 between the Company, as issuer, and The Bank of New York Trust Company, N.A., as Trustee (incorporated by reference to Exhibit 2.11 to the Company's 1997 Annual Report on Form 20-F filed with the Commission, File No. 1-11884).
4.5	Seventh Supplemental Indenture dated as of March 16, 1998 to Indenture dated as of July 15, 1994 between the Company, as issuer, and The Bank of New York Trust Company, N.A., as Trustee (incorporated by reference to Exhibit 2.12 to the Company's 1997 Annual Report on Form 20-F filed with the Commission, File No. 1-11884).
4.6	Eighth Supplemental Indenture dated as of March 16, 1998 to Indenture dated as of July 15, 1994 between the Company, as issuer, and The Bank of New York Trust Company, N.A., as Trustee (incorporated by reference to Exhibit 2.13 to the Company's 1997 Annual Report on Form 20-F filed with the Commission, File No. 1-11884).
4.7	Ninth Supplemental Indenture dated as of February 2, 2001 to Indenture dated as of July 15, 1994 between the Company, as issuer, and The Bank of New York Trust Company, N.A., as Trustee (incorporated by reference to Exhibit 2.10 to the Company's 2000 Annual Report on Form 20-F filed with the Commission, File No. 1-11884).
4.8	Tenth Supplemental Indenture dated as of February 2, 2001 to Indenture dated as of July 15, 1994 between the Company, as issuer, and The Bank of New York Trust Company, N.A., as Trustee (incorporated by reference to Exhibit 2.11 to the Company's 2000 Annual Report on Form 20-F filed with the Commission, File No. 1-11884).
4.9	Eleventh Supplemental Indenture dated as of May 18, 2001 to Indenture dated as of July 15, 1994 between the Company, as issuer, and The Bank of New York Trust Company, N.A., as Trustee (incorporated by Reference to Exhibit 2.12 to the Company's 2001 Annual Report on Form 20-F filed with the Commission, File No. 1-11884).
4.10	Twelfth Supplemental Indenture dated as of May 9, 2003 to Indenture dated as of July 15, 1994 between the Company, as issuer, and The Bank of New York Trust Company, N.A., as Trustee (incorporated by reference to Exhibit 2.13 to the Company's 2003 Annual Report on Form 20-F filed with the Commission, File No. 1-11884).

Table of Contents

- 4.11 Thirteenth Supplemental Indenture dated as of November 21, 2003 to Indenture dated as of July 15, 1994 between the Company, as issuer, and The Bank of New York Trust Company, N.A., as Trustee (incorporated by reference to Exhibit 2.14 to the Company's 2003 Annual Report on Form 20-F filed with the Commission, File No. 1-11884.)
- 4.12 Fourteenth Supplemental Indenture dated as of June 12, 2006 to Indenture dated as of July 15, 1994 between the Company, as issuer, and The Bank of New York Trust Company, N.A., as Trustee (incorporated by reference to Exhibit 4.13 to the Company's 2006 Annual Report on Form 10-K filed with the Commission).
- 4.13 Fifteenth Supplemental Indenture dated as of June 12, 2006 to Indenture dated as of July 15, 1994 between the Company, as issuer, and The Bank of New York Trust Company, N.A., as Trustee (incorporated by reference to Exhibit 4.14 to the Company's 2006 Annual Report on Form 10-K filed with the Commission).
- 4.14 Form of Indenture dated as of July 31, 2006 between the Company, as issuer, and The Bank of New York Trust Company, N.A., as Trustee (incorporated by reference to Exhibit 4.1 to the Company's Registration Statement on Form S-3 (No. 333-136186) filed with the Commission on July 31, 2006).
- 4.15 Indenture dated as of January 25, 2007 among the Company, as issuer, The Bank of New York, as trustee, transfer agent, principal paying agent and security registrar, and AIB/BNY Fund Management (Ireland) Limited, as Irish paying agent (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the Commission on January 26, 2007).
- 10.1 Amended and Restated Registration Rights Agreement dated as of July 30, 1997 among the Company, A. Wilhelmsen AS., Cruise Associates, Monument Capital Corporation, Archinav Holdings, Ltd. and Overseas Cruiseship, Inc. (incorporated by reference to Exhibit 2.20 to the Company's 1997 Annual Report on Form 20-F filed with the Commission, File No. 1-11884).
- 10.2 Credit Agreement dated as of March 27, 2003, amended and restated as of June 29, 2007 among the Company and various financial institutions and Citibank, N.A. as Administrative Agent (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the Commission on July 3, 2007).
- 10.3 Credit Agreement dated as of April 6, 2006, amended as of December 15, 2006, among the Company and various financial institutions and Citibank, N.A. as Administrative Agent (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the Commission on April 19, 2006 and Exhibit 10.5 to the Company's 2006 Annual Report on Form 10-K filed with the Commission).
- 10.4 Credit Agreement dated as of November 7, 2006 among the Company, various financial institutions and Citibank, N.A. as Administrative Agent (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the Commission on November 8, 2006).
- 10.5 Credit Agreement dated as of March 26, 2007 among the Company and various financial institutions and Citibank, N.A. as Administrative Agent (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the Commission on March 29, 2007).
- 10.6 Credit Agreement dated as of February 6, 2008 among the Company and various financial institutions and Nordea Bank Finland PLC, acting through its New York Branch, as Administrative Agent (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the Commission on February 11, 2008).

Table of Contents

- 10.7 Credit Agreement dated as of August 7, 2008 among Celebrity Solstice Inc., KfW IPEX-Bank GmbH, as agent for Euler Hermes Kreditversicherungs AG and administrative agent, and KfW IPEX-Bank GmbH and BNP Paribas S.A., as lenders (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the Commission on August 11, 2008).
- 10.8 Credit Agreement dated as of December 19, 2008 among Celebrity Solstice V Inc., KfW IPEX-Bank GmbH, as agent for Euler Hermes Kreditversicherungs AG and administrative agent, and KfW IPEX-Bank GmbH, as lender (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the Commission on December 24, 2008).
- 10.9 Office Building Lease Agreement dated July 25, 1989 between Miami-Dade County and the Company, as amended (incorporated by reference to Exhibits 10.116 and 10.117 to the Company's Registration Statement on Form F-1, File No. 33-46157, filed with the Commission).
- 10.10 Office Building Lease Agreement dated January 18, 1994 between Miami-Dade County and the Company (incorporated by reference to Exhibit 2.13 to the Company's 1993 Annual Report on Form 20-F filed with the Commission, File No. 1-11884).
- 10.11 Lease by and between City of Wichita, Kansas and the Company dated as of December 1, 1997, together with First Supplemental Lease Agreement dated December 1, 2000 (incorporated by reference to Exhibit 4.7 to the Company's 2002 Annual Report on Form 20-F filed with the Commission).
- 10.12 Multi-Tenant Office Lease Agreement dated May 3, 2000 between the Company and Opus Real Estate National IV FL, L.L.C. (formerly Miramar 75, L.L.C.), together with four Amendments thereto dated June 1, 2000, November 20, 2000, October 11, 2001 and September 25, 2003 (incorporated by reference to Exhibit 4.6 to the Company's 2003 Annual Report on Form 20-F filed with the Commission).
- 10.13 Lease Agreement dated January 24, 2005, as amended through March 20, 2006, between the Company and Workstage-Oregon, LLC (incorporated by reference to Exhibit 10.7 to the Company's 2004 Annual Report on Form 10-K filed with the Commission, Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2005 filed with the Commission, and Exhibit 10.12 to the Company's 2007 Annual Report on Form 10-K filed with the Commission).
- 10.14 Lease dated August 30, 2006 between DV3 Addlestone Limited, RCL Investments Ltd. (formerly Harmony Investments (Global) Limited) and the Company (incorporated by reference to Exhibit 10.12 to the Company's 2006 Annual Report on Form 10-K filed with the Commission).
- 10.15 1995 Incentive Stock Option Plan of the Company, as amended (incorporated by reference to Exhibit 4 to the Company's Registration Statement on Form S-8, File No. 333-84980, filed with the Commission).
- 10.16 Royal Caribbean Cruises Ltd. 2000 Stock Award Plan, as Amended and Restated through September 18, 2006 (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the Commission on December 8, 2005 and Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the Commission on September 22, 2006).
- 10.17 Form of Royal Caribbean Cruises Ltd. 2000 Stock Award Plan Stock Option Certificate - Incentive Stock Options (incorporated by reference to Exhibit 10.34 to the Company's 2007 Annual Report on Form 10-K filed with the Commission).
- 10.18 Form of Royal Caribbean Cruises Ltd. 2000 Stock Award Plan Stock Option Certificate - Non-Qualified Shares (incorporated by reference to Exhibit 10.35 to the Company's 2007 Annual Report on Form 10-K filed with the Commission).

Table of Contents

- 10.19 Form of Royal Caribbean Cruises Ltd. 2000 Stock Award Plan Restricted Stock Unit Agreement (incorporated by reference to Exhibit 10.36 to the Company's 2007 Annual Report on Form 10-K filed with the Commission).
- 10.20 Form of Royal Caribbean Cruises Ltd. 2008 Equity Incentive Plan Stock Option Award Agreement - Incentive Options (incorporated by reference to Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2008 filed with the Commission).
- 10.21 Form of Royal Caribbean Cruises Ltd. 2008 Equity Incentive Plan Stock Option Award Agreement - Nonqualified shares (incorporated by reference to Exhibit 10.4 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2008 filed with the Commission).
- 10.22 Form of Royal Caribbean Cruises Ltd. 2008 Equity Incentive Plan Restricted Stock Unit Agreement (incorporated by reference to Exhibit 10.5 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2008 filed with the Commission).
- 10.23 Employment Agreement dated July 25, 2007, amended as of December 19, 2008, between the Company and Richard D. Fain (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2007 filed with the Commission and Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the Commission on December 23, 2008).
- 10.24 Amended and Restated Trust Agreement dated September 21, 2007, amended as of December 19, 2008, between the Company and Northern Trust, N.A. (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the period ended September 30, 2007 filed with the Commission and Exhibit 10.2 to the Company's Current Report on Form 8-K filed with the Commission on December 23, 2008).
- 10.25 Employment Agreement dated July 25, 2007 between the Company and Adam M. Goldstein (incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2007 filed with the Commission).
- 10.26 Employment Agreement dated July 25, 2007 between Celebrity Cruises Inc. and Daniel J. Hanrahan (incorporated by reference to Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2007 filed with the Commission).
- 10.27 Employment Agreement dated July 25, 2007 between the Company and Brian J. Rice (incorporated by reference to Exhibit 10.4 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2007 filed with the Commission).
- 10.28 Employment Agreement dated July 25, 2007 between the Company and Harri U. Kulovaara (incorporated by reference to Exhibit 10.5 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2007 filed with the Commission).
- 10.29 Description of consulting arrangement between the Company and William K. Reilly (incorporated by reference to Exhibit 10.16 to the Company's 2004 Annual Report on Form 10-K filed with the Commission).
- 10.30 Royal Caribbean Cruises Ltd. et. al. Board of Directors Non Qualified Deferred Compensation Plan, as amended through December 12, 2006 (incorporated by reference to Exhibit 10.4 to the Company's Current Report on Form 8-K filed with the Commission on December 8, 2005 and Exhibit 10.25 to the Company's 2006 Annual Report on Form 10-K filed with the Commission).
- 10.31 Amendment to Royal Caribbean Cruises Ltd. et. al. Board of Directors Non Qualified Deferred Compensation Plan, dated as of November 11, 2008.
- 10.32 Royal Caribbean Cruises Ltd. et. al. Non Qualified Deferred Compensation Plan Rabbi Trust (incorporated by reference to Exhibit 10.18 to the Company's 2004 Annual Report on Form 10-K filed with the Commission).

Table of Contents

- 10.33 Royal Caribbean Cruises Ltd. Executive Incentive Plan as amended as of December 12, 2006 (incorporated by reference to Exhibit 10.27 to the Company's 2006 Annual Report on Form 10-K filed with the Commission).
- 10.34 Amendment to Royal Caribbean Cruises Ltd. Executive Incentive Plan, dated as of November 11, 2008.
- 10.35 Royal Caribbean Cruises Ltd. et. al. Non Qualified Deferred Compensation Plan, formerly Royal Caribbean Cruises Ltd. et. al. Non Qualified 401(k) Plan, as amended through December 31, 2007 (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed with the Commission on December 8, 2005, Exhibit 10.29 to the Company's 2006 Annual Report on Form 10-K filed with the Commission, Exhibit 10.28 to the Company's 2007 Annual Report on Form 10-K filed with the Commission, and Exhibit 10.29 to the Company's 2007 Annual Report on Form 10-K filed with the Commission).
- 10.36 Amendment to the Royal Caribbean Cruises Ltd. et. al. Non Qualified Deferred Compensation Plan, dated as of November 11, 2008.
- 10.37 Royal Caribbean Cruises Ltd. Supplemental Executive Retirement Plan as amended through September 12, 2008 (incorporated by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K filed with the Commission on December 8, 2005, Exhibit 10.31 to the Company's 2006 Annual Report on Form 10-K filed with the Commission, Exhibit 10.31 to the Company's 2007 Annual Report on Form 10-K filed with the Commission, and Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2008 filed with the Commission).
- 10.38 Amendment to the Royal Caribbean Cruises Ltd. Supplemental Executive Retirement Plan dated as of November 11, 2008.
- 10.39 Summary of Royal Caribbean Cruises Ltd. Board of Directors Compensation.
- 10.40 Cruise Policy effective as of October 3, 2007 for Members of the Board of Directors of the Company (incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2007 filed with the Commission).
- 10.41 Royal Caribbean Cruises Ltd. Executive Short-Term Bonus Plan dated as of September 12, 2008 (incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2008 filed with the Commission).
- 12.1 Statement regarding computation of fixed charge coverage ratio.
- 21.1 List of Subsidiaries.
- 23.1 Consent of PricewaterhouseCoopers LLP, an independent registered certified public accounting firm.
- 23.2 Consent of Drinker Biddle & Reath LLP.
- 24.1 Power of Attorney
- 31.1 Certification of Richard D. Fain required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934.
- 31.2 Certification of Brian J. Rice required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934.
- 32.1 Certification of Richard D. Fain and Brian J. Rice pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code.

Table of Contents

ROYAL CARIBBEAN CRUISES LTD.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

	Page
<u>Report of Independent Registered Certified Public Accounting Firm</u>	F-2
<u>Consolidated Statements of Operations</u>	F-3
<u>Consolidated Balance Sheets</u>	F-4
<u>Consolidated Statements of Cash Flows</u>	F-5
<u>Consolidated Statements of Shareholders' Equity</u>	F-7
<u>Notes to the Consolidated Financial Statements</u>	F-8

F-1

Table of Contents

Report of Independent Registered Certified Public Accounting Firm

To the Board of Directors and Shareholders

of Royal Caribbean Cruises, Ltd.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, shareholders' equity and cash flows present fairly, in all material respects, the financial position of Royal Caribbean Cruises, Ltd. and its subsidiaries at December 31, 2008 and December 31, 2007, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2008 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Report on Internal Control Over Financial Reporting appearing under Item 9A. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

PricewaterhouseCoopers LLP

Miami, Florida

February 23, 2009

Table of Contents**ROYAL CARIBBEAN CRUISES LTD.****CONSOLIDATED STATEMENTS OF OPERATIONS**

	Year Ended December 31,		
	2008	2007	2006
	(in thousands, except per share data)		
Passenger ticket revenues	\$ 4,730,289	\$ 4,427,384	\$ 3,838,648
Onboard and other revenues	1,802,236	1,721,755	1,390,936
Total revenues	6,532,525	6,149,139	5,229,584
Cruise operating expenses:			
Commissions, transportation and other	1,192,316	1,124,022	917,929
Onboard and other	458,385	405,637	331,218
Payroll and related	657,721	584,081	501,874
Food	342,620	322,996	278,604
Fuel	722,007	546,029	480,187
Other operating	1,030,617	998,933	739,817
Total cruise operating expenses	4,403,666	3,981,698	3,249,629
Marketing, selling and administrative expenses	776,522	783,040	699,864
Depreciation and amortization expenses	520,353	483,066	421,645
	5,700,541	5,247,804	4,371,138
Operating Income	831,984	901,335	858,446
Other income (expense):			
Interest income	14,116	20,025	15,238
Interest expense, net of interest capitalized	(327,312)	(333,784)	(267,861)
Other income	54,934	15,829	28,099
	(258,262)	(297,930)	(224,524)
Net Income	\$ 573,722	\$ 603,405	\$ 633,922
Basic Earnings per Share:			
Net income	\$ 2.69	\$ 2.84	\$ 3.01
Diluted Earnings per Share:			
Net income	\$ 2.68	\$ 2.82	\$ 2.94

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

ROYAL CARIBBEAN CRUISES LTD.
CONSOLIDATED BALANCE SHEETS

	As of December 31, 2008 2007	
	(in thousands, except share data)	
Assets		
Current assets		
Cash and cash equivalents	\$ 402,878	\$ 230,784
Trade and other receivables, net	271,287	313,640
Inventories	96,077	96,813
Prepaid expenses and other assets	125,160	137,662
Derivative financial instruments	81,935	213,892
Total current assets	977,337	992,791
Property and equipment, net	13,878,998	12,253,784
Goodwill	779,246	797,791
Other assets	827,729	937,915
	\$ 16,463,310	\$ 14,982,281
Liabilities and Shareholders Equity		
Current liabilities		
Current portion of long-term debt	\$ 471,893	\$ 351,725
Accounts payable	245,225	222,895
Accrued interest	128,879	132,450
Accrued expenses and other liabilities	687,369	401,224
Customer deposits	968,520	1,084,359
Hedged firm commitments	172,339	146,642
Total current liabilities	2,674,225	2,339,295
Long-term debt	6,539,510	5,346,547
Other long-term liabilities	446,563	539,096
Commitments and contingencies (Note 16)		
Shareholders equity		
Preferred stock (\$0.01 par value; 20,000,000 shares authorized; none outstanding)		
Common stock (\$0.01 par value; 500,000,000 shares authorized; 223,899,076 and 223,509,136 shares issued, December 31, 2008 and December 31, 2007, respectively)	2,239	2,235
Paid-in capital	2,952,540	2,942,935
Retained earnings	4,592,529	4,114,877
Accumulated other comprehensive (loss) income	(319,936)	120,955
Treasury stock (11,076,701 and 11,026,271 common shares at cost, December 31, 2008 and December 31, 2007, respectively)	(424,360)	(423,659)
Total shareholders equity	6,803,012	6,757,343
	\$ 16,463,310	\$ 14,982,281

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**ROYAL CARIBBEAN CRUISES LTD.****CONSOLIDATED STATEMENTS OF CASH FLOWS**

	2008	Year Ended December 31, 2007 (in thousands)	2006
Operating Activities			
Net income	\$ 573,722	\$ 603,405	\$ 633,922
Adjustments:			
Depreciation and amortization	520,353	483,066	421,645
Accretion of original issue discount on debt	1,750	1,810	17,902
Changes in operating assets and liabilities:			
Decrease (increase) in trade and other receivables, net	28,150	(122,682)	(38,855)
Increase in inventories	(140)	(19,424)	(7,441)
Decrease (increase) in prepaid expenses and other assets	12,884	(37,650)	707
Increase (decrease) in accounts payable	22,322	23,398	(29,671)
(Decrease) increase in accrued interest	(3,571)	78,160	(2,196)
Increase in accrued expenses and other liabilities	39,766	72,035	24,011
(Decrease) increase in customer deposits	(118,541)	184,713	9,724
Accreted interest paid on LYONs repurchase			(121,199)
Other, net	(5,440)	1,863	39,957
Net cash provided by operating activities	1,071,255	1,268,694	948,506
Investing Activities			
Purchases of property and equipment	(2,223,534)	(1,317,381)	(1,178,960)
Repayment (purchase) of notes from TUI Travel		100,000	(100,000)
Purchase of Pullmantur, net of cash acquired			(553,312)
Cash received on settlement of derivative financial instruments	269,815	59,392	7,288
Loans and equity contributions to unconsolidated affiliates	(52,323)		(12,019)
Proceeds from sale of investment in Island Cruises	51,400		
Other, net	(22,607)	(12,569)	(12,075)
Net cash used in investing activities	(1,977,249)	(1,170,558)	(1,849,078)
Financing Activities			
Proceeds from issuance of debt	2,223,402	1,934,979	2,933,915
Debt issuance costs	(23,872)	(10,146)	(10,004)
Repayments of debt	(987,547)	(1,805,798)	(1,785,773)
Dividends paid	(128,045)	(98,298)	(124,460)
Proceeds from exercise of common stock options	3,817	19,632	23,026
Purchases of treasury stock			(164,582)
Other, net	(4,369)	(3,758)	7,585
Net cash provided by financing activities	1,083,386	36,611	879,707
Effect of exchange rate changes on cash	(5,298)	(8,483)	
Net increase (decrease) in cash and cash equivalents	172,094	126,264	(20,865)
Cash and cash equivalents at beginning of year	230,784	104,520	125,385

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Cash and cash equivalents at end of year	\$ 402,878	\$ 230,784	\$ 104,520
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Supplemental Disclosures

Cash paid during the year for:

Interest, net of amount capitalized	\$ 321,206	\$ 285,206	\$ 376,817
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Non-cash Investing Transactions

We accrued for purchases of property and equipment paid in 2009	\$ 63,857	\$	\$
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F-5

Table of Contents

Supplemental Schedule of Noncash Investing Activity

The Company purchased all of the capital stock of Pullmantur for approximately \$558.9 million in November 2006. In conjunction with the acquisition, liabilities were assumed as follows:

Fair value of assets acquired	\$ 1,111,117
Cash paid for capital stock	(558,948)
Liabilities assumed	\$ 552,169

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**ROYAL CARIBBEAN CRUISES LTD.****CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY**

	Common Stock	Paid-in Capital	Retained Earnings (in thousands)	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Shareholders Equity
Balances at January 1, 2006	\$ 2,165	\$ 2,706,236	\$3,132,286	\$ (28,263)	\$(257,959)	\$ 5,554,465
Issuance under employee related plans	12	42,031			(559)	41,484
Purchases of treasury stock					(164,582)	(164,582)
Common stock dividends			(126,997)			(126,997)
Changes related to cash flow derivative hedges				3,507		3,507
Adoption of SFAS Statement No. 158				(6,981)		(6,981)
Minimum pension liability adjustment				834		834
Foreign currency translation adjustments				101		101
Debt converted to common stock	48	155,774				155,822
Net income			633,922			633,922
Balances at December 31, 2006	2,225	2,904,041	3,639,211	(30,802)	(423,100)	6,091,575
Issuance under employee related plans	10	38,894			(559)	38,345
Common stock dividends			(127,739)			(127,739)
Changes related to cash flow derivative hedges				152,523		152,523
Change in defined benefit plans				3,500		3,500
Foreign currency translation adjustments				(4,266)		(4,266)
Net income			603,405			603,405
Balances at December 31, 2007	2,235	2,942,935	4,114,877	120,955	(423,659)	6,757,343
Issuance under employee related plans	4	9,605			(701)	8,908
Common stock dividends			(96,070)			(96,070)
Changes related to cash flow derivative hedges				(430,051)		(430,051)
Change in defined benefit plans				(2,835)		(2,835)
Foreign currency translation adjustments				(8,005)		(8,005)
Net income			573,722			573,722
Balances at December 31, 2008	\$ 2,239	\$ 2,952,540	\$4,592,529	\$ (319,936)	\$(424,360)	\$ 6,803,012

Comprehensive income is as follows (in thousands):

	Year Ended December 31,		
	2008	2007	2006
Net income	\$ 573,722	\$ 603,405	\$ 633,922
Changes related to cash flow derivative hedges	(430,051)	152,523	3,507
Minimum pension liability adjustment			834
Change in defined benefit plans	(2,835)	3,500	
Foreign currency translation adjustments	(8,005)	(4,266)	101
Total comprehensive income	\$ 132,831	\$ 755,162	\$ 638,364

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The following tables summarize activity in accumulated other comprehensive income (loss) related to derivatives designated as cash flow hedges, change in defined benefit plans and the foreign currency translation adjustments (in thousands):

	Year Ended December 31,		
	2008	2007	2006
Accumulated net (loss) gain on cash flow derivative hedges at beginning of year	\$ 137,859	\$ (14,664)	\$ (18,171)
Net gain (loss) on cash flow derivative hedges	(374,810)	163,444	(7,483)
Net (loss) gain reclassified into earnings	(55,241)	(10,921)	10,990
Accumulated net gain (loss) on cash flow derivative hedges at end of year	\$ (292,192)	\$ 137,859	\$ (14,664)

	Changes related to cash flow derivative hedges	Change in defined benefit plans	Foreign currency translation adjustments	Accumulated other comprehensive income (loss)
Accumulated other comprehensive loss at beginning of the year	\$ 137,859	\$ (12,739)	\$ (4,165)	\$ 120,955
Current-period change	(430,051)	(2,835)	(8,005)	(440,891)
Accumulated other comprehensive loss at end of year	\$ (292,192)	\$ (15,574)	\$ (12,170)	\$ (319,936)

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

ROYAL CARIBBEAN CRUISES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 1. General

Description of Business

We are a global cruise company. We own five cruise brands, Royal Caribbean International, Celebrity Cruises, Pullmantur, Azamara Cruises, and CDF Croisières de France with 20, nine, six, two and one ships, respectively, at December 31, 2008. Our ships operate on a selection of worldwide itineraries that call on approximately 425 destinations. We also have a 50% investment in a joint venture with TUI AG which operates the brand TUI Cruises. *Celebrity Galaxy*, a 1,850-berth ship currently part of Celebrity Cruises, will be sold to TUI Cruises to serve as its first ship and will sail under a new name beginning in May 2009.

Basis for Preparation of Consolidated Financial Statements

The consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America. Estimates are required for the preparation of financial statements in accordance with accounting principles generally accepted in the United States of America. Actual results could differ from these estimates. All significant intercompany accounts and transactions are eliminated in consolidation. We consolidate entities over which we have control, usually evidenced by a direct ownership interest of greater than 50% and variable interest entities where we are determined to be the primary beneficiary. For affiliates where significant influence over financial and operating policies exists, usually evidenced by a direct ownership interest from 20% to 50%, the investment is accounted for using the equity method.

Note 2. Summary of Significant Accounting Policies

Revenues and Expenses

Deposits received on sales of passenger cruises are initially recorded as customer deposit liabilities on our balance sheet. Customer deposits are subsequently recognized as passenger ticket revenues, together with revenues from onboard and other goods and services and all associated direct costs of a voyage, upon completion of voyages with durations of ten days or less, and on a pro rata basis for voyages in excess of ten days.

Cash and Cash Equivalents

Cash and cash equivalents include cash and marketable securities with original maturities of less than 90 days.

Inventories

Inventories consist of provisions, supplies and fuel carried at the lower of cost (weighted-average) or market.

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation and amortization. We capitalize interest as part of the cost of acquiring certain assets. Improvement costs that we believe add value to our ships are capitalized as additions to the ship and depreciated over the improvements' estimated useful lives. The estimated cost and accumulated depreciation of replaced or refurbished ship components are written off and any resulting losses are recognized in cruise operating expenses. Costs of repairs and maintenance are charged to cruise operating expenses as incurred and drydocking costs are deferred and charged to expense on a

Table of Contents

straight-line basis over the period to the next scheduled drydock. Deferred drydock costs consist of the costs to drydock the vessel and other costs incurred in connection with the drydock which are necessary to maintain the vessel's class certification. Liquidated damages received from shipyards as a result of the late delivery of a new ship are recorded as reductions to the cost basis of the ship. We review long-lived assets for impairment whenever events or changes in circumstances indicate, based on estimated undiscounted future cash flows, that the carrying amount of these assets may not be fully recoverable.

Depreciation of property and equipment is computed using the straight-line method over estimated useful lives of primarily 30 years for ships, net of a 15% projected residual value, and three to 40 years for other property and equipment. Depreciation for assets under capital leases and leasehold improvements is computed using the shorter of the lease term or related asset life. (See Note 6. *Property and Equipment*.)

Goodwill

Goodwill represents the excess of cost over the fair value of net tangible and identifiable intangible assets acquired. We review goodwill for impairment at the reporting unit level annually, or when events or circumstances dictate, more frequently. The impairment review for goodwill consists of a two-step process of first determining the fair value of the reporting unit and comparing it to the carrying value of the net assets allocated to the reporting unit. If the fair value of the reporting unit exceeds the carrying value, no further analysis or write-down of goodwill is required. If the fair value of the reporting unit is less than the carrying value of the net assets, the implied fair value of the reporting unit is allocated to all the underlying assets and liabilities, including both recognized and unrecognized tangible and intangible assets, based on their fair value. If necessary, goodwill is then written down to its implied fair value.

Our goodwill impairment test is performed annually during the fourth quarter. We determined there was no goodwill impairment as of December 31, 2008, 2007 and 2006.

Intangible Assets

In connection with our acquisitions, we have acquired certain intangible assets of which value has been assigned to them based on our estimates. Intangible assets that are deemed to have an indefinite life are not amortized, but are subject to an annual impairment test, or when events or circumstances dictate, more frequently. The indefinite-life intangible asset impairment test consists of a comparison of the fair value of the indefinite-life intangible asset with its carrying amount. If the carrying amount exceeds its fair value, an impairment loss is recognized in an amount equal to that excess. If the fair value exceeds its carrying amount, the indefinite-life intangible asset is not considered impaired.

Other intangible assets assigned finite useful lives are amortized on a straight-line basis over their estimated useful lives.

Our indefinite-life intangible assets impairment test is performed annually during the fourth quarter. We determined there was no indefinite-life intangible asset impairment as of December 31, 2008, 2007 and 2006.

Advertising Costs

Advertising costs are expensed as incurred except those costs which result in tangible assets, such as brochures, which are treated as prepaid expenses and charged to expense as consumed. Advertising costs consist of media advertising as well as brochure, production and direct mail costs. Media advertising was \$152.5 million, \$153.4 million and \$141.3 million, and brochure, production and direct mail costs were \$100.0 million, \$99.0 million and \$89.5 million for the years 2008, 2007 and 2006, respectively.

Derivative Instruments

We enter into various forward, swap and option contracts to manage our interest rate exposure and to limit our exposure to fluctuations in foreign currency exchange rates and fuel prices. These instruments are designated as hedges and are recorded on the balance sheet at their fair value. Our derivative instruments are not held for trading or speculative purposes.

Table of Contents

At inception of the hedge relationship, a derivative instrument that hedges the exposure to changes in the fair value of a recognized asset or liability, or a firm commitment is designated as a fair value hedge. A derivative instrument that hedges a forecasted transaction or the variability of cash flows related to a recognized asset or liability is designated as a cash flow hedge.

Changes in the fair value of derivatives that are designated as fair value hedges are offset against changes in the fair value of the underlying hedged assets, liabilities or firm commitments. Changes in fair value of derivatives that are designated as cash flow hedges are recorded as a component of accumulated other comprehensive (loss) income until the underlying hedged transactions are recognized in earnings. The foreign-currency transaction gain or loss of our nonderivative financial instrument designated as a hedge of our net investment in our foreign operations is recognized as a component of accumulated other comprehensive income along with the associated foreign currency translation adjustment of the foreign operation.

On an ongoing basis, we assess whether derivatives used in hedging transactions are highly effective in offsetting changes in the fair value or cash flow of hedged items. If it is determined that a derivative is not highly effective as a hedge or hedge accounting is discontinued, any change in fair value of the derivative since the last date at which it was determined to be effective is recognized in earnings. In addition, the ineffective portion of our highly effective hedges is recognized in earnings immediately and reported in other income (expense) in our consolidated statements of operations.

Cash flows from derivative instruments that are designated as fair value or cash flow hedges are classified in the same category as the cash flows from the underlying hedged items. In the event that hedge accounting is discontinued, cash flows subsequent to the date of discontinuance are classified consistent with the nature of the instrument.

Foreign Currency Translations and Transactions

We translate assets and liabilities of our foreign subsidiaries whose functional currency is the local currency, at exchange rates in effect at the balance sheet date. We translate revenues and expenses at weighted-average exchange rates for the period. Equity is translated at historical rates and the resulting foreign currency translation adjustments are included as a component of accumulated other comprehensive (loss) income, which is reflected as a separate component of shareholders' equity. Exchange gains or losses arising from the remeasurement of monetary assets and liabilities denominated in a currency other than the functional currency of the entity involved are immediately included in our earnings, unless certain liabilities have been designated to act as a hedge of a net investment in a foreign operation. The majority of our transactions are settled in United States dollars. Gains or losses resulting from transactions denominated in other currencies are recognized in income at each balance sheet date. Exchange gains for 2008 were \$23.0 million, and exchange losses for 2007 and 2006 were \$6.7 million and \$2.4 million, respectively, and were recorded in other income.

Concentrations of Credit Risk

We monitor concentrations of credit risk associated with financial and other institutions with which we conduct significant business. Credit risk, including but not limited to counterparty nonperformance under derivative instruments, our revolving credit facility and new ship progress payment guarantees, is not considered significant, as we primarily conduct business with large, well-established financial institutions and insurance companies that we have well established relationships with and that have credit risks acceptable to us or the credit risk is spread out among a large number of creditors. We do not anticipate nonperformance by any of our significant counterparties. In addition, we have established guidelines regarding credit ratings and investment maturities that we follow to maintain safety and liquidity. We do not normally require collateral or other security to support credit relationships; however, in certain circumstances this option is available to us. We normally require guarantees to support new ship progress payments to shipyards.

Table of Contents*Earnings Per Share*

Basic earnings per share is computed by dividing net income by the weighted-average number of shares of common stock outstanding during each period. Diluted earnings per share incorporates the incremental shares issuable upon the assumed exercise of stock options and conversion of potentially dilutive securities. In addition, net income is adjusted to add back the amount of interest recognized in the period associated with convertible dilutive securities. (See Note 11. *Earnings Per Share*.)

Stock-Based Employee Compensation

Effective January 1, 2006, we adopted Statement of Financial Accounting Standard (SFAS) No. 123 (revised 2004), Share-Based Payment, (SFAS 123R). SFAS 123R requires the measurement and recognition of compensation expense at the fair value of employee stock awards. Compensation expense for awards and related tax effects is recognized as they vest. We have adopted SFAS 123R using the modified prospective transition method in which we are recognizing compensation expense on the unvested portion of the awards over the remaining vesting period. Under this transition method, prior period results have not been restated. In addition, SFAS 123R requires us to estimate the amount of expected forfeitures in calculating compensation costs for all outstanding awards. Previously, we had accounted for forfeitures as they occurred. As of January 1, 2006, the cumulative effect of adopting the expected forfeiture method and the impact on cash flows was not significant.

The impact of SFAS 123R was a reduction of our net income by approximately \$2.9 million, \$10.3 million and \$11.3 million for each of the years ended December 31, 2008, 2007, and 2006, respectively. The impact on basic and diluted earnings per share was \$0.01 for the year ended December 31, 2008 and \$0.05 for each of the years ended December 31, 2007 and December 31, 2006.

Segment Reporting

We operate five cruise brands, Royal Caribbean International, Celebrity Cruises, Pullmantur, Azamara Cruises and CDF Croisières de France. The brands have been aggregated as a single reportable segment based on the similarity of their economic characteristics as well as products and services provided.

Information by geographic area is shown in the table below. Passenger ticket revenues are attributed to geographic areas based on where the reservation originates.

	2008	2007	2006
Passenger ticket revenues:			
United States	60%	63%	76%
All other countries	40%	37%	24%

Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 defines fair value, establishes a formal framework for measuring fair value and expands disclosures about fair value measurements. Broadly, SFAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. SFAS 157 applies prospectively to fair value measurements performed after the required effective dates as follows: on January 1, 2008, the standard applied to the measurements of fair values of financial instruments and recurring fair value measurements of non-financial assets and liabilities; on January 1, 2009, the standard will apply to non-recurring measurements of non-financial assets and liabilities such as our measurement of potential impairments of goodwill, other intangibles and other long-lived assets. On January 1, 2008, we adopted the provisions of SFAS 157 for our measurement of fair value of financial instruments and recurring fair value measurements of

Table of Contents

non-financial assets and liabilities. These provisions did not have a material impact on our consolidated financial statements. We do not expect the adoption of the remaining provisions of SFAS 157 to have a material impact on our consolidated financial statements.

SFAS 157 establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are inputs that market participants would use in pricing the asset or liability developed based on market data obtained from sources independent of the Company. Unobservable inputs are inputs that reflect the Company's assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. The hierarchy is broken down into three levels based on the reliability of the inputs as follows:

1. Level 1 Inputs - Quoted prices (unadjusted) in active markets for identical assets or liabilities that we have the ability to access.
2. Level 2 Inputs - Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
3. Level 3 Inputs - Inputs that are unobservable for the asset or liability.

The availability of observable inputs can vary and is affected by a wide variety of factors. To the extent that valuation is based on inputs that are less observable or unobservable in the market, the determination of fair value requires more judgment. Accordingly, the degree of judgment exercised by the Company in determining fair value is greatest for instruments categorized in Level 3. In certain cases, the inputs used to measure fair value of a specific asset or liability may fall into different levels of the fair value hierarchy. In such cases, for disclosure purposes the level in the fair value hierarchy within which the fair value measurement in its entirety falls is determined based on the lowest level input that is significant to the fair value measurement in its entirety.

Fair value is a market-based measure considered from the perspective of a market participant who holds the asset or owes the liability rather than an entity-specific measure. Therefore, even when market assumptions are not readily available, the Company's own assumptions are set to reflect those that market participants would use in pricing the asset or liability at the measurement date. For our financial instruments that are recorded at fair value, fair value is measured as follows:

Exchange-traded equity securities and mutual funds: Fair value is based on quoted prices in active markets. Valuation of these items does not entail a significant amount of judgment and the inputs that are significant to the fair value measurement are Level 1 in the fair value hierarchy.

Derivative Financial Instruments: Our derivative financial instruments consist of foreign currency forward contracts and interest rate, cross currency and fuel swaps. Fair value is derived using valuation models that utilize the income valuation approach. These valuation models take into account the contract terms such as maturity, as well as other inputs such as exchange rates, fuel types, fuel curves, interest rate yield curves, creditworthiness of the counterparty and the Company, as well as other data points. The data sources utilized in these valuation models that are significant to the fair value measurement are Level 2 in the fair value hierarchy.

In conjunction with the adoption of SFAS 157, we adopted SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159). SFAS 159 provides an option, on an instrument-by-instrument basis, for certain financial instruments and other items that are not otherwise measured at fair value, to be reported at fair value with changes in fair value reported in earnings. After the initial adoption, the election is generally made at the acquisition of the instrument and it may not be revoked. At adoption, we did not elect to apply the fair value option to any eligible items, and accordingly, the adoption of the standard did not have an impact on our consolidated financial statements.

Table of Contents

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations*, (SFAS 141R). SFAS 141R requires the acquiring entity in a business combination to recognize the full fair value of assets acquired and liabilities assumed in the transaction whether full or partial acquisition, establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed, requires expensing of most transaction and restructuring costs, and requires the acquirer to disclose all information needed to evaluate and understand the nature and financial effect of the business combination. SFAS 141R applies to all transactions or other events in which an entity obtains control of one or more businesses, including combinations achieved without transfer of consideration, for example, by contract alone or through the lapse of minority veto rights. SFAS 141R applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first fiscal year beginning after December 15, 2008. Currently, the adoption of SFAS 141R is not expected to have a significant impact on our financial position, results of operations or cash flows. The impact on future acquisitions by the Company will depend largely on the nature and terms of such future acquisitions, if any.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements - An Amendment of ARB No. 51*, (SFAS 160). SFAS 160 requires reporting entities to present noncontrolling (minority) interests as equity instead of as a liability or mezzanine equity and provides guidance on the accounting for transactions between an entity and noncontrolling interests. SFAS 160 is effective the first fiscal year beginning after December 15, 2008, and interim periods within that fiscal year. SFAS 160 applies prospectively as of the beginning of the fiscal year SFAS 160 is initially applied, except for the presentation and disclosure requirements which are applied retrospectively for all periods presented subsequent to adoption. The adoption of SFAS 160 will not have a material impact on our consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities - An Amendment of FASB Statement No. 133* (SFAS 133), (SFAS 161). SFAS 161 requires enhanced disclosures about an entity's derivative and hedging activities and thereby improves the transparency of financial reporting. Entities are required to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. SFAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. SFAS 161 will be effective for our fiscal year 2009 interim and annual consolidated financial statements and the relevant disclosures will be added at such time.

Reclassifications

Reclassifications have been made to prior year amounts to conform to the current year presentation.

Note 3. Business Combination

In November 2006, we completed our acquisition of Pullmantur, a Madrid-based cruise and tour operator. The Pullmantur brand increases our presence in Spain and provides us with an opportunity to further grow our business in Europe and Latin America and to increase our product offerings. Pullmantur also provides us an opportunity for incremental guest, revenue and earnings growth. We purchased all of the capital stock of Pullmantur for approximately 436.3 million, or approximately \$558.9 million. We include Pullmantur's results of operations on a two-month lag to allow for more timely preparation of our consolidated financial statements.

The acquisition was accounted for as a business purchase combination using the purchase method of accounting under the provisions of Statement of Financial Accounting Standards No. 141, *Business Combinations*. The purchase price was allocated to tangible and identifiable intangible assets acquired and liabilities assumed based on their estimated fair values at the acquisition date, with the excess allocated to goodwill. Approximately 352.3 million or \$451.4 million was allocated to goodwill and approximately 189.4 million or \$242.6 million was allocated to acquired intangible assets.

Table of Contents

	United States \$ (in thousands)
Total current assets	\$ 58,931
Property and equipment (mostly ships)	366,800
Other non-current assets	5,488
Goodwill	451,355
Other intangible assets	242,600
Current portion of long-term debt	(14,897)
Other current liabilities	(110,520)
Long-term debt	(338,700)
Other long-term liabilities	(102,109)
Net assets acquired	\$ 558,948

Of the \$242.6 million of acquired intangible assets, approximately 168.6 million or \$216.0 million was assigned to the value associated with the awareness and reputation of the Pullmantur brand among its passengers and is considered an indefinite-life intangible asset. Finite-life intangible assets identified of approximately 20.8 million or \$26.6 million have a weighted-average useful life of approximately 4.8 years. The amount allocated to goodwill was adjusted in 2007 by 20.2 million or approximately \$25.9 million as a result of the finalization of the purchase price allocation to the net assets acquired, primarily driven by our completion of the fleet valuation.

Note 4. Goodwill

In 2008, 2007 and 2006, we completed our annual goodwill impairment test and determined there was no impairment. The carrying amount of goodwill attributable to our Royal Caribbean International and the Pullmantur reporting units was as follows (in thousands):

	Royal Caribbean		
	International	Pullmantur	Total
Balance at December 31, 2006	\$ 283,723	\$ 437,791	\$ 721,514
Foreign currency translation adjustment		50,377	50,377
Purchase price adjustments		25,900	25,900
Balance at December 31, 2007	283,723	514,068	797,791
Foreign currency translation adjustment		(18,545)	(18,545)
Balance at December 31, 2008	\$ 283,723	\$ 495,523	\$ 779,246

We performed the annual impairment review for goodwill during the fourth quarter of 2008. We determined the fair value of our two reporting units which include goodwill, Royal Caribbean International and Pullmantur, using a probability-weighted discounted cash flow model. The principal assumptions used in the discounted cash flow model are projected operating results, weighted average cost of capital, and terminal value. Cash flows were calculated using our 2009 projected operating results as a base. To that base we added future years cash flows assuming multiple revenue and expense scenarios that reflect the impact on each reporting unit of different global economic environments beyond 2009.

We discounted the projected cash flows using rates specific to each reporting unit based on their respective weighted average cost of capital. Based on the probability-weighted discounted cash flows of each reporting unit we determined the fair values of Royal Caribbean International and Pullmantur exceeded their carrying values. Therefore, we did not proceed to step two of the impairment analysis and we do not consider goodwill to be impaired.

Table of Contents**Note 5. Intangible Assets**

Intangible assets consist of the following (in thousands):

	2008	2007
Indefinite-life intangible asset Pullmantur tradename	\$ 246,014	\$ 222,525
Foreign currency translation adjustment	(10,404)	23,489
Total	\$ 235,610	\$ 246,014

We performed the annual impairment review of our trademarks and trade names during the fourth quarter of 2008 using a discounted cash flow model and the relief-from-royalty method. The royalty rate used is based on comparable royalty agreements in the tourism and hospitality industry. We used the same discount rate used in valuing the Pullmantur reporting unit. Based on the discounted cash flow model we determined the fair value of our trademarks and trade names exceeded their carrying value.

Finite-life intangible assets and related accumulated amortization are immaterial to our 2008, 2007, and 2006 consolidated financial statements.

Note 6. Property and Equipment

Property and equipment consists of the following (in thousands):

	2008	2007
Land	\$ 16,288	\$ 16,288
Ships	16,214,832	14,284,639
Ships under construction	749,822	652,131
Other	862,129	705,304
	17,843,071	15,658,362
Less accumulated depreciation and amortization	(3,964,073)	(3,404,578)
	\$ 13,878,998	\$ 12,253,784

Ships under construction include progress payments for the construction of new ships as well as planning, design, interest, commitment fees and other associated costs. We capitalized interest costs of \$44.4 million, \$39.9 million and \$27.8 million for the years 2008, 2007 and 2006, respectively.

Note 7. Other Assets*Variable Interest Entities*

Financial Accounting Standard Board Interpretation No. 46 (Revised), Consolidation of Variable Interest Entities (FIN 46), addresses consolidation by business enterprises of Variable Interest Entities (VIEs), which are entities in which the equity investors have not provided enough equity to finance its activities or the equity investors (1) cannot directly or indirectly make decisions about the entity's activities through their voting rights or similar rights; (2) do not have the obligation to absorb the expected losses of the entity; (3) do not have the right to receive the expected residual returns of the entity; or (4) have voting rights that are not proportionate to their economic interests and the entity's activities involve or are conducted on behalf of an investor with a disproportionately small voting interest.

We have determined that our 40% minority interest in a ship repair and maintenance facility which we invested in 2001 and again in 2008, is a VIE. The facility serves cruise and cargo ships, oil and gas tankers, and offshore units. We utilize this facility, amongst other ship repair facilities, for our regularly scheduled drydocks and certain emergency repairs as may be required. As of December 31, 2008, our investment in

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this entity including equity and loans, which is also our maximum exposure to loss as we are not contractually required to provide any financial or other support to the facility, was approximately \$72.2 million and was included within other assets in the consolidated balance sheet. Of this amount, \$26.1 million was invested in 2008 as part of an expansion of the facility. We have determined we are not the primary beneficiary as we would not absorb a majority of the facility's expected losses nor receive a majority of the facility's residual returns. Accordingly, we do not consolidate this entity and account for this investment under the equity method of accounting.

F-15

Table of Contents

In conjunction with our acquisition of Pullmantur, we obtained a 49% minority interest in Pullmantur Air, S.A. (Pullmantur Air), a small air business that operates three aircraft in support of Pullmantur's operations. We have determined Pullmantur Air is a VIE for which we are the primary beneficiary as we are obligated to absorb the losses. In accordance with FIN46, we have consolidated the assets and liabilities of Pullmantur Air at their fair value. The assets and liabilities of Pullmantur Air are immaterial to our December 31, 2008 and 2007 consolidated financial statements.

Other

During 2007, we received proceeds from the repayment of \$100.0 million of notes from TUI Travel, which we purchased in March 2006.

Note 8. Long-Term Debt

Long-term debt consists of the following (in thousands):

	2008	2007
\$1.225 billion unsecured revolving credit facility, LIBOR plus 0.575% and a facility fee of 0.175% due 2012	\$ 600,000	\$ 30,000
Unsecured senior notes and senior debentures, 6.88% to 8.75%, due 2010 through 2016, 2018 and 2027	2,520,575	2,623,029
1.0 billion unsecured senior notes, 5.625%, due 2014	1,463,785	1,437,429
\$570 million unsecured term loan, 3.95% due through 2013	366,429	447,857
\$589 million unsecured term loan, 4.39% due through 2014	462,786	546,929
\$300 million unsecured term loan, LIBOR plus 0.8%, due through 2010	200,000	200,000
\$225 million unsecured term loan, LIBOR plus 1.0%, due through 2012	128,543	160,695
\$530 million unsecured term loan, LIBOR plus 1.01%, due through 2015	492,143	
\$519 million unsecured term loan, LIBOR plus 0.45%, due through 2020	519,146	
\$7.3 million unsecured term loan, LIBOR plus 2.5%, due through 2022	6,179	
Unsecured term loans, LIBOR plus 0.8%, due 2010	200,000	200,000
Capital lease obligations	51,817	52,333
	7,011,403	5,698,272
Less current portion	(471,893)	(351,725)
Long-term portion	\$ 6,539,510	\$ 5,346,547

During 2008, we borrowed \$530.0 million under an unsecured term loan due through 2015. The loan bears interest of approximately 5.40% at December 31, 2008. The proceeds were used towards the purchase of *Independence of the Seas*, which was delivered in April 2008.

During 2008, we borrowed \$519.1 million under an unsecured term loan due through 2020. The loan bears interest of approximately 4.28% at December 31, 2008. The proceeds were used towards the purchase of *Celebrity Solstice*, which was delivered in October 2008.

Under certain of our agreements, the contractual interest rate and commitment fee vary with our debt rating. During 2008, our credit rating was lowered from BBB- with a negative outlook to BB with a negative outlook by Standard and Poor's. In January 2009, Standard and Poor's placed our credit rating on credit watch with negative implications. In addition, our credit rating was lowered from Ba1 with a stable outlook to Ba2 with a negative outlook by Moody's.

The unsecured senior notes and senior debentures are not redeemable prior to maturity.

Table of Contents

Our debt agreements contain covenants that require us, among other things, to maintain minimum net worth and fixed coverage ratio and limit our net debt-to-capital ratio. We are in compliance with all covenants as of December 31, 2008. Following is a schedule of annual maturities on long-term debt as of December 31, 2008 for each of the next five years (in thousands):

Year	
2009	\$ 471,893
2010	820,701
2011	822,098
2012	918,733
2013	1,144,768

Note 9. Shareholders Equity

We declared cash dividends on our common stock of \$0.15 per share in the first three quarters of 2008 and each of the quarters of 2007. Commencing in the fourth quarter 2008 our board of directors discontinued the quarterly dividends.

Note 10. Stock-Based Employee Compensation

As discussed in Note 2, *Summary of Significant Accounting Policies*, we adopted the provisions of SFAS 123R effective January 1, 2006. We have four stock-based compensation plans, which provide for awards to our officers, directors and key employees. The plans consist of a 1990 Employee Stock Option Plan, a 1995 Incentive Stock Option Plan, a 2000 Stock Award Plan, and a 2008 Equity Plan. The 1990 Stock Option Plan and the 1995 Incentive Stock Option Plan terminated by their terms in March 2000 and February 2005, respectively. The 2000 Stock Award Plan, as amended, and the 2008 Equity Plan provide for the issuance of (i) incentive and non-qualified stock options, (ii) stock appreciation rights, (iii) restricted stock, (iv) restricted stock units and (v) performance shares of up to 13,000,000 shares of our common stock for the 2000 Stock Award Plan and 5,000,000 shares of our common stock for the 2008 Equity Plan. During any calendar year, no one individual shall be granted awards of more than 500,000 shares. We awarded 669,538, 271,594 and 204,154 restricted stock units in 2008, 2007 and 2006, respectively. Options and restricted stock units outstanding as of December 31, 2008 vest in equal installments over four to five years from the date of grant. Generally, options and restricted stock units are forfeited if the recipient ceases to be a director or employee before the shares vest. Options are granted at a price not less than the fair value of the shares on the date of grant and expire not later than ten years after the date of grant.

In September 2006, the Compensation Committee amended the Company's 2000 Stock Award Plan. The amendment extends the period during which a participant must exercise non-qualified options following a termination of service to one year. It also limits the period for exercise of both qualified and non-qualified options following termination of service due to a participant's death or disability to one year. This amendment is effective for options granted on or after September 18, 2006. The amendment did not have any impact on our 2008, 2007 and 2006 consolidated financial statements.

We also provide an Employee Stock Purchase Plan to facilitate the purchase by employees of up to 800,000 shares of common stock in the aggregate. Offerings to employees are made on a quarterly basis. Subject to certain limitations, the purchase price for each share of common stock is equal to 90% of the average of the market prices of the common stock as reported on the New York Stock Exchange on the first business day of the purchase period and the last business day of each month of the purchase period. Shares of common stock of 36,836, 20,759 and 18,116 were issued under the ESPP at a weighted-average price of \$20.97, \$37.25 and \$36.00 during 2008, 2007 and 2006, respectively.

Under an executive compensation program approved in 1994, we award to a trust on behalf of our chief executive officer, 10,086 shares of common stock per quarter, up to a maximum of 806,880 shares. Effective January 1, 2009, these shares will be issued directly to our chief executive officer rather than to the trust.

Table of Contents

Total compensation expense recognized for employee stock based compensation for the year ended December 31, 2008 was \$5.7 million. Of this amount, \$6.4 million, which included a benefit of approximately \$8.2 million due to a change in the employee forfeiture rate assumption was included within marketing, selling and administrative expenses and income of \$0.7 million was included within payroll and related expenses which also included a benefit of approximately \$1.0 million due to the change in the forfeiture rate. Total compensation expenses recognized for employee stock based compensation for the years ended December 31, 2007, and 2006 was \$19.0 million, and \$18.4 million, respectively. Of these amounts, \$16.3 million, and \$13.8 million was included within marketing, selling and administrative expenses and \$2.7 million, and \$4.6 million was included within payroll and related expenses for the years ended December 31, 2007, and 2006, respectively.

The fair value of each stock option grant is estimated on the date of grant using the Black-Scholes option pricing model. The estimated fair value of stock options, less estimated forfeitures, is amortized over the vesting period using the graded-vesting method. The assumptions used in the Black-Scholes option-pricing model are as follows:

	2008	2007	2006
Dividend yield	1.9%	1.3%	1.4%
Expected stock price volatility	31.4%	28.0%	33.0%
Risk-free interest rate	2.8%	4.8%	4.5%
Expected option life	5 years	5 years	5 years

Expected volatility was based on a combination of historical and implied volatilities. The risk-free interest rate is based on United States Treasury zero coupon issues with a remaining term equal to the expected option life assumed at the date of grant. The expected term was calculated based on historical experience and represents the time period options actually remain outstanding. We estimated forfeitures based on historical pre-vesting forfeitures and shall revise those estimates in subsequent periods if actual forfeitures differ from those estimates.

Stock options activity and information about stock options outstanding are summarized in the following tables:

Stock Options Activity	Number of Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (years)	Aggregate Intrinsic Value ¹ (in thousands)
Outstanding at January 1, 2008	5,654,673	\$ 35.14	5.12	\$ 50,692
Granted	2,062,299	\$ 33.07		
Exercised	(167,213)	\$ 22.13		
Canceled	(903,600)	\$ 37.99		
Outstanding at December 31, 2008	6,646,159	\$ 34.44	5.38	\$ 2,933
Options Exercisable at December 31, 2008	3,993,455	\$ 33.15	3.12	\$ 2,860

¹ The intrinsic value represents the amount by which the fair value of stock exceeds the option exercise price as of December 31, 2008. The weighted-average estimated fair value of stock options granted was \$8.72, \$12.93 and \$14.03 during the years ended December 31, 2008, 2007 and 2006 respectively. The total intrinsic value of stock options exercised during the years ended December 31, 2008, 2007 and 2006 was \$2.0 million, \$16.8 million and \$22.3 million, respectively. As of December 31, 2008, there was approximately \$8.4 million of total unrecognized compensation cost, net of estimated forfeitures, related to stock options granted under our stock incentive plans which is expected to be recognized over a weighted-average period of 1.6 years.

Table of Contents

Restricted stock units are converted into shares of common stock upon vesting on a one-for-one basis. The cost of these awards is determined using the fair value of our common stock on the date of the grant, and compensation expense is recognized over the vesting period. Restricted stock activity is summarized in the following table:

Restricted Stock Activity	Number of Awards	Weighted-Average Grant Date Fair Value
Non-vested share units at January 1, 2008	486,510	\$ 44.43
Granted	669,538	\$ 33.79
Vested	(181,022)	\$ 43.30
Canceled	(112,292)	\$ 45.59
Non-vested share units expected to vest at December 31, 2008	862,734	\$ 36.24

The weighted-average estimated fair value of restricted stock units granted during the year ended December 31, 2007, and 2006 were \$44.43 and \$43.61, respectively. As of December 31, 2008, we had \$9.9 million of total unrecognized compensation expense, net of estimated forfeitures, related to restricted stock unit grants, which will be recognized over the weighted-average period of 2.0 years.

Note 11. Earnings Per Share

A reconciliation between basic and diluted earnings per share is as follows (in thousands, except per share data):

	Year Ended December 31,		
	2008	2007	2006
Net income	573,722	603,405	633,922
Interest on dilutive convertible notes			17,237
Net income for diluted earnings per share	\$ 573,722	\$ 603,405	\$ 651,159
Weighted-average common shares outstanding	213,477	212,784	210,703
Dilutive effect of stock options and restricted stock awards	718	1,471	1,725
Dilutive effect of convertible notes			9,057
Diluted weighted-average shares outstanding	214,195	214,255	221,485
Basic earnings per share:			
Net income	\$ 2.69	\$ 2.84	\$ 3.01
Diluted earnings per share:			
Net income	\$ 2.68	\$ 2.82	\$ 2.94

Diluted earnings per share did not include options to purchase 5.3 million, 2.8 million and 3.2 million shares for each of the years ended December 31, 2008, 2007 and 2006, respectively, because the effect of including them would have been antidilutive.

Note 12. Retirement Plan

We maintain a defined contribution pension plan covering full-time shoreside employees who have completed the minimum period of continuous service. Annual contributions to the plan are based on fixed percentages of participants' salaries and years of service, not to exceed certain maximums. Pension expenses were \$17.3 million, \$15.1 million and \$13.9 million for the years ended December 31, 2008, 2007 and 2006, respectively, for the plan.

Table of Contents

Note 13. Income Taxes

We and the majority of our subsidiaries are currently exempt from United States corporate tax on United States source income from the international operation of ships pursuant to Section 883 of the Internal Revenue Code. Regulations under Section 883 have limited the activities that are considered the international operation of a ship or incidental thereto. Accordingly, our provision for United States federal and state income taxes includes taxes on certain activities not considered incidental to the international operation of our ships.

Additionally, some of our ship-operating subsidiaries are subject to income tax under the tonnage tax regimes of Malta or the United Kingdom. Under these regimes, income from qualifying activities is not subject to corporate income tax. Instead, these subsidiaries are subject to a tonnage tax computed by reference to the tonnage of the ship or ships registered under the relevant provisions of the tax regimes. Income from activities not considered qualifying activities, which we do not consider significant, remains subject to Maltese or United Kingdom corporate income tax.

Income tax expense for items not qualifying under Section 883 or under tonnage tax regimes, and for the remainder of our subsidiaries was not significant for the years ended December 31, 2008, 2007 and 2006.

We do not expect to incur income taxes on future distributions of undistributed earnings of foreign subsidiaries. Consequently, no deferred income taxes have been provided for the distribution of these earnings.

Note 14. Derivatives

Fair Value Hedges

During 2008, 2007 and 2006, we recognized in earnings, a net gain of approximately \$15.6 million, a net loss of approximately \$8.4 million and a net loss of \$1.2 million, respectively, which represented the total ineffectiveness of all fair value hedges. During 2007, we recognized a gain of approximately \$21.4 million related to derivative instruments associated with firm commitments which no longer qualified as fair value hedges. The gain primarily represented changes in the fair value of the derivative instruments from the last date the instruments were effective to the termination of the instruments. These amounts are reported in other income (expense) in our consolidated statements of operations.

Cash Flow Hedges

During 2008, 2007 and 2006, we recognized in earnings, a net loss of \$1.7 million, a net gain of \$1.1 million and a net loss of \$0.5 million, respectively, which represented the total ineffectiveness of all cash flow hedges. During 2008, we recognized a gain of \$3.3 million related to the discontinuance of certain cash flow hedges as it was deemed probable that the original forecasted transaction would not occur by the end of the originally specified time period. In addition, during 2007 we recognized a gain of \$1.7 million related to certain derivative instruments which were no longer effective as cash flow hedges. These amounts are reported in other income (expense) in our consolidated statements of operations.

At December 31, 2008, \$146.5 million of estimated unrealized net losses associated with our cash flow hedges are expected to be reclassified as earnings from other accumulated comprehensive income within the next twelve months. Reclassification is expected to occur primarily as the result of fuel consumption associated with our hedged forecasted fuel purchases. At December 31, 2008, we have hedged the variability in future cash flows for certain forecasted transactions occurring through the second half of 2011.

Table of Contents*Hedge of Net Investment in a Foreign Operation*

In 2006, in conjunction with our acquisition of Pullmantur, we obtained a bridge loan with a notional amount of 750.0 million, or approximately \$960.5 million, of which we drew 701.0 million, or approximately \$925.1 million, to finance the acquisition. We designated a portion of this bridge loan, approximately 478.8 million, or approximately \$631.8 million, as a nonderivative hedge of our net investment in Pullmantur and, accordingly, included approximately \$18.7 million of foreign-currency transaction losses in the foreign currency translation adjustment component of accumulated other comprehensive loss at December 31, 2006.

In 2007, prior to repaying the bridge loan, we included approximately \$12.7 million of foreign-currency transaction gains in the foreign currency translation adjustment component of accumulated other comprehensive (loss) income.

Prior to the repayment of the bridge loan, we issued 1.0 billion unsecured senior notes to refinance the acquisition of Pullmantur and to repay amounts under our \$1.2 billion revolving credit facility. During 2008 and 2007, we designated a portion of the 1.0 billion unsecured senior notes as a nonderivative hedge of our net investment in Pullmantur. The designated portion was approximately 393.0 million and 466.0 million, or approximately \$549.1 million and \$679.9 million at December 31, 2008 and 2007, respectively. During 2008 and 2007, we included approximately \$23.2 million and \$76.7 million of foreign-currency transaction losses, respectively, related to the 1.0 billion unsecured senior notes in the foreign currency translation adjustment component of accumulated other comprehensive loss.

Note 15. Fair Value Measurements

The Company uses quoted prices in active markets when available to determine the fair value of its financial instruments and does not hold them for trading or other speculative purposes. The estimated fair value of our financial instruments that are not measured at fair value on a recurring basis are as follows (in thousands):

	2008	2007
Long-term debt (including current portion of long-term debt)	\$ 5,132,547	\$ 5,558,984

In addition as discussed in Note 2, *Summary of Significant Accounting Policies*, we adopted the provisions of SFAS 157, Fair Value Measurements effective January 1, 2008. SFAS 157 defines fair value, establishes a formal framework for measuring fair value and expands disclosures about fair value measurements.

Table of Contents

The following table presents information about the Company's financial instruments recorded at fair value on a recurring basis as of December 31, 2008, segregated among the appropriate levels within the fair value hierarchy:

Description	Total	Fair Value Measurements at December 31, 2008 Using			Level 3		
		Level 1	Level 2	Level 3			
Assets:							
Derivative financial instruments ¹	\$ 284,175	\$	\$ 284,175	\$			
Investments ²	14,238	14,238					
Total Assets	\$ 298,413	\$ 14,238	\$ 284,175	\$			
\$ (28,284)		\$—	\$—	\$937,993		\$ (28,284)	
Residential mortgage-backed securities:							
Agency-issued mortgage-backed securities	291,410	(3,494)	—	—	291,410	(3,494)	
Agency-issued collateralized mortgage obligations—fixed rate	2,308,447	(55,006)	85,120	(2,774)	2,393,567	(57,780)	
Agency-issued commercial mortgage-backed securities	188,691	(11,128)	—	—	188,691	(11,128)	
Equity securities	1,869	(405)	117	(34)	1,986	(439)	
Total temporarily impaired securities (1)	\$3,728,410	\$ (98,317)	\$85,237	\$ (2,808)	\$3,813,647	\$ (101,125)	

As of June 30, 2013, we identified a total of 124 investments that were in unrealized loss positions, of which 4 investments totaling \$85 million with unrealized losses of \$2.8 million have been in an impaired position for a period of time greater than 12 months. As of June 30, 2013, we do not intend to sell any impaired debt or equity securities prior to recovery of our adjusted cost basis, and it is more likely than not that we will not be required to sell any of our securities prior to recovery of our adjusted cost basis. Based on our analysis as of June 30, 2013, we deem all impairments to be temporary, and therefore changes in value for our temporarily impaired securities as of the same date are included in other comprehensive income. Market valuations and impairment analyses on assets in the available-for-sale securities portfolio are reviewed and monitored on a quarterly basis.

Table of Contents

The following table summarizes our unrealized losses on our available-for-sale securities portfolio into categories of less than 12 months and 12 months or longer as of December 31, 2012:

(Dollars in thousands)	December 31, 2012					
	Less than 12 months		12 months or longer		Total	
	Fair Value of Investments	Unrealized Losses	Fair Value of Investments	Unrealized Losses	Fair Value of Investments	Unrealized Losses
Residential mortgage-backed securities:						
Agency-issued mortgage-backed securities	\$22,831	\$(107)	\$—	\$—	\$22,831	\$(107)
Agency-issued collateralized mortgage obligations—fixed rate	461,397	(995)	—	—	461,397	(995)
Agency-issued collateralized mortgage obligations—variable rate	—	—	7,908	(4)	7,908	(4)
Agency-issued commercial mortgage-backed securities	150,581	(489)	—	—	150,581	(489)
Municipal bonds and notes	2,098	(11)	—	—	2,098	(11)
Equity securities	97	(61)	255	(266)	352	(327)
Total temporarily impaired securities	\$637,004	\$(1,663)	\$8,163	\$(270)	\$645,167	\$(1,933)

Table of Contents

The following table summarizes the remaining contractual principal maturities and fully taxable equivalent yields on debt securities classified as available-for-sale as of June 30, 2013. Interest income on certain municipal bonds and notes (non-taxable investments) are presented on a fully taxable equivalent basis using the federal statutory tax rate of 35.0 percent. The weighted average yield is computed using the amortized cost of debt securities, which are reported at fair value. For U.S. treasury securities, the expected maturity is the actual contractual maturity of the notes. Expected remaining maturities for certain U.S. agency debentures may occur earlier than their contractual maturities because the note issuers have the right to call outstanding amounts ahead of their contractual maturity. Expected maturities for mortgage-backed securities may differ significantly from their contractual maturities because mortgage borrowers have the right to prepay outstanding loan obligations with or without penalties. Mortgage-backed securities classified as available-for-sale typically have original contractual maturities from 10 to 30 years whereas expected average lives of these securities tend to be significantly shorter and vary based upon structure.

	June 30, 2013									
	Total	One Year or Less		After One Year to Five Years		After Five Years to Ten Years		After Ten Years		
(Dollars in thousands)	Carrying Value	Weighted-Average Yield	Carrying Value	Weighted-Average Yield	Carrying Value	Weighted-Average Yield	Carrying Value	Weighted-Average Yield	Carrying Value	Weighted-Average Yield
U.S. treasury securities	\$24,999	0.13%	\$24,999	0.13%	\$—	—%	\$—	—%	\$—	—%
U.S. agency debentures	3,403,589	1.54	151,542	1.36	2,533,087	1.49	718,960	1.76	—	—
Residential mortgage-backed securities:										
Agency-issued mortgage-backed securities	1,214,035	2.32	—	—	—	—	1,107,136	2.26	106,899	2.95
Agency-issued collateralized mortgage obligations - fixed rate	3,468,682	1.92	—	—	—	—	—	—	3,468,682	1.92
Agency-issued collateralized mortgage obligations - variable rate	1,438,772	0.70	—	—	—	—	—	—	1,438,772	0.70
Agency-issued commercial mortgage-backed securities	401,204	1.82	—	—	—	—	—	—	401,204	1.82
Municipal bonds and notes	87,001	5.98	1,211	5.49	21,266	5.65	45,692	6.03	18,832	6.26
Total	\$10,038,282	1.69	\$177,752	1.22	\$2,554,353	1.52	\$1,871,788	2.16	\$5,434,389	1.63

Table of Contents

The following table presents the components of gains and losses (realized and unrealized) on investment securities for the three and six months ended June 30, 2013 and 2012:

(Dollars in thousands)	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
Gross gains on investment securities:				
Available-for-sale securities, at fair value (1)	\$2,850	\$5,322	\$2,850	\$5,343
Marketable securities (fair value accounting)	2,427	3,303	4,345	3,619
Non-marketable securities (fair value accounting):				
Venture capital and private equity fund investments	44,339	33,288	71,720	59,398
Other venture capital investments	200	1,556	2,840	3,333
Other investments	—	—	—	21
Non-marketable securities (equity method accounting):				
Other investments	4,754	5,389	7,469	6,811
Non-marketable securities (cost method accounting):				
Venture capital and private equity fund investments	767	538	1,790	945
Other investments	191	264	336	306
Total gross gains on investment securities	55,528	49,660	91,350	79,776
Gross losses on investment securities:				
Available-for-sale securities, at fair value (1)	(2,075)	(755)	(2,120)	(1,650)
Marketable securities (fair value accounting)	(461)	(754)	(2,534)	(754)
Non-marketable securities (fair value accounting):				
Venture capital and private equity fund investments	(10,703)	(18,618)	(15,445)	(32,533)
Other venture capital investments	(1,190)	(3,219)	(1,654)	(9,882)
Non-marketable securities (equity method accounting):				
Other investments	(232)	(327)	(477)	(703)
Non-marketable securities (cost method accounting):				
Venture capital and private equity fund investments	(304)	(177)	(773)	(540)
Other investments	(2)	(1)	(348)	(66)
Total gross losses on investment securities	(14,967)	(23,851)	(23,351)	(46,128)
Gains on investment securities, net	\$40,561	\$25,809	\$67,999	\$33,648
Gains attributable to noncontrolling interests, including carried interest	\$31,067	\$14,502	\$53,363	\$21,840

Includes realized gains on sales of available-for-sale securities that are recognized in the income statement.

(1) Unrealized gains on available-for-sale securities are recognized in other comprehensive income and not shown in the table above. The cost basis of available-for-sale securities sold is determined on a specific identification basis.

6. Loans and Allowance for Loan Losses

We serve a variety of commercial clients in the technology, life science, venture capital/private equity and premium wine industries. Our technology clients generally tend to be in the industries of hardware (semiconductors, communications and electronics), software and related services, and clean technology. Because of the diverse nature of clean technology products and services, for our loan-related reporting purposes, cleantech-related loans are reported under our hardware, software, life science and other commercial loan categories, as applicable. Our life science clients are concentrated in the medical devices and biotechnology sectors. Loans made to venture capital/private equity firm clients typically enable them to fund investments prior to their receipt of funds from capital calls. Loans to the premium wine industry focus on vineyards and wineries that produce grapes and wines of high quality.

In addition to commercial loans, we make consumer loans through SVB Private Bank and provide real estate secured loans to eligible employees through our EHOP. Our private banking clients are primarily venture capital/private

equity professionals and executive leaders in the innovation companies they support. These products and services include real estate secured home equity lines of credit, which may be used to finance real estate investments and loans used to purchase, renovate or refinance

Table of Contents

personal residences. These products and services also include restricted stock purchase loans and capital call lines of credit.

We also provide community development loans made as part of our responsibilities under the Community Reinvestment Act. These loans are included within "Construction loans" below and are primarily secured by real estate. The composition of loans, net of unearned income of \$83 million and \$77 million at June 30, 2013 and December 31, 2012, respectively, is presented in the following table:

(Dollars in thousands)	June 30, 2013	December 31, 2012
Commercial loans:		
Software	\$3,558,323	\$3,261,489
Hardware	1,205,541	1,118,370
Venture capital/private equity	1,923,516	1,732,699
Life science	1,084,720	1,066,199
Premium wine	142,562	143,511
Other	309,517	315,453
Total commercial loans	8,224,179	7,637,721
Real estate secured loans:		
Premium wine (1)	465,962	413,513
Consumer loans (2)	778,482	685,300
Total real estate secured loans	1,244,444	1,098,813
Construction loans	66,587	65,742
Consumer loans	86,962	144,657
Total loans, net of unearned income (3)	\$9,622,172	\$8,946,933

(1) Included in our premium wine portfolio are gross construction loans of \$132 million and \$148 million at June 30, 2013 and December 31, 2012, respectively.

(2) Consumer loans secured by real estate at June 30, 2013 and December 31, 2012 were comprised of the following:

(Dollars in thousands)	June 30, 2013	December 31, 2012
Loans for personal residence	\$593,988	\$503,378
Loans to eligible employees	115,974	110,584
Home equity lines of credit	68,520	71,338
Consumer loans secured by real estate	\$778,482	\$685,300

(3) Included within our total loan portfolio are credit card loans of \$78 million and \$64 million at June 30, 2013 and December 31, 2012, respectively.

Table of Contents

Credit Quality

The composition of loans, net of unearned income of \$83 million and \$77 million at June 30, 2013 and December 31, 2012, respectively, broken out by portfolio segment and class of financing receivable is as follows:

(Dollars in thousands)	June 30, 2013	December 31, 2012
Commercial loans:		
Software	\$3,558,323	\$3,261,489
Hardware	1,205,541	1,118,370
Venture capital/private equity	1,923,516	1,732,699
Life science	1,084,720	1,066,199
Premium wine	608,524	557,024
Other	376,104	381,195
Total commercial loans	8,756,728	8,116,976
Consumer loans:		
Real estate secured loans	778,482	685,300
Other consumer loans	86,962	144,657
Total consumer loans	865,444	829,957
Total loans, net of unearned income	\$9,622,172	\$8,946,933

20

Table of Contents

The following table summarizes the aging of our gross loans, broken out by portfolio segment and class of financing receivable as of June 30, 2013 and December 31, 2012:

(Dollars in thousands)	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Loans Past Due 90 Days or More Still Accruing Interest
June 30, 2013:						
Commercial loans:						
Software	\$ 765	\$ 1,082	\$ 727	\$ 2,574	\$ 3,584,748	\$ 727
Hardware	7,493	56	—	7,549	1,185,481	—
Venture capital/private equity	3,311	4,670	—	7,981	1,934,594	—
Life science	185	415	722	1,322	1,094,259	722
Premium wine	636	4,035	—	4,671	604,873	—
Other	109	92	412	613	375,006	412
Total commercial loans	12,499	10,350	1,861	24,710	8,778,961	1,861
Consumer loans:						
Real estate secured loans	—	—	—	—	774,692	—
Other consumer loans	25	—	—	25	85,917	—
Total consumer loans	25	—	—	25	860,609	—
Total gross loans excluding impaired loans	12,524	10,350	1,861	24,735	9,639,570	1,861
Impaired loans	—	1,365	16,649	18,014	23,145	—
Total gross loans	\$ 12,524	\$ 11,715	\$ 18,510	\$ 42,749	\$ 9,662,715	\$ 1,861
December 31, 2012:						
Commercial loans:						
Software	\$ 5,890	\$ 238	\$ 19	\$ 6,147	\$ 3,284,489	\$ 19
Hardware	167	32	—	199	1,107,422	—
Venture capital/private equity	7	—	—	7	1,749,896	—
Life science	207	117	—	324	1,076,468	—
Premium wine	—	—	—	—	554,886	—
Other	280	—	—	280	378,619	—
Total commercial loans	6,551	387	19	6,957	8,151,780	19
Consumer loans:						
Real estate secured loans	—	—	—	—	683,254	—
Other consumer loans	111	—	—	111	143,867	—
Total consumer loans	111	—	—	111	827,121	—
Total gross loans excluding impaired loans	6,662	387	19	7,068	8,978,901	19
Impaired loans	3,901	9,676	2,269	15,846	22,433	—
Total gross loans	\$ 10,563	\$ 10,063	\$ 2,288	\$ 22,914	\$ 9,001,334	\$ 19

Table of Contents

The following table summarizes our impaired loans as they relate to our allowance for loan losses, broken out by portfolio segment and class of financing receivable as of June 30, 2013 and December 31, 2012:

(Dollars in thousands)	Impaired loans for which there is a related allowance for loan losses	Impaired loans for which there is no related allowance for loan losses	Total carrying value of impaired loans	Total unpaid principal of impaired loans (1)
June 30, 2013:				
Commercial loans:				
Software	\$5,637	\$995	\$6,632	\$6,936
Hardware	22,595	1,987	24,582	45,444
Venture capital/private equity	89	—	89	89
Premium wine	—	1,511	1,511	1,794
Other	—	3,772	3,772	4,562
Total commercial loans	28,321	8,265	36,586	58,825
Consumer loans:				
Real estate secured loans	—	3,619	3,619	9,593
Other consumer loans	954	—	954	1,192
Total consumer loans	954	3,619	4,573	10,785
Total	\$29,275	\$11,884	\$41,159	\$69,610
December 31, 2012:				
Commercial loans:				
Software	\$3,191	\$72	\$3,263	\$4,475
Hardware	21,863	—	21,863	38,551
Venture capital/private equity	—	—	—	—
Premium wine	—	4,398	4,398	4,716
Other	—	5,415	5,415	9,859
Total commercial loans	25,054	9,885	34,939	57,601
Consumer loans:				
Real estate secured loans	—	2,239	2,239	7,341
Other consumer loans	1,101	—	1,101	1,300
Total consumer loans	1,101	2,239	3,340	8,641
Total	\$26,155	\$12,124	\$38,279	\$66,242

The unpaid principal balances for hardware and real estate secured consumer loans as of December 31, 2012 have (1) been corrected from previously reported amounts resulting in the total unpaid principal of impaired loans at December 31, 2012 changing from \$55.4 million to \$66.2 million.

Table of Contents

The following table summarizes our average impaired loans, broken out by portfolio segment and class of financing receivable for the three and six months ended June 30, 2013 and 2012:

(Dollars in thousands)	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
Average impaired loans:				
Commercial loans:				
Software	\$5,473	\$1,896	\$4,794	\$1,716
Hardware	24,519	21,468	24,076	16,865
Venture capital/private equity	30	—	15	—
Life science	596	88	455	117
Premium wine	1,536	3,527	2,936	3,455
Other	4,165	3,506	4,692	4,075
Total commercial loans	36,319	30,485	36,968	26,228
Consumer loans:				
Real estate secured loans	4,071	2,645	3,374	7,746
Other consumer loans	1,069	2,170	1,099	2,595
Total consumer loans	5,140	4,815	4,473	10,341
Total average impaired loans	\$41,459	\$35,300	\$41,441	\$36,569

The following tables summarize the activity relating to our allowance for loan losses for the three and six months ended June 30, 2013 and 2012, broken out by portfolio segment:

Three months ended June 30, 2013 (dollars in thousands)	Beginning			Provision for (Reduction of) Loan Losses	Ending Balance June 30, 2013
	Balance March 31, 2013	Charge-offs	Recoveries		
Commercial loans:					
Software	\$45,010	\$(3,574)	) \$397	\$4,965	\$46,798
Hardware	27,869	(4,434)	) 403	9,350	33,188
Venture capital/private equity	10,482	—	—	3,111	13,593
Life science	13,946	(491)	) 886	(2,600)	) 11,741
Premium wine	3,699	—	41	53	3,793
Other	3,975	(6,007)	) 2,375	3,311	3,654
Total commercial loans	104,981	(14,506)	) 4,102	18,190	112,767
Consumer loans	7,224	(869)	) 67	382	6,804
Total allowance for loan losses	\$112,205	\$(15,375)	) \$4,169	\$18,572	\$119,571

Table of Contents

Six months ended June 30, 2013 (dollars in thousands)	Beginning Balance December 31, 2012	Charge-offs	Recoveries	Provision for (Reduction of) Loan Losses	Ending Balance June 30, 2013
Commercial loans:					
Software	\$42,648	\$(5,092)	\$639	\$ 8,603	\$46,798
Hardware	29,761	(6,431)	849	9,009	33,188
Venture capital/private equity	9,963	—	—	3,630	13,593
Life science	13,606	(2,561)	1,089	(393)	11,741
Premium wine	3,523	—	131	139	3,793
Other	3,912	(6,048)	2,381	3,409	3,654
Total commercial loans	103,413	(20,132)	5,089	24,397	112,767
Consumer loans	7,238	(869)	447	(12)	6,804
Total allowance for loan losses	\$ 110,651	\$(21,001)	\$5,536	\$ 24,385	\$ 119,571
Three months ended June 30, 2012 (dollars in thousands)	Beginning Balance March 31, 2012	Charge-offs	Recoveries	Provision for (Reduction of) Loan Losses	Ending Balance June 30, 2012
Commercial loans:					
Software	\$35,425	\$(2,118)	\$1,329	\$ 3,345	\$37,981
Hardware	30,348	(10,413)	329	2,368	22,632
Venture capital/private equity	7,214	—	—	2,438	9,652
Life science	10,292	(122)	92	1,398	11,660
Premium wine	3,738	(584)	187	55	3,396
Other	4,802	(286)	1,107	(681)	4,942
Total commercial loans	91,819	(13,523)	3,044	8,923	90,263
Consumer loans	9,103	(607)	331	(924)	7,903
Total allowance for loan losses	\$100,922	\$(14,130)	\$3,375	\$ 7,999	\$98,166
Six months ended June 30, 2012 (dollars in thousands)	Beginning Balance December 31, 2011	Charge-offs	Recoveries	Provision for (Reduction of) Loan Losses	Ending Balance June 30, 2012
Commercial loans:					
Software	\$38,263	\$(2,977)	\$4,088	\$(1,393)	\$37,981
Hardware	16,810	(14,261)	434	19,649	22,632
Venture capital/private equity	7,319	—	—	2,333	9,652
Life science	10,243	(235)	313	1,339	11,660
Premium wine	3,914	(584)	265	(199)	3,396
Other	5,817	(2,456)	1,151	430	4,942
Total commercial loans	82,366	(20,513)	6,251	22,159	90,263
Consumer loans	7,581	(607)	560	369	7,903
Total allowance for loan losses	\$89,947	\$(21,120)	\$6,811	\$22,528	\$98,166

Table of Contents

The following table summarizes the allowance for loan losses individually and collectively evaluated for impairment as of June 30, 2013 and December 31, 2012, broken out by portfolio segment:

(Dollars in thousands)	June 30, 2013		December 31, 2012	
	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Individually Evaluated for Impairment	Collectively Evaluated for Impairment
Commercial loans:				
Software	\$1,365	\$ 45,433	\$762	\$ 41,886
Hardware	8,756	24,432	5,251	24,510
Venture capital/private equity	45	13,548	—	9,963
Life science	—	11,741	—	13,606
Premium wine	—	3,793	—	3,523
Other	—	3,654	—	3,912
Total commercial loans	10,166	102,601	6,013	97,400
Consumer loans	187	6,617	248	6,990
Total allowance for loan losses	\$10,353	\$ 109,218	\$6,261	\$ 104,390

Credit Quality Indicators

For each individual client, we establish an internal credit risk rating for that loan, which is used for assessing and monitoring credit risk as well as performance of the loan and the overall portfolio. Our internal credit risk ratings are also used to summarize the risk of loss due to failure by an individual borrower to repay the loan. For our internal credit risk ratings, each individual loan is given a risk rating of 1 through 10. Loans risk-rated 1 through 4 are performing loans and translate to an internal rating of “Pass”, with loans risk-rated 1 being cash secured. Loans risk-rated 5 through 7 are performing loans, however, we consider them as demonstrating higher risk which requires more frequent review of the individual exposures; these translate to an internal rating of “Performing (Criticized)”. A majority of our Performing (Criticized) loans are from our SVB Accelerator practice, serving our emerging or early stage clients. Loans risk-rated 8 and 9 are loans that are considered to be impaired and are on nonaccrual status. Loans are placed on nonaccrual status when they become 90 days past due as to principal or interest payments (unless the principal and interest are well secured and in the process of collection), or when we have determined, based upon most recent available information, that the timely collection of principal or interest is not probable; these loans are deemed “impaired” (For further description of nonaccrual loans, refer to Note 2—“Summary of Significant Accounting Policies” under Part II, Item 8 of our 2012 Form 10-K). Loans rated 10 are charged-off and are not included as part of our loan portfolio balance. We review our credit quality indicators for performance and appropriateness of risk ratings as part of our evaluation process for our allowance for loan losses. The following table summarizes the credit quality indicators, broken out by portfolio segment and class of financing receivables as of June 30, 2013 and December 31, 2012:

Table of Contents

(Dollars in thousands)	Pass	Performing (Criticized)	Impaired	Total
June 30, 2013:				
Commercial loans:				
Software	\$3,310,603	\$276,719	\$6,632	\$3,593,954
Hardware	973,721	219,310	24,582	1,217,613
Venture capital/private equity	1,941,817	758	89	1,942,664
Life science	992,121	103,460	—	1,095,581
Premium wine	596,685	12,859	1,511	611,055
Other	359,870	15,750	3,772	379,392
Total commercial loans	8,174,817	628,856	36,586	8,840,259
Consumer loans:				
Real estate secured loans	768,434	6,257	3,619	778,310
Other consumer loans	81,332	4,609	954	86,895
Total consumer loans	849,766	10,866	4,573	865,205
Total gross loans	\$9,024,583	\$639,722	\$41,159	\$9,705,464
December 31, 2012:				
Commercial loans:				
Software	\$3,050,449	\$240,187	\$3,263	\$3,293,899
Hardware	970,802	136,819	21,863	1,129,484
Venture capital/private equity	1,748,663	1,240	—	1,749,903
Life science	956,276	120,516	—	1,076,792
Premium wine	545,697	9,189	4,398	559,284
Other	360,291	18,608	5,415	384,314
Total commercial loans	7,632,178	526,559	34,939	8,193,676
Consumer loans:				
Real estate secured loans	663,911	19,343	2,239	685,493
Other consumer loans	132,818	11,160	1,101	145,079
Total consumer loans	796,729	30,503	3,340	830,572
Total gross loans	\$8,428,907	\$557,062	\$38,279	\$9,024,248

Table of Contents

TDRs

As of June 30, 2013 we had 19 TDRs with a total carrying value of \$34.3 million where concessions have been granted to borrowers experiencing financial difficulties, in an attempt to maximize collection. There were unfunded commitments available for funding of \$0.6 million to the clients associated with these TDRs as of June 30, 2013. The following table summarizes our loans modified in TDRs, broken out by portfolio segment and class of financing receivables at June 30, 2013 and December 31, 2012:

(Dollars in thousands)	June 30, 2013	December 31, 2012
Loans modified in TDRs:		
Commercial loans:		
Software	\$2,251	\$2,021
Hardware	23,318	20,514
Venture capital/ private equity	676	—
Premium wine	1,511	2,593
Other	4,197	5,900
Total commercial loans	31,953	31,028
Consumer loans:		
Real estate secured loans	1,373	2,199
Other consumer loans	954	1,101
Total consumer loans	2,327	3,300
Total	\$34,280	\$34,328

The following table summarizes the recorded investment in loans modified in TDRs, broken out by portfolio segment and class of financing receivable, for modifications made during the three and six months ended June 30, 2013 and 2012:

(Dollars in thousands)	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
Loans modified in TDRs during the period:				
Commercial loans:				
Software	\$778	\$—	\$778	\$100
Hardware	5,629	12,747	5,629	13,198
Venture capital/ private equity	89	—	676	—
Premium wine	—	—	—	275
Other	—	535	—	2,440
Total commercial loans	6,496	13,282	7,083	16,013
Consumer loans:				
Real estate secured loans	—	289	—	411
Other consumer loans	—	—	70	—
Total consumer loans	—	289	70	411
Total loans modified in TDR's during the period (1)	\$6,496	\$13,571	\$7,153	\$16,424

There were partial charge-offs of \$1.2 million on loans classified as TDRs for both the three and six months ended (1) June 30, 2013. There were partial charge-offs of \$10.0 million and \$10.9 million, respectively, on loans classified as TDRs during the three and six months ended June 30, 2012.

During the three and six months ended June 30, 2013, new TDRs of \$6.5 million and \$7.2 million, respectively, were modified through payment deferrals granted to our clients, and no principal or interest was forgiven.

During the three and six months ended June 30, 2012, new TDRs of \$3.6 million and \$6.3 million, respectively, were modified through payment deferrals granted to our clients, and \$10.0 million and \$10.1 million, respectively, were

modified through partial forgiveness of principal.

27

Table of Contents

The related allowance for loan losses for the majority of our TDRs is determined on an individual basis by comparing the carrying value of the loan to the present value of the estimated future cash flows, discounted at the pre-modification contractual interest rate. For certain TDRs, the related allowance for loan losses is determined based on the fair value of the collateral if the loan is collateral dependent.

The following table summarizes the recorded investment in loans modified in TDRs within the previous 12 months that subsequently defaulted during the three and six months ended June 30, 2013 and 2012, broken out by portfolio segment and class of financing receivable:

(Dollars in thousands)	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
TDRs modified within the previous 12 months that defaulted during the period:				
Commercial loans:				
Software	\$—	\$—	\$—	\$100
Hardware	4,154	452	4,154	452
Premium wine	—	1,859	—	1,859
Other	—	—	2,750	—
Total commercial loans	4,154	2,311	6,904	2,411
Consumer loans	70	1,289	70	1,289
Total TDRs modified within the previous 12 months that defaulted in the period	\$4,224	\$3,600	\$6,974	\$3,700

Charge-offs and defaults on previously restructured loans are evaluated to determine the impact to the allowance for loan losses, if any. The evaluation of these defaults may impact the assumptions used in calculating the reserve on other TDRs and impaired loans as well as management's overall outlook of macroeconomic factors that affect the reserve on the loan portfolio as a whole. After evaluating the charge-offs and defaults experienced on our TDRs we determined that no change to our reserving methodology was necessary to determine the allowance for loan losses as of June 30, 2013.

Table of Contents

7. Short-Term Borrowings and Long-Term Debt

The following table represents outstanding short-term borrowings and long-term debt at June 30, 2013 and December 31, 2012:

(Dollars in thousands)	Maturity	Principal value at June 30, 2013	Carrying Value	
			June 30, 2013	December 31, 2012
Short-term borrowings:				
Federal funds purchased	—	—	—	160,000
Other short-term borrowings	(1)	5,400	5,400	6,110
Total short-term borrowings			\$5,400	\$166,110
Long-term debt:				
5.375% Senior Notes	September 15, 2020	\$350,000	\$348,101	\$347,995
6.05% Subordinated Notes (2)	June 1, 2017	45,964	52,728	54,571
7.0% Junior Subordinated Debentures	October 15, 2033	50,000	55,109	55,196
Total long-term debt			\$455,938	\$457,762

(1) Represents cash collateral received from our counterparty for our interest rate swap agreement related to our 6.05% Subordinated Notes.

(2) At June 30, 2013 and December 31, 2012, included in the carrying value of our 6.05% Subordinated Notes were \$7.2 million and \$9.0 million, respectively, related to hedge accounting associated with the notes.

Interest expense related to short-term borrowings and long-term debt was \$5.8 million and \$11.6 million for the three and six months ended June 30, 2013, respectively, and \$6.3 million and \$12.6 million for the three and six months ended June 30, 2012, respectively. Interest expense is net of the hedge accounting impact from our interest rate swap agreements related to our 6.05% Subordinated Notes. The weighted average interest rate associated with our short-term borrowings as of June 30, 2013 was 0.07 percent.

Available Lines of Credit

We have certain facilities in place to enable us to access short-term borrowings on a secured (using available-for-sale securities as collateral) and an unsecured basis. These include repurchase agreements and uncommitted federal funds lines with various financial institutions. As of June 30, 2013, we had no outstanding borrowings against our uncommitted federal funds lines. We also pledge securities to the FHLB of San Francisco and the discount window at the Federal Reserve Bank. The market value of collateral pledged to the FHLB of San Francisco (comprised primarily of U.S. agency debentures) at June 30, 2013 totaled \$1.4 billion, all of which was unused and available to support additional borrowings. The market value of collateral pledged at the discount window of the Federal Reserve Bank at June 30, 2013 totaled \$626 million, all of which was unused and available to support additional borrowings.

8. Derivative Financial Instruments

We primarily use derivative financial instruments to manage interest rate risk, currency exchange rate risk, and to assist customers with their risk management objectives. Also, in connection with negotiating credit facilities and certain other services, we often obtain equity warrant assets giving us the right to acquire stock in private, venture-backed companies in the technology and life science industries.

Interest Rate Risk

Interest rate risk is our primary market risk and can result from timing and volume differences in the repricing of our interest rate-sensitive assets and liabilities and changes in market interest rates. To manage interest rate risk for our 6.05% Subordinated Notes, we entered into a fixed-for-floating interest rate swap agreement at the time of debt issuance based upon LIBOR with matched-terms. Net cash benefits associated with our interest rate swaps are recorded as a reduction in "Interest expense—Borrowings," a component of net interest income. The fair value of our interest rate swaps is calculated using a discounted cash flow method and adjusted for credit valuation associated with counterparty risk. Changes in fair value of the interest rate swaps are reflected in either other assets (for swaps in an asset position) or other liabilities (for swaps in a liability position).

Table of Contents

We assess hedge effectiveness under ASC 815, Derivatives and Hedging, using the long-haul method. Any differences associated with our interest rate swaps that arise as a result of hedge ineffectiveness are recorded through net gains on derivative instruments, in noninterest income, a component of consolidated net income.

Currency Exchange Risk

We enter into foreign exchange forward contracts to economically reduce our foreign exchange exposure risk associated with the net difference between foreign currency denominated assets and liabilities, primarily in Pound Sterling and Euro. We do not designate any foreign exchange forward contracts as derivative instruments that qualify for hedge accounting. Changes in currency rates on foreign currency denominated loans are included in other noninterest income, a component of noninterest income. We may experience ineffectiveness in the economic hedging relationship, because the loans are revalued based upon changes in the currency's spot rate on the principal value, while the forwards are revalued on a discounted cash flow basis. We record forward agreements in gain positions in other assets and loss positions in other liabilities, while net changes in fair value are recorded through net gains on derivative instruments, in noninterest income, a component of consolidated net income. Additionally, through our global banking operations we maintain customer deposits denominated in the Euro and Pound Sterling which are used to fund certain loans in these currencies to limit our exposure to currency fluctuations.

Other Derivative Instruments

Equity Warrant Assets

Our equity warrant assets are concentrated in private, venture-backed companies in the technology and life science industries. Most of these warrant agreements contain net share settlement provisions, which permit us to pay the warrant exercise price using shares issuable under the warrant ("cashless exercise"). We value our equity warrant assets using a modified Black-Scholes option pricing model, which incorporates assumptions about the underlying asset value, volatility, and the risk-free rate. We make valuation adjustments for estimated remaining life and marketability for warrants issued by private companies. Equity warrant assets are recorded at fair value in other assets, while changes in their fair value are recorded through net gains on derivative instruments, in noninterest income, a component of consolidated net income.

Loan Conversion Options

In connection with negotiating certain credit facilities, we occasionally extend loan facilities which have convertible option features. The convertible loans may be converted into a certain number of shares determined by dividing the principal amount of the loan by the applicable conversion price. Because our loan conversion options have underlying and notional values and had no initial net investment, these assets qualify as derivative instruments. We value our loan conversion options using a modified Black-Scholes option pricing model, which incorporates assumptions about the underlying asset value, volatility, and the risk-free rate. Loan conversion options are recorded at fair value in other assets, while changes in their fair value are recorded through net gains on derivative instruments, in noninterest income, a component of consolidated net income.

Other Derivatives

We sell forward and option contracts to clients who wish to mitigate their foreign currency exposure. We economically reduce the currency risk from this business by entering into opposite way contracts with correspondent banks. This relationship does not qualify for hedge accounting. The contracts generally have terms of one year or less, although we may have contracts extending for up to five years. Generally, we have not experienced nonperformance on these contracts, have not incurred credit losses, and anticipate performance by all counterparties to such agreements. Contracts in an asset position are included in other assets and contracts in a liability position are included in other liabilities. The net change in the fair value of these contracts is recorded through net gains on derivative instruments, in noninterest income, a component of consolidated net income.

We sell interest rate contracts to clients who wish to mitigate their interest rate exposure. We economically reduce the interest rate risk from this business by entering into opposite way contracts with correspondent banks. We do not designate any of these contracts (which are derivative instruments) as qualifying for hedge accounting. Contracts in an asset position are included in other assets and contracts in a liability position are included in other liabilities. The net change in the fair value of these derivatives is recorded through net gains on derivative instruments, in noninterest income, a component of consolidated net income.

Counterparty Credit Risk

We are exposed to credit risk if counterparties to our derivative contracts do not perform as expected. We mitigate counterparty credit risk through credit approvals, limits, monitoring procedures and obtaining collateral, as appropriate.

30

Table of Contents

The total notional or contractual amounts, fair value, collateral and net exposure of our derivative financial instruments at June 30, 2013 and December 31, 2012 were as follows:

(Dollars in thousands)	Balance Sheet Location	June 30, 2013		Collateral (1)	Net Exposure (2)	December 31, 2012		Collateral (1)	Net Exposure (2)
		Notional or Contractual Amount	Fair Value			Notional or Contractual Amount	Fair Value		
Derivatives designated as hedging instruments:									
Interest rate risks:									
Interest rate swaps	Other assets	\$45,964	\$7,224	\$5,400	\$1,824	\$45,964	\$9,005	\$6,110	\$2,895
Derivatives not designated as hedging instruments:									
Currency exchange risks:									
Foreign exchange forwards	Other assets	105,162	1,899	—	1,899	51,010	488	—	488
Foreign exchange forwards	Other liabilities	47,834	(40)	—	(40)	102,956	(1,728)	—	(1,728)
Net exposure			1,859	—	1,859		(1,240)	—	(1,240)
Other derivative instruments:									
Equity warrant assets	Other assets	173,299	76,584	—	76,584	164,332	74,272	—	74,272
Other derivatives:									
Client foreign exchange forwards	Other assets	449,340	14,281	—	14,281	385,470	11,864	—	11,864
Client foreign exchange forwards	Other liabilities	399,527	(11,043)	—	(11,043)	356,026	(9,930)	—	(9,930)
Client foreign currency options	Other assets	85,200	215	—	215	132,237	1,189	—	1,189
Client foreign currency options	Other liabilities	85,200	(215)	—	(215)	132,237	(1,189)	—	(1,189)
Loan conversion options	Other assets	9,430	1,595	—	1,595	9,782	890	—	890
Client interest rate derivatives	Other assets	151,022	136	—	136	144,950	558	—	558
Client interest rate derivatives	Other liabilities	151,022	(145)	—	(145)	144,950	(590)	—	(590)
Net exposure			4,824	—	4,824		2,792	—	2,792
Net			\$90,491	\$5,400	\$85,091		\$84,829	\$6,110	\$78,719

(1) Cash collateral received from our counterparty for our interest rate swap agreement is recorded as a component of “short-term borrowings” on our consolidated balance sheets.

(2) Net exposure for contracts in a gain position reflects the replacement cost in the event of nonperformance by all such counterparties. The credit ratings of our institutional counterparties as of June 30, 2013 remain at investment grade or higher and there were no material changes in their credit ratings during the three and six months ended

June 30, 2013.

31

Table of Contents

A summary of our derivative activity and the related impact on our consolidated statements of income for the three and six months ended June 30, 2013 and 2012 is as follows:

(Dollars in thousands)	Statement of income location	Three months ended		Six months ended June	
		June 30, 2013	2012	30, 2013	2012
Derivatives designated as hedging instruments:					
Interest rate risks:					
Net cash benefit associated with interest rate swaps	Interest expense—borrowings	\$633	\$1,696	\$1,267	\$3,925
Changes in fair value of interest rate swaps	Net gains on derivative instruments	(33	) 108	27	497
Net gains associated with interest rate risk derivatives		\$600	\$1,804	\$1,294	\$4,422
Derivatives not designated as hedging instruments:					
Currency exchange risks:					
Losses on revaluations of foreign currency instruments	Other noninterest income	\$(586	) \$(3,367	) \$(7,650	) \$(1,482
Gains on internal foreign exchange forward contracts, net	Net gains on derivative instruments	712	2,993	6,912	942
Net gains (losses) associated with currency risk		\$126	\$(374	) \$(738	) \$(540
Other derivative instruments:					
Gains on equity warrant assets	Net gains on derivative instruments	\$7,190	\$4,876	\$10,695	\$11,811
Gains on client foreign exchange forward contracts, net	Net gains on derivative instruments	\$1,013	\$1,330	\$1,810	\$2,395
Net gains (losses) on other derivatives (1)	Net gains on derivative instruments	\$94	\$(594	) \$572	\$(956

(1) Primarily represents the change in fair value of loan conversion options.

Balance Sheet Offsetting

Certain of our derivative and other financial instruments are subject to enforceable master netting arrangements with our counterparties. These agreements provide for the net settlement of multiple contracts with a single counterparty through a single payment, in a single currency, in the event of default on or termination of any one contract. The following table summarizes our assets subject to enforceable master netting arrangements as of June 30, 2013 and December 31, 2012:

Table of Contents

(Dollars in thousands)	Gross Amounts of Recognized Assets	Gross Amounts offset in the Statement of Financial Position	Net Amounts of Assets Presented in the Statement of Financial Position	Gross Amounts Not Offset in the Statement of Financial Position But Subject to Master Netting Arrangements		
				Financial Instruments	Cash Collateral Received	Net Amount
June 30, 2013						
Derivative Assets:						
Interest rate swaps	\$7,224	\$—	\$7,224	\$(1,824)	\$(5,400)	\$—
Foreign exchange forwards	16,180	—	16,180	(7,579)	—	8,601
Foreign currency options	215	—	215	(107)	—	108
Client interest rate derivatives	136	—	136	(47)	—	89
Total derivative assets:	23,755	—	23,755	(9,557)	(5,400)	8,798
Reverse repurchase, securities borrowing, and similar arrangements	130,603	—	130,603	(130,603)	—	—
Total	\$154,358	\$—	\$154,358	\$(140,160)	\$(5,400)	\$8,798
December 31, 2012						
Derivative Assets:						
Interest rate swaps	\$9,005	\$—	\$9,005	\$(2,895)	\$(6,110)	\$—
Foreign exchange forwards	12,352	—	12,352	(7,363)	—	4,989
Foreign currency options	1,189	—	1,189	(218)	—	971
Client interest rate derivatives	558	—	558	(24)	—	534
Total derivative assets:	23,104	—	23,104	(10,500)	(6,110)	6,494
Reverse repurchase, securities borrowing, and similar arrangements	133,357	—	133,357	(133,357)	—	—
Total	\$156,461	\$—	\$156,461	\$(143,857)	\$(6,110)	\$6,494

The following table summarizes our liabilities subject to enforceable master netting arrangements as of June 30, 2013 and December 31, 2012:

(Dollars in thousands)	Gross Amounts of Recognized Liabilities	Gross Amounts offset in the Statement of Financial Position	Net Amounts of Liabilities Presented in the Statement of Financial	Gross Amounts Not Offset in the Statement of Financial Position But Subject to Master Netting Arrangements		
				Financial Instruments	Cash Collateral Pledged	Net Amount

Position

June 30, 2013

Derivative Liabilities:

Foreign exchange forwards	\$11,083	\$—	\$11,083	\$(7,134)	) \$—	\$3,949
Foreign currency options	215	—	215	(108)	) —	107
Client interest rate derivatives	145	—	145	(88)	) —	57
Total derivative liabilities:	11,443	—	11,443	(7,330)	) —	4,113
Repurchase, securities lending, and similar arrangements	—	—	—	—	—	—
Total	\$11,443	\$—	\$11,443	\$(7,330)	) \$—	\$4,113

December 31, 2012

Derivative Liabilities:

Foreign exchange forwards	\$11,658	\$—	\$11,658	\$(5,720)	) \$—	\$5,938
Foreign currency options	1,189	—	1,189	(971)	) —	218
Client interest rate derivatives	590	—	590	(567)	) —	23
Total derivative assets:	13,437	—	13,437	(7,258)	) —	6,179
Repurchase, securities lending, and similar arrangements	—	—	—	—	—	—
Total	\$13,437	\$—	\$13,437	\$(7,258)	) \$—	\$6,179

33

Table of Contents

9. Other Noninterest Income and Other Noninterest Expense

A summary of other noninterest income for the three and six months ended June 30, 2013 and 2012 is as follows:

(Dollars in thousands)	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
Unused commitment fees	\$3,371	\$3,678	\$6,847	\$6,733
Fund management fees	2,940	3,124	5,709	5,952
Service-based fee income (1)	2,001	2,172	3,805	4,546
Net gains on the sale of certain assets related to our equity management services business	—	4,243	—	4,243
Loan syndication fees	750	1,375	750	1,500
Losses on revaluation of foreign currency instruments (2)	(586	) (3,367	) (7,650	) (1,482
Currency revaluation (losses) gains (3)	80	(1,548	) 25	(933
Other	3,674	2,987	6,271	5,183
Total other noninterest income	\$12,230	\$12,664	\$15,757	\$25,742

(1) Includes income from SVB Analytics.

(2) Represents the revaluation of foreign currency denominated financial instruments issued and held by us, primarily loans, deposits and cash.

(3) Primarily represents the revaluation of foreign currency denominated investments in certain funds. Included in these amounts are gains of \$0.3 million and \$0.1 million for the three and six months ended June 30, 2013, respectively, attributable to noncontrolling interests calculated based on the ownership percentages of the noncontrolling interests. This compares to gains of \$1.3 million and \$0.8 million for the comparable 2012 periods.

A summary of other noninterest expense for the three and six months ended June 30, 2013 and 2012 is as follows:

(Dollars in thousands)	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
Telephone	\$1,512	\$1,547	\$3,069	\$3,331
Client services	1,856	1,739	3,791	2,992
Data processing services	1,882	1,310	3,794	2,715
Tax credit fund amortization	1,338	962	2,655	2,020
Postage and supplies	680	628	1,218	1,253
Dues and publications	445	557	903	1,031
Other	1,975	2,675	4,193	3,883
Total other noninterest expense	\$9,688	\$9,418	\$19,623	\$17,225

Table of Contents

10. Segment Reporting

We have three reportable segments for management reporting purposes: Global Commercial Bank, SVB Private Bank and SVB Capital. The results of our operating segments are based on our internal management reporting process. Our operating segments' primary source of revenue is from net interest income, which is primarily the difference between interest earned on loans, net of funds transfer pricing ("FTP"), and interest paid on deposits, net of FTP. Accordingly, our segments are reported using net interest income, net of FTP. FTP is an internal measurement framework designed to assess the financial impact of a financial institution's sources and uses of funds. It is the mechanism by which an earnings credit is given for deposits raised, and an earnings charge is made for funded loans. FTP is calculated at an instrument level based on account characteristics.

We also evaluate performance based on provision for loan losses, noninterest income and noninterest expense, which are presented as components of segment operating profit or loss. In calculating each operating segment's noninterest expense, we consider the direct costs incurred by the operating segment as well as certain allocated direct costs. As part of this review, we allocate certain corporate overhead costs to a corporate account. We do not allocate income taxes to our segments. Additionally, our management reporting model is predicated on average asset balances; therefore, period-end asset balances are not presented for segment reporting purposes. Changes in an individual client's primary relationship designation have resulted, and in the future may result, in the inclusion of certain clients in different segments in different periods.

Unlike financial reporting, which benefits from the comprehensive structure provided by GAAP, our internal management reporting process is highly subjective, as there is no comprehensive, authoritative guidance for management reporting. Our management reporting process measures the performance of our operating segments based on our internal operating structure, which is subject to change from time to time, and is not necessarily comparable with similar information for other financial services companies.

The following is a description of the services that our three reportable segments provide:

Global Commercial Bank provides solutions to the financial needs of commercial clients through lending, deposit products, cash management services, and global banking and trade products and services. It also serves the needs of our non-U.S. clients with global banking products, including loans, deposits and global finance, in key foreign entrepreneurial markets, where applicable. Our Global Commercial Bank segment is comprised of results from our Commercial Bank, and also includes SVB Specialty Lending, SVB Analytics and our Debt Fund Investments. (For further description of these operating segments, refer to Note 20—"Segment Reporting" under Part II, Item 8 of our 2012 Form 10-K.)

SVB Private Bank provides banking products and a range of credit services primarily to venture capital/private equity professionals using both long-term secured and short-term unsecured lines of credit.

SVB Capital is the venture capital investment arm of SVBFG, which focuses primarily on funds management. SVB Capital manages funds (primarily venture capital funds) on behalf of third party limited partners and SVB Financial Group. The SVB Capital family of funds is comprised of funds of funds and direct venture funds. SVB Capital generates income for the Company primarily through management fees, carried interest arrangements and returns through the Company's investments in the funds.

The summary financial results of our operating segments are presented along with a reconciliation to our consolidated interim results. The Other Items column reflects the adjustments necessary to reconcile the results of the operating segments to the consolidated financial statements prepared in conformity with GAAP. Noninterest income in the Other Items column is primarily attributable to noncontrolling interests and gains on equity warrant assets.

Noninterest expense in the Other Items column primarily consists of expenses associated with corporate support functions such as finance, human resources, marketing, legal and other expenses. Additionally, average assets in the Other Items column primarily consists of cash and cash equivalents.

Table of Contents

Our segment information for the three and six months ended June 30, 2013 and 2012 is as follows:

(Dollars in thousands)	Global Commercial Bank (1)	SVB Private Bank	SVB Capital (1)	Other Items	Total
Three months ended June 30, 2013					
Net interest income	\$154,586	\$ 5,927	\$3	\$9,565	\$170,081
Provision for loan losses	(18,190)	(382)	—	—	(18,572)
Noninterest income	48,361	253	7,281	42,344	98,239
Noninterest expense (2)	(102,283)	(3,461)	(2,757)	(34,791)	(143,292)
Income before income tax expense (3)	\$82,474	\$ 2,337	\$4,527	\$17,118	\$106,456
Total average loans, net of unearned income	\$8,203,231	\$ 871,746	\$—	\$(52,804)	\$9,022,173
Total average assets (4)	20,364,334	885,259	269,771	573,934	22,093,298
Total average deposits	18,137,218	472,613	—	4,339	18,614,170
Three months ended June 30, 2012					
Net interest income (loss)	\$146,420	\$ 5,516	\$9	\$(11)	\$151,934
(Provision for) reduction of loan losses	(8,923)	924	—	—	(7,999)
Noninterest income	52,494	151	4,557	23,224	80,426
Noninterest expense (2)	(98,686)	(3,223)	(2,872)	(30,985)	(135,766)
Income (loss) before income tax expense (3)	\$91,305	\$ 3,368	\$1,694	\$(7,772)	\$88,595
Total average loans, net of unearned income	\$6,479,544	\$ 742,130	\$—	\$15,508	\$7,237,182
Total average assets (4)	19,022,506	747,445	251,295	869,630	20,890,876
Total average deposits	17,131,816	253,482	—	22,338	17,407,636
Six months ended June 30, 2013					
Net interest income	\$303,522	\$ 12,031	\$4	\$17,693	\$333,250
(Provision for) reduction of loan losses	(24,397)	12	—	—	(24,385)
Noninterest income	94,902	487	12,722	68,732	176,843
Noninterest expense (2)	(207,861)	(6,922)	(5,143)	(72,380)	(292,306)
Income (loss) before income tax expense (3)	\$166,166	\$ 5,608	\$7,583	\$14,045	\$193,402
Total average loans, net of unearned income	\$8,036,833	\$ 858,351	\$—	\$(42,696)	\$8,852,488
Total average assets (4)	20,413,630	869,682	254,343	665,662	22,203,317
Total average deposits	18,219,590	471,648	—	8,130	18,699,368
Six months ended June 30, 2012					
Net interest income	\$289,684	\$ 10,481	\$16	\$2,690	\$302,871
Provision for loan losses	(22,159)	(369)	—	—	(22,528)
Noninterest income	92,422	308	8,144	38,845	139,719
Noninterest expense (2)	(195,129)	(6,349)	(5,408)	(60,892)	(267,778)
Income before income tax expense (3)	\$164,818	\$ 4,071	\$2,752	\$(19,357)	\$152,284
Total average loans, net of unearned income	\$6,255,450	\$ 740,049	\$—	\$25,266	\$7,020,765
Total average assets (4)	18,789,624	744,703	254,835	772,547	20,561,709
Total average deposits	16,916,965	246,991	—	22,744	17,186,700

(1) Global Commercial Bank's and SVB Capital's components of net interest income, noninterest income, noninterest expense and total average assets are shown net of noncontrolling interests for all periods presented.

The Global Commercial Bank segment includes direct depreciation and amortization of \$5.3 million and \$3.6 million for the three months ended June 30, 2013 and 2012, respectively, and \$10.4 million and \$7.0 million for the six months ended June 30, 2013 and 2012, respectively.

(3) The internal reporting model used by management to assess segment performance does not calculate income tax expense by segment. Our effective tax rate is a reasonable approximation of the segment rates.

(4) Total average assets equals the greater of total average assets or the sum of total liabilities and total stockholders' equity for each segment.

36

Table of Contents

11. Off-Balance Sheet Arrangements, Guarantees and Other Commitments

In the normal course of business, we use financial instruments with off-balance sheet risk to meet the financing needs of our customers. These financial instruments include commitments to extend credit, commercial and standby letters of credit and commitments to invest in venture capital and private equity fund investments. These instruments involve credit risk to varying degrees. Credit risk is defined as the possibility of sustaining a loss because other parties to the financial instrument fail to perform in accordance with the terms of the contract.

Commitments to Extend Credit

The following table summarizes information related to our commitments to extend credit at June 30, 2013 and December 31, 2012:

(Dollars in thousands)	June 30, 2013	December 31, 2012
Loan commitments available for funding: (1)		
Fixed interest rate commitments	\$983,843	\$862,120
Variable interest rate commitments	7,946,395	6,906,580
Total loan commitments available for funding	8,930,238	7,768,700
Commercial and standby letters of credit (2)	855,498	842,091
Total unfunded credit commitments	\$9,785,736	\$8,610,791
Commitments unavailable for funding (3)	\$1,395,591	\$1,315,072
Maximum lending limits for accounts receivable factoring arrangements (4)	878,437	880,057
Reserve for unfunded credit commitments (5)	25,647	22,299

(1) Represents commitments which are available for funding, due to clients meeting all collateral, compliance and financial covenants required under loan commitment agreements.

(2) See below for additional information on our commercial and standby letters of credit.

(3) Represents commitments which are currently unavailable for funding, due to clients failing to meet all collateral, compliance and financial covenants under loan commitment agreements.

(4) We extend credit under accounts receivable factoring arrangements when our clients' sales invoices are deemed creditworthy under existing underwriting practices.

(5) Our reserve for unfunded credit commitments includes an allowance for both our unfunded loan commitments and our letters of credit.

Commercial and Standby Letters of Credit

The table below summarizes our commercial and standby letters of credit at June 30, 2013. The maximum potential amount of future payments represents the amount that could be remitted under letters of credit if there were a total default by the guaranteed parties, without consideration of possible recoveries under recourse provisions or from the collateral held or pledged.

(Dollars in thousands)	Expires In One Year or Less	Expires After One Year	Total Amount Outstanding	Maximum Amount of Future Payments
Financial standby letters of credit	\$737,914	\$50,881	\$788,795	\$788,795
Performance standby letters of credit	48,218	12,215	60,433	60,433
Commercial letters of credit	6,270	—	6,270	6,270
Total	\$792,402	\$63,096	\$855,498	\$855,498

At June 30, 2013 and December 31, 2012, deferred fees related to financial and performance standby letters of credit were \$7.0 million and \$5.5 million, respectively. At June 30, 2013, collateral in the form of cash of \$357 million and available-for-sale securities of \$5.7 million were available to us to reimburse losses, if any, under financial and performance standby letters of credit.

Table of Contents

Commitments to Invest in Venture Capital and Private Equity Funds

We make commitments to invest in venture capital and private equity funds, which in turn make investments generally in, or in some cases make loans to, privately-held companies. Commitments to invest in these funds are generally made for a 10-year period from the inception of the fund. Although the limited partnership agreements governing these investments typically do not restrict the general partners from calling 100% of committed capital in one year, it is customary for these funds to generally call most of the capital commitments over 5 to 7 years; however in certain cases, the funds may not call 100% of committed capital over the life of the fund. The actual timing of future cash requirements to fund these commitments is generally dependent upon the investment cycle, overall market conditions, and the nature and type of industry in which the privately held companies operate. The following table details our total capital commitments, unfunded capital commitments, and our ownership percentage in each fund at June 30, 2013:

Our Ownership in Venture Capital/Private Equity Funds (Dollars in thousands)	SVBFG Capital Commitments	SVBFG Unfunded Commitments	SVBFG Ownership of each Fund	
Silicon Valley BancVentures, LP	\$6,000	\$ 270	10.7	%
SVB Capital Partners II, LP (1)	1,200	162	5.1	
SVB Capital Shanghai Yangpu Venture Capital Fund	945	163	6.8	
SVB Strategic Investors Fund, LP	15,300	688	12.6	
SVB Strategic Investors Fund II, LP	15,000	1,050	8.6	
SVB Strategic Investors Fund III, LP	15,000	2,063	5.9	
SVB Strategic Investors Fund IV, LP	12,239	3,305	5.0	
Strategic Investors Fund V Funds	515	374	Various	
Strategic Investors Fund VI Funds	500	492	0.2	
SVB Capital Preferred Return Fund, LP	12,688	—	20.0	
SVB Capital—NT Growth Partners, LP	24,670	1,340	33.0	
Other private equity fund (2)	9,338	—	58.2	
Partners for Growth, LP	25,000	9,750	50.0	
Debt funds (equity method accounting)	64,861	6,750	Various	
Other fund investments (3)	305,157	58,233	Various	
Total	\$508,413	\$ 84,640		

(1) Our ownership includes direct ownership of 1.3 percent and indirect ownership interest of 3.8 percent through our investment in SVB Strategic Investors Fund II, LP.

(2) Our ownership includes direct ownership of 41.5 percent and indirect ownership interests of 12.6 percent and 4.1 percent in the fund through our ownership interest of SVB Capital - NT Growth Partners, LP and SVB Capital Preferred Return Fund, LP, respectively.

(3) Represents commitments to 308 funds (primarily venture capital funds) where our ownership interest is generally less than 5 percent of the voting interests of each such fund.

Table of Contents

The following table details the amounts of remaining unfunded commitments to venture capital and private equity funds by our consolidated managed funds of funds (including our interest and the noncontrolling interests) at June 30, 2013:

Limited Partnership (Dollars in thousands)	Unfunded Commitments
SVB Strategic Investors Fund, LP	\$ 2,298
SVB Strategic Investors Fund II, LP	8,110
SVB Strategic Investors Fund III, LP	29,083
SVB Strategic Investors Fund IV, LP	76,925
Strategic Investors Fund V Funds	269,595
Strategic Investors Fund VI Funds	15,179
SVB Capital Preferred Return Fund, LP	13,172
SVB Capital—NT Growth Partners, LP	14,754
Other private equity fund	3,967
Total	\$ 433,083

12. Income Taxes

We are subject to income tax in the U.S. federal jurisdiction and various state and foreign jurisdictions and have identified our federal tax return and tax returns in California and Massachusetts as “major” tax filings. U.S. federal tax examinations through 2009 have been concluded. Our U.S. federal tax returns for 2010 and subsequent years remain open to examination. Our California and Massachusetts tax returns for 2008 and subsequent years remain open to examination.

At June 30, 2013, our unrecognized tax benefit was \$0.5 million, the recognition of which would reduce our income tax expense by \$0.3 million. We do not expect that our unrecognized tax benefit will materially change in the next 12 months.

13. Fair Value of Financial Instruments

Fair Value Measurements

Our available-for-sale securities, derivative instruments and certain non-marketable and marketable securities are financial instruments recorded at fair value on a recurring basis. We make estimates regarding valuation of assets and liabilities measured at fair value in preparing our interim consolidated financial statements.

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (the “exit price”) in an orderly transaction between market participants at the measurement date. There is a three-level hierarchy for disclosure of assets and liabilities recorded at fair value. The classification of assets and liabilities within the hierarchy is based on whether the inputs to the valuation methodology used for measurement are observable or unobservable and the significance of those inputs in the fair value measurement. Observable inputs reflect market-derived or market-based information obtained from independent sources, while unobservable inputs reflect our estimates about market data and views of market participants. The three levels for measuring fair value are based on the reliability of inputs and are as follows:

Level 1

Fair value measurements based on quoted prices in active markets for identical assets or liabilities that we have the ability to access. Valuation adjustments and block discounts are not applied to instruments utilizing Level 1 inputs. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these instruments does not entail a significant degree of judgment. Assets utilizing Level 1 inputs include exchange-traded equity securities and certain marketable securities accounted for under fair value accounting.

Level 2

Fair value measurements based on quoted prices in markets that are not active or for which all significant inputs are observable, directly or indirectly. Valuations for the available-for-sale securities are provided by third party external pricing service providers. We review the methodologies used to determine the fair value, including understanding the nature and observability of the inputs used to determine the price. Additional corroboration, such as obtaining a non-binding price from a broker, may be obtained depending on the frequency of trades of the security and the level of

liquidity or depth of the market. The valuation methodology that is generally used for the Level 2 assets is the income approach. Below is a summary of the significant inputs used for each class of Level 2 assets and liabilities:

39

Table of Contents

U.S. treasury securities: U.S. treasury securities are considered by most investors to be the most liquid fixed income investments available. These securities are priced relative to market prices on similar U.S. treasury securities.

U.S. agency debentures: Fair value measurements of U.S. agency debentures are based on the characteristics specific to bonds held, such as issuer name, coupon rate, maturity date and any applicable issuer call option features.

Valuations are based on market spreads relative to similar term benchmark market interest rates, generally U.S. treasury securities.

Agency-issued mortgage-backed securities: Agency-issued mortgage-backed securities are pools of individual conventional mortgage loans underwritten to U.S. agency standards with similar coupon rates, tenor, and other attributes such as geographic location, loan size and origination vintage. Fair value measurements of these securities are based on observable price adjustments relative to benchmark market interest rates taking into consideration estimated loan prepayment speeds.

Agency-issued collateralized mortgage obligations: Agency-issued collateralized mortgage obligations are structured into classes or tranches with defined cash flow characteristics and are collateralized by U.S. agency-issued mortgage pass-through securities. Fair value measurements of these securities incorporate similar characteristics of mortgage pass-through securities such as coupon rate, tenor, geographic location, loan size and origination vintage, in addition to incorporating the effect of estimated prepayment speeds on the cash flow structure of the class or tranche. These measurements incorporate observable market spreads over an estimated average life after considering the inputs listed above.

Agency-issued commercial mortgage-backed securities: Fair value measurements of these securities are based on spreads to benchmark market interest rates (usually U.S. treasury rates or rates observable in the swaps market), prepayment speeds, loan default rate assumptions and loan loss severity assumptions on underlying loans.

Municipal bonds and notes: Bonds issued by municipal governments generally have stated coupon rates, final maturity dates and are subject to being called ahead of the final maturity date at the option of the issuer. Fair value measurements of these securities are priced based on spreads to other municipal benchmark bonds with similar characteristics; or, relative to market rates on U.S. treasury bonds of similar maturity.

Interest rate swap assets: Fair value measurements of interest rate swaps are priced considering the coupon rate of the fixed leg of the contract and the variable coupon on the floating leg of the contract. Valuation is based on both spot and forward rates on the swap yield curve and the credit worthiness of the contract counterparty.

Foreign exchange forward and option contract assets and liabilities: Fair value measurements of these assets and liabilities are priced based on spot and forward foreign currency rates and option volatility assumptions and the credit worthiness of the contract counterparty.

Equity warrant assets (public portfolio): Fair value measurements of equity warrant assets of public portfolio companies are priced based on the Black-Scholes option pricing model that use the publicly-traded equity prices (underlying stock value), stated strike prices, option expiration dates, the risk-free interest rate and market-observable option volatility assumptions. Overall model asset values are further adjusted for certain warrants that have lockup restriction features.

Level 3

The fair value measurement is derived from valuation techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect our own estimates of assumptions we believe market participants would use in pricing the asset. Below is a summary of the valuation techniques used for each class of Level 3 assets:

Venture capital and private equity fund investments: Fair value measurements are based on the net asset value per share as obtained from the investee funds' management, as the funds do not have a readily determinable fair value and the funds prepare their financial statements using guidance consistent with the fair value accounting. We account for differences between our measurement date and the date of the fund investment's net asset value by using the most recent available financial information from the investee general partner, adjusted for any contributions paid, distributions received from the investment, and significant fund transactions or market events during the reporting period.

Other venture capital investments: Fair value measurements are based on consideration of a range of factors including, but not limited to, the price at which the investment was acquired, the term and nature of the investment, local market

conditions, values for comparable securities, and as it relates to the private company, the current and projected operating performance, exit strategies and financing transactions subsequent to the acquisition of the investment. The significant unobservable inputs used in the fair value measurement include the information about each portfolio company, including actual and forecasted results, cash position, recent or planned transactions and market comparable companies. Significant changes to any one of these inputs in isolation could result in a significant change in the fair value measurement, however, we generally consider all factors available through ongoing communication with the portfolio companies and venture capital fund managers to determine whether there are changes to the portfolio company or the environment that indicate a change in the fair value measurement.

Table of Contents

Equity warrant assets (private portfolio): Fair value measurements of equity warrant assets of private portfolio companies are priced based on a modified Black-Scholes option pricing model to estimate the asset value by using stated strike prices, option expiration dates, risk-free interest rates and option volatility assumptions. Option volatility assumptions used in the modified Black-Scholes model are based on public market indices whose members operate in similar industries as companies in our private company portfolio. Option expiration dates are modified to account for estimates to actual life relative to stated expiration. Overall model asset values are further adjusted for a general lack of liquidity due to the private nature of the associated underlying company. There is a direct correlation between changes in the volatility and remaining life assumptions in isolation and the fair value measurement while there is an inverse correlation between changes in the liquidity discount assumption and the fair value measurement.

It is our policy to maximize the use of observable inputs and minimize the use of unobservable inputs when developing fair value measurements. When available, we use quoted market prices to measure fair value. If market prices are not available, fair value measurement is based upon valuation techniques that use primarily market-based or independently-sourced market parameters, including interest rate yield curves, prepayment speeds, option volatilities and currency rates. Substantially all of our financial instruments use the foregoing methodologies, and are categorized as a Level 1 or Level 2 measurement in the fair value hierarchy. However, in certain cases, when market observable inputs for our valuation techniques may not be readily available, we are required to make judgments about assumptions we believe market participants would use in estimating the fair value of the financial instrument, and based on the significance of those judgments, the measurement may be determined to be a Level 3 fair value measurement.

The degree of management judgment involved in determining the fair value of a financial instrument is dependent upon the availability of quoted market prices or observable market parameters. For financial instruments that trade actively and have quoted market prices or observable market parameters, there is minimal subjectivity involved in measuring fair value. When observable market prices and parameters are not fully available, management judgment is necessary to estimate fair value. For inactive markets, there is little information, if any, to evaluate if individual transactions are orderly. Accordingly, we are required to estimate, based upon all available facts and circumstances, the degree to which orderly transactions are occurring and provide more weighting to price quotes that are based upon orderly transactions. In addition, changes in the market conditions may reduce the availability of quoted prices or observable data. For example, reduced liquidity in the capital markets or changes in secondary market activities could result in observable market inputs becoming unavailable. Therefore, when market data is not available, we use valuation techniques requiring more management judgment to estimate the appropriate fair value measurement. Accordingly, the degree of judgment exercised by management in determining fair value is greater for financial assets and liabilities categorized as Level 3.

Table of Contents

The following fair value hierarchy table presents information about our assets and liabilities that are measured at fair value on a recurring basis as of June 30, 2013:

(Dollars in thousands)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at June 30, 2013
Assets				
Available-for-sale securities:				
U.S. treasury securities	\$ —	\$ 24,999	\$—	\$24,999
U.S. agency debentures	—	3,403,589	—	3,403,589
Residential mortgage-backed securities:				
Agency-issued mortgage-backed securities	—	1,214,035	—	1,214,035
Agency-issued collateralized mortgage obligations - fixed rate	—	3,468,682	—	3,468,682
Agency-issued collateralized mortgage obligations - variable rate	—	1,438,772	—	1,438,772
Agency-issued commercial mortgage-backed securities	—	401,204	—	401,204
Municipal bonds and notes	—	87,001	—	87,001
Equity securities	1,049	4,010	—	5,059
Total available-for-sale securities	1,049	10,042,292	—	10,043,341
Non-marketable securities (fair value accounting):				
Venture capital and private equity fund investments	—	—	741,522	741,522
Other venture capital investments	—	—	123,493	123,493
Total non-marketable securities (fair value accounting)	—	—	865,015	865,015
Other assets:				
Marketable securities	9,063	—	—	9,063
Interest rate swaps	—	7,224	—	7,224
Foreign exchange forward and option contracts	—	16,395	—	16,395
Equity warrant assets	—	3,355	73,229	76,584
Loan conversion options	—	1,595	—	1,595
Client interest rate derivatives	—	136	—	136
Total assets (1)	\$ 10,112	\$ 10,070,997	\$938,244	\$ 11,019,353
Liabilities				
Foreign exchange forward and option contracts	\$ —	\$ 11,298	\$—	\$ 11,298
Client interest rate derivatives	—	145	—	145
Total liabilities	\$ —	\$ 11,443	\$—	\$ 11,443

(1) Included in Level 1 and Level 3 assets are \$8.6 million and \$778 million, respectively, attributable to noncontrolling interests calculated based on the ownership percentages of the noncontrolling interests.

Table of Contents

The following fair value hierarchy table presents information about our assets and liabilities that are measured at fair value on a recurring basis as of December 31, 2012:

(Dollars in thousands)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at December 31, 2012
Assets				
Available-for-sale securities:				
U.S. treasury securities	\$ —	\$ 25,247	\$—	\$25,247
U.S. agency debentures	—	3,447,628	—	3,447,628
Residential mortgage-backed securities:				
Agency-issued mortgage-backed securities	—	1,473,433	—	1,473,433
Agency-issued collateralized mortgage obligations - fixed rate	—	4,103,974	—	4,103,974
Agency-issued collateralized mortgage obligations - variable rate	—	1,772,748	—	1,772,748
Agency-issued commercial mortgage-backed securities	—	422,098	—	422,098
Municipal bonds and notes	—	93,529	—	93,529
Equity securities	4,520	—	—	4,520
Total available-for-sale securities	4,520	11,338,657	—	11,343,177
Non-marketable securities (fair value accounting):				
Venture capital and private equity fund investments	—	—	665,921	665,921
Other venture capital investments	—	—	127,091	127,091
Total non-marketable securities (fair value accounting)	—	—	793,012	793,012
Other assets:				
Marketable securities	1,144	9,184	—	10,328
Interest rate swaps	—	9,005	—	9,005
Foreign exchange forward and option contracts	—	13,541	—	13,541
Equity warrant assets	—	8,143	66,129	74,272
Loan conversion options	—	890	—	890
Client interest rate derivatives	—	558	—	558
Total assets (1)	\$ 5,664	\$ 11,379,978	\$859,141	\$ 12,244,783
Liabilities				
Foreign exchange forward and option contracts	\$ —	\$ 12,847	\$—	\$12,847
Client interest rate derivatives	—	590	—	590
Total liabilities	\$ —	\$ 13,437	\$—	\$13,437

Included in Level 1, Level 2, and Level 3 assets are \$1.1 million, \$8.7 million, and \$708 million, respectively, (1) attributable to noncontrolling interests calculated based on the ownership percentages of the noncontrolling interests.

Table of Contents

The following table presents additional information about Level 3 assets measured at fair value on a recurring basis for the three and six months ended June 30, 2013 and 2012, respectively:

(Dollars in thousands)	Beginning Balance	Total Realized and Unrealized Gains (Losses) Included in Income	Purchases	Sales	Issuances	Distributions and Other Settlements	Transfers Into Level 3	Transfers Out of Level 3	Ending Balance
Three months ended June 30, 2013									
Non-marketable securities (fair value accounting):									
Venture capital and private equity fund investments	\$701,076	\$33,728	\$35,574	\$—	\$—	\$(28,856)	\$—	\$—	\$741,522
Other venture capital investments	124,786	(939)	28	(364)	—	(18)	—	—	123,493
Total non-marketable securities (fair value accounting) (1)	825,862	32,789	35,602	(364)	—	(28,874)	—	—	865,015
Other assets:									
Equity warrant assets (2)	66,046	6,468	—	(2,189)	2,388	1,014	—	(498)	73,229
Total assets	\$891,908	\$39,257	\$35,602	\$(2,553)	\$2,388	\$(27,860)	\$—	\$(498)	\$938,244
Three months ended June 30, 2012									
Non-marketable securities (fair value accounting):									
Venture capital and private equity fund investments	\$620,356	\$14,557	\$33,365	\$—	\$—	\$(28,682)	\$—	\$—	\$639,596
Other venture capital investments	127,951	(3,540)	211	(3,932)	—	16	—	(595)	120,111
Other investments	1,002	—	—	—	—	(1,002)	—	—	—
Total non-marketable securities (fair value accounting) (1)	749,309	11,017	33,576	(3,932)	—	(29,668)	—	(595)	759,707
Other assets:									
Equity warrant assets (2)	65,217	5,853	—	(6,075)	3,873	—	—	(249)	68,619
Total assets	\$814,526	\$16,870	\$33,576	\$(10,007)	\$3,873	\$(29,668)	\$—	\$(844)	\$828,326
Six months ended June 30, 2013									
Non-marketable securities (fair value accounting):									
	\$665,921	\$56,238	\$65,318	\$—	\$—	\$(45,955)	\$—	\$—	\$741,522

Venture capital and private equity fund investments										
Other venture capital investments	127,091	1,249	194	(385)	—	(1,095)	—	(3,561)	)	123,493
Total non-marketable securities (fair value accounting) (1)	793,012	57,487	65,512	(385)	—	(47,050)	—	(3,561)	)	865,015
Other assets:										
Equity warrant assets (2)	66,129	7,927	—	(4,439)	4,314	1,378	—	(2,080)	)	73,229
Total assets	\$859,141	\$65,414	\$65,512	\$(4,824)	\$4,314	\$(45,672)	\$—	\$(5,641)	)	\$938,244
Six months ended June 30, 2012										
Non-marketable securities (fair value accounting):										
Venture capital and private equity fund investments	\$611,824	\$26,661	\$55,081	\$—	\$—	\$(53,970)	\$—	\$—	)	\$639,596
Other venture capital investments	124,121	(7,127)	7,935	(4,239)	—	16	—	(595)	)	120,111
Other investments	987	21	—	—	—	(1,008)	—	—)	—
Total non-marketable securities (fair value accounting) (1)	736,932	19,555	63,016	(4,239)	—	(54,962)	—	(595)	)	759,707
Other assets:										
Equity warrant assets (2)	63,030	9,648	—	(9,718)	6,173	1	—	(515)	)	68,619
Total assets	\$799,962	\$29,203	\$63,016	\$(13,957)	\$6,173	\$(54,961)	\$—	\$(1,110)	)	\$828,326

(1) Realized and unrealized gains (losses) are recorded on the line items “gains on investment securities, net”, and “other noninterest income”, components of noninterest income.

(2) Realized and unrealized gains (losses) are recorded on the line item “gains on derivative instruments, net”, a component of noninterest income.

Table of Contents

The following table presents the amount of unrealized gains (losses) included in earnings (which is inclusive of noncontrolling interest) attributable to Level 3 assets still held at June 30, 2013:

(Dollars in thousands)	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
Non-marketable securities (fair value accounting):				
Venture capital and private equity fund investments	\$34,390	\$14,543	\$57,011	\$26,192
Other venture capital investments	(209)	10,819	1,117	8,208
Other investments	—	—	—	21
Total non-marketable securities (fair value accounting) (1)	34,181	25,362	58,128	34,421
Other assets:				
Equity warrant assets (2)	5,240	2,888	6,279	3,392
Total unrealized gains	\$39,421	\$28,250	\$64,407	\$37,813
Unrealized gains attributable to noncontrolling interests	\$28,482	\$21,721	\$50,245	\$28,969

(1) Unrealized gains (losses) are recorded on the line items “gains on investment securities, net”, and “other noninterest income”, components of noninterest income.

(2) Unrealized gains (losses) are recorded on the line item “gains on derivative instruments, net”, a component of noninterest income.

The following table presents quantitative information about the significant unobservable inputs used for certain of our Level 3 fair value measurements at June 30, 2013. We have not included in this table our venture capital and private equity fund investments (fair value accounting) as we use net asset value per share (as obtained from the general partners of the investments) as a practical expedient to determine fair value.

(Dollars in thousands)	Fair value	Valuation Technique	Significant Unobservable Inputs	Weighted Average
June 30, 2013:				
Other venture capital investments (fair value accounting)	\$123,493	Private company equity pricing	(1)	(1) %
Equity warrant assets (private portfolio)	73,229	Modified Black-Scholes option pricing model	Volatility	40.6 %
			Risk-Free interest rate	0.7 %
			Marketability discount (2)	22.5 %
			Remaining life assumption (3)	45.0 %
December 31, 2012:				
Other venture capital investments (fair value accounting)	127,091	Private company equity pricing	(1)	(1) %
Equity warrant assets (private portfolio)	66,129	Modified Black-Scholes option pricing model	Volatility	45.2 %
			Risk-Free interest rate	0.4 %
			Marketability discount (2)	22.5 %
			Remaining life assumption (3)	45.0 %

(1) In determining the fair value of our other venture capital investment portfolio, we evaluate a variety of factors related to each underlying private portfolio company including, but not limited to, actual and forecasted results, cash position, recent or planned transactions and market comparable companies. Additionally, we have ongoing

communication with the portfolio companies and venture capital fund managers, to determine whether there is a material change in fair value. These factors are specific to each portfolio company and a weighted average or range of values of the unobservable inputs is not meaningful.

(2) Our marketability discount is applied to all private company warrants to account for a general lack of liquidity due to the private nature of the associated underlying company. The quantitative measure used is based on long-run averages and is influenced over time by various factors, including market conditions. On a quarterly basis, a sensitivity analysis is performed on our marketability discount.

(3) We adjust the contractual remaining term of private company warrants based on our estimate of the actual remaining life, which we determine by utilizing historical data on cancellations and exercises. At June 30, 2013, the weighted average

45

Table of Contents

contractual remaining term was 6.4 years, compared to our estimated remaining life of 2.9 years. On a quarterly basis, a sensitivity analysis is performed on our remaining life assumption.

For the three and six months ended June 30, 2013 and 2012, we did not have any material transfers between Level 2 and Level 1. Transfers from Level 3 to Level 2 for the six months ended June 30, 2013 included \$3.6 million due to the IPO of one of our portfolio companies. Transfers from Level 3 to Level 2 for the three and six months ended June 30, 2012 included \$0.6 million due to the IPO of one of our portfolio companies. All other transfers from Level 3 to Level 2 for the three and six months ended June 30, 2013, and 2012 were due to the transfer of equity warrant assets from our private portfolio to our public portfolio (see our Level 3 reconciliation above). All amounts reported as transfers represent the fair value as of the date of the change in circumstances that caused the transfer.

Financial Instruments not Carried at Fair Value

FASB guidance over financial instruments requires that we disclose estimated fair values for our financial instruments not carried at fair value. Fair value estimates, methods and assumptions, set forth below for our financial instruments, are made solely to comply with these requirements.

Fair values are based on estimates or calculations at the transaction level using present value techniques in instances where quoted market prices are not available. Because broadly traded markets do not exist for many of our financial instruments, the fair value calculations attempt to incorporate the effect of current market conditions at a specific time. The aggregation of the fair value calculations presented herein does not represent, and should not be construed to represent, the underlying value of the Company.

The following describes the methods and assumptions used in estimating the fair values of financial instruments, excluding financial instruments already recorded at fair value as described above.

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand, cash balances due from banks, interest-earning deposits, securities purchased under agreement to resell and other short-term investment securities. The carrying amount is a reasonable estimate of fair value because of the insignificant risk of changes in fair value due to changes in market interest rates, and the instruments are purchased in conjunction with our cash management activities.

Non-Marketable Securities (Cost and Equity Method Accounting)

Non-marketable securities includes other investments (equity method accounting), low income housing tax credit funds (equity method accounting), venture capital and private equity fund investments (cost method accounting), and other venture capital investments (cost method accounting). Other investments (equity method accounting) includes our investment in SPD Silicon Valley Bank ("SPD-SVB"), our joint venture bank in China. At this time, the carrying value of our investment in SPD-SVB is a reasonable estimate of fair value. The fair value of the remaining other investments (equity method accounting) and the fair value of venture capital and private equity fund investments (cost method accounting) and other venture capital investments (cost method accounting) is based on financial information obtained from the investee or obtained from the fund investments' or debt fund investments' respective general partners. For private company investments, estimated fair value is based on consideration of a range of factors including, but not limited to, the price at which the investment was acquired, the term and nature of the investment, local market conditions, values for comparable securities, current and projected operating performance, exit strategies, and financing transactions subsequent to the acquisition of the investment. For our fund investments, we utilize the net asset value per share as obtained from the general partners of the investments. We adjust the net asset value per share for differences between our measurement date and the date of the fund investment's net asset value by using the most recently available financial information from the investee general partner, for example March 31st for our June 30th consolidated financial statements, adjusted for any contributions paid, distributions received from the investment, and significant fund transactions or market events during the reporting period. The carrying value of our low income housing tax credit funds (equity method accounting) is a reasonable estimate of fair value.

Loans

The fair value of fixed and variable rate loans is estimated by discounting contractual cash flows using rates that reflect current pricing for similar loans and the projected forward yield curve. This method is not based on the exit price concept of fair value required under ASC 820, Fair Value Measurements and Disclosures.

Table of Contents

FHLB and Federal Reserve Bank Stock

Investments in FHLB and Federal Reserve Bank stock are recorded at cost. The carrying amounts of these investments are reasonable estimates of fair value because the securities are restricted to member banks and they do not have a readily determinable market value.

Accrued Interest Receivable and Payable

The carrying amounts of accrued interest receivable and payable are reasonable estimates of fair value due to the short-term nature of these balances.

Deposits

The fair value of deposits with no stated maturity, such as noninterest-bearing demand deposits, interest-bearing checking accounts, money market accounts and interest-bearing sweep deposits is equal to the amount payable on demand at the measurement date. The fair value of time deposits is estimated by discounting the cash flows using our cost of borrowings and the projected forward yield curve over their remaining contractual term.

Short-Term Borrowings

Short-term borrowings at both June 30, 2013 and December 31, 2012 included cash collateral received from our counterparty for our interest rate swap agreement related to our 6.05% Subordinated Notes. Short term-borrowings at December 31, 2012 also included federal funds purchased. The carrying amount of our federal funds purchased is a reasonable estimate of fair value because of the relatively short time between the origination of the instrument and its contractual maturity. The carrying amount of the cash collateral is a reasonable estimate of fair value.

Long-Term Debt

Long-term debt at June 30, 2013 and December 31, 2012 included our 5.375% Senior Notes, 7.0% Junior Subordinated Debentures and 6.05% Subordinated Notes. The fair value of long-term debt is generally based on quoted market prices, when available, or is estimated based on calculations utilizing third-party pricing services and current market spread, price indications from reputable dealers or observable market prices of the underlying instrument(s), whichever is deemed more reliable. Also included in the estimated fair value of our 6.05% Subordinated Notes are amounts related to hedge accounting associated with the note.

Off-Balance Sheet Financial Instruments

The fair value of net available commitments to extend credit is estimated based on the average amount we would receive or pay to execute a new agreement with identical terms and pricing, while taking into account the counterparties' credit standing.

Letters of credit are carried at their fair value, which was equivalent to the residual premium or fee at June 30, 2013 and December 31, 2012. Commitments to extend credit and letters of credit typically result in loans with a market interest rate if funded.

Table of Contents

The following fair value hierarchy table presents the estimated fair values of our financial instruments that are not carried at fair value at June 30, 2013 and December 31, 2012:

(Dollars in thousands)	Carrying Amount	Estimated Fair Value		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
June 30, 2013:				
Financial assets:				
Cash and cash equivalents	\$873,251	\$873,251	\$—	\$—
Non-marketable securities (cost and equity method accounting)	390,410	—	—	440,085
Net commercial loans	8,643,961	—	—	8,794,118
Net consumer loans	858,640	—	—	890,101
FHLB and Federal Reserve Bank stock	40,532	—	—	40,532
Accrued interest receivable	68,571	—	68,571	—
Financial liabilities:				
Other short-term borrowings	5,400	5,400	—	—
Non-maturity deposits (1)	18,533,244	18,533,244	—	—
Time deposits	156,830	—	156,884	—
5.375% Senior Notes	348,101	—	383,684	—
6.05% Subordinated Notes (2)	52,728	—	57,559	—
7.0% Junior Subordinated Debentures	55,109	—	52,289	—
Accrued interest payable	6,586	—	6,586	—
Off-balance sheet financial assets:				
Commitments to extend credit	—	—	—	22,090
December 31, 2012:				
Financial assets:				
Cash and cash equivalents	\$1,008,983	\$1,008,983	\$—	\$—
Non-marketable securities (cost and equity method accounting)	391,253	—	—	425,741
Net commercial loans	8,013,563	—	—	8,180,597
Net consumer loans	822,719	—	—	860,772
FHLB and Federal Reserve Bank stock	39,806	—	—	39,806
Accrued interest receivable	64,167	—	64,167	—
Financial liabilities:				
Federal funds purchased	160,000	160,000	—	—
Other short-term borrowings	6,110	6,110	—	—
Non-maturity deposits (1)	19,021,264	19,021,264	—	—
Time deposits	155,188	—	155,027	—
5.375% Senior Notes	347,995	—	393,701	—
6.05% Subordinated Notes (2)	54,571	—	61,639	—
7.0% Junior Subordinated Debentures	55,196	—	51,959	—
Accrued interest payable	6,494	—	6,494	—
Off-balance sheet financial assets:				
Commitments to extend credit	—	—	—	20,562

(1) Includes noninterest-bearing demand deposits, interest-bearing checking accounts, money market accounts and interest-bearing sweep deposits.

At June 30, 2013 and December 31, 2012, included in the carrying value and estimated fair value of our 6.05% (2) Subordinated Notes was \$7.2 million and \$9.0 million, respectively, related to hedge accounting associated with the notes.

48

Table of Contents

Investments in Entities that Calculate Net Asset Value Per Share

FASB guidance over certain fund investments requires that we disclose the fair value of funds, significant investment strategies of the investees, redemption features of the investees, restrictions on the ability to sell investments, estimate of the period of time over which the underlying assets are expected to be liquidated by the investee, and unfunded commitments related to the investments.

Our investments in debt funds and venture capital and private equity fund investments generally cannot be redeemed. Alternatively, we expect distributions, if any, to be received primarily through IPOs and M&A activity of the underlying assets of the fund. We currently do not have any plans to sell any of these fund investments. If we decide to sell these investments in the future, the investee fund's management must approve of the buyer before the sale of the investments can be completed. The fair values of the fund investments have been estimated using the net asset value per share of the investments, adjusted for any differences between our measurement date and the date of the fund investment's net asset value by using the most recently available financial information from the investee general partner, for example March 31st, for our June 30th consolidated financial statements, adjusted for any contributions paid, distributions received from the investment, and significant fund transactions or market events during the reporting period.

The following table is a summary of the estimated fair values of these investments and remaining unfunded commitments for each major category of these investments as of June 30, 2013:

(Dollars in thousands)	Carrying Amount	Fair Value	Unfunded Commitments
Non-marketable securities (fair value accounting):			
Venture capital and private equity fund investments (1)	\$ 741,522	\$741,522	\$ 433,083
Non-marketable securities (equity method accounting):			
Other investments (2)	53,962	55,404	17,258
Non-marketable securities (cost method accounting):			
Venture capital and private equity fund investments (3)	156,391	203,847	46,512
Total	\$ 951,875	\$1,000,773	\$ 496,853

Venture capital and private equity fund investments within non-marketable securities (fair value accounting) include investments made by our managed funds of funds and one of our direct venture funds. These investments represent investments in venture capital and private equity funds that invest primarily in U.S. and global (1) technology and life sciences companies. Included in the fair value and unfunded commitments of fund investments under fair value accounting are \$663 million and \$425 million, respectively, attributable to noncontrolling interests. It is estimated that we will receive distributions from the fund investments over the next 10 to 13 years, depending on the age of the funds and any potential extensions of terms of the funds.

Other investments within non-marketable securities (equity method accounting) include investments in debt funds and venture capital and private equity fund investments that invest in or lend money to primarily U.S. and global (2) technology and life sciences companies. It is estimated that we will receive distributions from the fund investments over the next 10 to 13 years, depending on the age of the funds.

Venture capital and private equity fund investments within non-marketable securities (cost method accounting) include investments in venture capital and private equity fund investments that invest primarily in U.S. and global (3) technology and life sciences companies. It is estimated that we will receive distributions from the fund investments over the next 10 to 13 years, depending on the age of the funds and any potential extensions of the terms of the funds.

14. Legal Matters

Certain lawsuits and claims arising in the ordinary course of business have been filed or are pending against us or our affiliates. In accordance with applicable accounting guidance, we establish accruals for all lawsuits, claims and expected settlements when we believe it is probable that a loss has been incurred and the amount of the loss is reasonably estimable. When a loss contingency is not both probable and estimable, we do not establish an accrual.

Any such loss estimates are inherently uncertain, based on currently available information and are subject to management's judgment and various assumptions. Due to the inherent subjectivity of these estimates and unpredictability of outcomes of legal proceedings, any amounts accrued may not represent the ultimate resolution of such matters.

To the extent we believe any potential loss relating to such lawsuits and claims may have a material impact on our liquidity, consolidated financial position, results of operations, and/or our business as a whole and is reasonably possible but not probable,

Table of Contents

we disclose information relating to any such potential loss, whether in excess of any established accruals or where there is no established accrual. We also disclose information relating to any material potential loss that is probable but not reasonably estimable. Where reasonably practicable, we will provide an estimate of loss or range of potential loss. No disclosures are generally made for any loss contingencies that are deemed to be remote.

Based upon information available to us, our review of lawsuits and claims filed or pending against us to date and consultation with our outside legal counsel, we have not recognized a material accrual liability for these matters, nor do we currently expect it is reasonably possible that these matters will result in a material liability to the Company. However, the outcome of litigation and other legal and regulatory matters is inherently uncertain, and it is possible that one or more of such matters currently pending or threatened could have an unanticipated material adverse effect on our liquidity, consolidated financial position, results of operations, and/or our business as a whole, in the future.

15. Related Parties

SVB Financial has commitments under two partially-syndicated revolving line of credit facilities totaling \$85 million to Gold Hill Capital 2008 LP, a venture debt fund, and Gold Hill Venture Lending 2008 LP, for which SVB Financial has ownership interests in each of the funds. Of the \$85 million, \$35 million is syndicated to another lender. SVB Financial has an 11.5 percent direct ownership interest and a 4.0 percent indirect ownership interest in Gold Hill Capital 08 LP through our 83.8 percent interest in its general partner, Gold Hill Capital 08, LLC. The line of credit is secured and bears an interest rate of national Prime plus one percent. The highest outstanding balance under SVB Financial's portion of the facility for the six months ended June 30, 2013 was \$34 million. SVB Financial's portion of the outstanding balance was \$34 million at June 30, 2013, compared to \$31 million at December 31, 2012.

During the six months ended June 30, 2013, the Bank made loans to related parties, including certain companies in which certain of our directors or their affiliated venture funds are beneficial owners of ten percent or more of the equity securities of such companies. Such loans: (a) were made in the ordinary course of business; (b) were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons; and (c) did not involve more than the normal risk of collectability or present other unfavorable features. Additionally, we also provide real estate secured loans to eligible employees through our EHOP.

16. Subsequent Events

We have evaluated all material subsequent events and determined there are no events that require disclosure.

Table of Contents

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

Forward-Looking Statements

This Quarterly Report on Form 10-Q, including in particular "Management's Discussion and Analysis of Financial Condition and Results of Operations" under Part I, Item 2 of this report, contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Management has in the past and might in the future make forward-looking statements orally to analysts, investors, the media and others. Forward-looking statements are statements that are not historical facts. Broadly speaking, forward-looking statements include, but are not limited to, the following:

• Projections of our net interest income, noninterest income, earnings per share, noninterest expenses (including professional services, compliance, compensation and other costs), cash flows, balance sheet positions, capital expenditures, liquidity and capitalization or other financial items

• Descriptions of our strategic initiatives, plans or objectives for future operations, including pending sales or acquisitions

• Forecasts of venture capital/private equity funding and investment levels

• Forecasts of future interest rates, economic performance, and income from investments

• Forecasts of expected levels of provisions for loan losses, loan growth and client funds

• Descriptions of assumptions underlying or relating to any of the foregoing

In this Quarterly Report on Form 10-Q, we make forward-looking statements, including, but not limited to, those discussing our management's expectations about:

• Market and economic conditions (including interest rate environment, and levels of public offerings, mergers/acquisitions and venture capital financing activities) and the associated impact on us

• The sufficiency of our capital, including sources of capital (such as funds generated through retained earnings) and the extent to which capital may be used or required

• The adequacy of our liquidity position, including sources of liquidity (such as funds generated through retained earnings)

• The adequacy of our liquidity position, including sources of liquidity (such as funds generated through retained earnings)

• The realization, timing, valuation and performance of equity or other investments

• The likelihood that the market value of our impaired investments will recover

• Our intent to sell our investment securities prior to recovery of our cost basis, or the likelihood of such

Expected cash requirements for unfunded commitments to certain investments, including capital calls

• Our overall management of interest rate risk, including managing the sensitivity of our interest-earning assets and interest-bearing liabilities to interest rates, and the impact to earnings from a change in interest rates

• The credit quality of our loan portfolio, including levels and trends of nonperforming loans, impaired loans, criticized loans and troubled debt restructurings

• The adequacy of reserves (including allowance for loan and lease losses) and the appropriateness of our methodology for calculating such reserves

• The level of loan and deposit balances

• The level of client investment fees and associated margins

• The profitability of our products and services

• Our strategic initiatives, including the expansion of operations in China, India, Israel, the UK and elsewhere (such as our joint venture bank in China and our branch in the UK)

Table of Contents

The expansion and growth of our noninterest income sources

Distributions of venture capital, private equity or debt fund investment proceeds; intentions to sell such fund investments

The changes in, or adequacy of, our unrecognized tax benefits and any associated impact

The extent to which counterparties, including those to our forward and option contracts, will perform their contractual obligations

The effect of application of certain accounting pronouncements

The effect of lawsuits and claims

Regulatory developments, including the nature and timing of the adoption and effectiveness of new requirements under the Dodd-Frank Act (as defined below), Basel guidelines, and other applicable laws and regulations, and their potential impact on us

You can identify these and other forward-looking statements by the use of words such as “becoming,” “may,” “will,” “should,” “predicts,” “potential,” “continue,” “anticipates,” “believes,” “estimates,” “seeks,” “expects,” “plans,” “intends,” the negative or comparable terminology. Although we believe that the expectations reflected in these forward-looking statements are reasonable, we have based these expectations on our beliefs as well as our assumptions, and such expectations may prove to be incorrect. Our actual results of operations and financial performance could differ significantly from those expressed in or implied by our management’s forward-looking statements.

For information with respect to factors that could cause actual results to differ from the expectations stated in the forward-looking statements, see “Risk Factors” set forth in our Annual Report on Form 10-K for the year ended December 31, 2012 (“2012 Form 10-K”), as filed with the SEC. We urge investors to consider all of these factors carefully in evaluating the forward-looking statements contained in this report. All subsequent written or oral forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by these cautionary statements. The forward-looking statements included in this filing are made only as of the date of this filing. We assume no obligation and do not intend to revise or update any forward-looking statements contained in this Quarterly Report on Form 10-Q.

The following discussion and analysis of financial condition and results of operations should be read in conjunction with our interim unaudited consolidated financial statements and accompanying notes as presented in Part I, Item 1 of this report and in conjunction with our 2012 Form 10-K.

Reclassifications

Certain prior period amounts have been reclassified to conform to current period presentations.

Management’s Overview of Second Quarter 2013 Performance

Overall, we had a strong second quarter of 2013, which reflected the strength of our clients and our business. We had net income available to common stockholders of \$48.6 million and diluted EPS was \$1.06. This compares to diluted EPS of \$1.06 in the second quarter of 2012, however the second quarter of 2012 included gains of \$0.12 from the sale of certain available for sale securities and the sale of certain assets related to our equity management services business. In the second quarter of 2013, compared to the second quarter of 2012, we experienced strong growth in net interest income as a result of exceptional loan growth with a record high average balance of \$9.0 billion. Our total client funds (which consist of on-balance sheet deposits and off-balance sheet client investment funds) increased to an all time high of \$42.7 billion as of June 30, 2013, reflecting growth from our existing clients and the addition of new clients. In addition, overall credit quality remained strong, and we saw growth in fee income and solid gains from our investment securities and equity warrant assets. Additionally, our liquidity and capital ratios continued to remain strong.

Second quarter 2013 results (compared to the second quarter 2012, where applicable) included:

Continued strong growth in our lending business with record high average loan balances of \$9.0 billion, an increase of \$1.8 billion, or 24.7 percent.

Average total client funds (including both average on-balance sheet deposits and off-balance sheet client investment funds) of \$41.8 billion, an increase of \$4.5 billion, or 12.2 percent.

Table of Contents

Net interest income (fully taxable equivalent basis) of \$170.5 million, an increase of \$18.1 million, or 11.9 percent, primarily due to an increase in interest income from loans attributable to growth in average balances, partially offset by lower overall loan yield. See “Results of Operations—Net Interest Income and Margin” for further details.

Net interest margin of 3.40 percent, an increase of 18 basis points, primarily reflective of a favorable shift in the mix of our interest-earning assets (higher average loan balances, lower average balances of cash and available-for-sale securities) and lower premium amortization expense on available-for-sale securities, partially offset by lower overall loan yield.

A provision for loan losses of \$18.6 million, compared to \$8.0 million. The provision of \$18.6 million for the second quarter of 2013 was primarily driven by \$8.8 million for period-end loan growth, as well as to provide for net charge-offs and a modest increase in our reserve for impaired loans.

Core fee income (deposit service charges, letters of credit fees, credit card fees, client investment fees, and foreign exchange fees) of \$36.5 million, an increase of \$3.2 million, or 9.7 percent. This increase reflects increased client activity and continued growth in our business, primarily from credit card fees, foreign exchange fees and deposit service charges. See “Results of Operations—Noninterest Income” for a description and non-GAAP reconciliation of core fee income.

Gains on investment securities of \$40.6 million, compared to \$25.8 million. Non-GAAP gains on investment securities, net of noncontrolling interests, were \$9.5 million, compared to \$11.3 million. The gains of \$11.3 million for the three months ended June 30, 2012 included gains of \$5.0 million from the sale of certain available-for-sale securities. See “Results of Operations—Noninterest Income—Gains on Investment Securities, Net” for further details and a non-GAAP reconciliation of gains on investment securities, net of noncontrolling interests.

Noninterest expense of \$143.3 million, an increase of \$7.5 million, or 5.5 percent. The increase was primarily driven by higher compensation expenses as a result of an increase in average full-time equivalent employees (“FTEs”), as well as increased premises and equipment expenses to support continued growth in our business and IT infrastructure initiatives. Average FTEs increased by 5.8 percent to 1,657 FTEs for the three months ended June 30, 2013, compared to 1,566 FTEs for the comparable 2012 period.

Overall, our liquidity remained strong based on the attributes of our period end available-for-sale securities portfolio, which totaled \$10.0 billion at June 30, 2013. Our available-for-sale securities portfolio continued to be a good source of liquidity as it was invested in high quality investments and generated steady monthly cash flows. Additionally, our available-for-sale securities portfolio continued to provide us with the ability to secure wholesale borrowings, as needed.

Overall, SVB Financial and the Bank continued to maintain strong capital positions. The Bank's Tier 1 leverage ratio increased from December 31, 2012 by 60 basis points to 7.66 percent at June 30, 2013, primarily reflective of strong earnings, while average assets remained relatively flat.

A summary of our performance for the three and six months ended June 30, 2013 and 2012 is as follows:

(Dollars in thousands, except per share data and ratios)	Three months ended June 30,			Six months ended June 30,		
	2013	2012	% Change	2013	2012	% Change
Income Statement:						
Diluted earnings per share	\$ 1.06	\$ 1.06	— %	\$ 1.96	\$ 1.85	5.9 %
Net income available to common stockholders	48,584	47,603	2.1	89,475	82,393	8.6
Net interest income	170,081	151,934	11.9	333,250	302,871	10.0
Net interest margin	3.40	% 3.22	% 18 bps	3.32	% 3.26	% 6 bps
Provision for loan losses	\$ 18,572	\$ 7,999	132.2 %	\$ 24,385	\$ 22,528	8.2 %
Noninterest income	98,239	80,426	22.1	176,843	139,719	26.6
Noninterest expense	143,292	135,766	5.5	292,306	267,778	9.2
Non-GAAP net income available to common stockholders (1)	48,584	42,069	15.5	89,475	76,859	16.4

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Non-GAAP diluted earnings per share (1)	1.06	0.94	12.8	1.96	1.72	14.0
Non-GAAP noninterest income, net of noncontrolling interest and excluding gains on sales of certain assets (2)	67,488	57,844	16.7	123,602	109,219	13.2

53

Table of Contents

Non-GAAP noninterest expense, net of noncontrolling interest (3)	140,425	131,819	6.5		286,579	261,013	9.8	
Balance Sheet:								
Average loans, net of unearned income	\$9,022,173	\$7,237,182	24.7	%	\$8,852,488	\$7,020,765	26.1	%
Average noninterest-bearing demand deposits	13,257,481	12,264,003	8.1		13,321,635	12,145,000	9.7	
Average interest-bearing deposits	5,356,689	5,143,633	4.1		5,377,733	5,041,700	6.7	
Average total deposits	18,614,170	17,407,636	6.9		18,699,368	17,186,700	8.8	
Earnings Ratios:								
Return on average assets (annualized) (4)	0.88	% 0.92	% (4.3)	%	0.81	% 0.81	% —	%
Return on average SVBFG stockholders' equity (annualized) (5)	10.12	11.21	(9.7)		9.52	9.95	(4.3)	
Asset Quality Ratios:								
Allowance for loan losses as a percentage of total period-end gross loans	1.23	% 1.25	% (2)	bps	1.23	% 1.25	% (2)	bps
Allowance for loan losses for performing loans as a percentage of total gross performing loans	1.13	1.18	(5)		1.13	1.18	(5)	
Gross loan charge-offs as a percentage of average total gross loans (annualized)	0.68	0.78	(10)		0.47	0.60	(13)	
Net loan charge-offs as a percentage of average total gross loans (annualized)	0.49	0.59	(10)		0.35	0.41	(6)	
Capital Ratios:								
Total risk-based capital ratio	14.03	% 13.85	% 18	bps	14.03	% 13.85	% 18	bps
Tier 1 risk-based capital ratio	12.84	12.62	22		12.84	12.62	22	
Tier 1 leverage ratio	8.78	8.07	71		8.78	8.07	71	
Tangible common equity to tangible assets (6)	8.34	8.06	28		8.34	8.06	28	
Tangible common equity to risk-weighted assets (6)	12.73	13.35	(62)		12.73	13.35	(62)	
Bank total risk-based capital ratio	12.42	12.24	18		12.42	12.24	18	
Bank tier 1 risk-based capital ratio	11.20	10.98	22		11.20	10.98	22	
Bank tier 1 leverage ratio	7.66	7.01	65		7.66	7.01	65	
Bank tangible common equity to tangible assets (6)	7.60	7.39	21		7.60	7.39	21	
Bank tangible common equity to risk-weighted assets (6)	11.18	11.86	(68)		11.18	11.86	(68)	
Other Ratios:								

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Operating efficiency ratio (7)	53.32	% 58.31	% (8.6)%	57.21	% 60.37	% (5.2)%
Non-GAAP operating efficiency ratio (3)	59.01	62.70	(5.9)	62.62	63.20	(0.9)
Book value per common share (8)	\$40.65	\$38.63	5.2	\$40.65	\$38.63	5.2
Other Statistics:						
Average full-time equivalent employees	1,657	1,566	5.8 %	1,656	1,561	6.1 %
Period-end full-time equivalent employees	1,657	1,562	6.1	1,657	1,562	6.1

See "Non-GAAP Net Income and Non-GAAP Diluted Earnings Per Common Share" for a description and (1) reconciliation of non-GAAP net income available to common stockholders and non-GAAP diluted earnings per share.

(2) See "Results of Operations–Noninterest Income" for a description and reconciliation of non-GAAP noninterest income.

(3) See "Results of Operations–Noninterest Expense" for a description and reconciliation of non-GAAP noninterest expense and non-GAAP operating efficiency ratio.

(4) Ratio represents annualized consolidated net income available to common stockholders divided by quarterly and year-to-date average assets.

(5) Ratio represents annualized consolidated net income available to common stockholders divided by quarterly and year-to-date average SVBFG stockholders' equity.

(6) See "Capital Resources–Capital Ratios" for a reconciliation of non-GAAP tangible common equity to tangible assets and tangible common equity to risk-weighted assets.

(7) The operating efficiency ratio is calculated by dividing total noninterest expense by total taxable-equivalent net interest income plus noninterest income.

(8) Book value per common share is calculated by dividing total SVBFG stockholders' equity by total outstanding common shares at period-end.

Table of Contents

Non-GAAP Net Income and Non-GAAP Diluted Earnings Per Common Share

We use and report non-GAAP net income and non-GAAP diluted earnings per common share, which excludes gains from sales of certain available-for-sale securities and gains from the sale of certain assets related to our equity management services business. We believe these non-GAAP financial measures, when taken together with the corresponding GAAP financial measures, provide meaningful supplemental information regarding our performance by excluding certain items that do not occur every reporting period. Our management uses, and believes that investors benefit from referring to, these non-GAAP financial measures in assessing our operating results and related trends, and when planning, forecasting and analyzing future periods. However, these non-GAAP financial measures should be considered in addition to, not as a substitute for or preferable to, financial measures prepared in accordance with GAAP.

A reconciliation of GAAP to non-GAAP net income available to common stockholders and non-GAAP diluted earnings per common share for the three and six months ended June 30, 2013 and 2012 is as follows:

(Dollars in thousands, except per share data and ratios)	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
Net income available to common stockholders	\$48,584	\$47,603	\$89,475	\$82,393
Less: gains on sales of certain available-for-sale securities (1)	—	(4,955)	—	(4,955)
Tax impact of gains on sales of certain available-for-sale securities	—	1,974	—	1,974
Less: gains on the sale of certain assets related to our equity management services business (2)	—	(4,243)	—	(4,243)
Tax impact of gains on the sale of certain assets related to our equity management services business	—	1,690	—	1,690
Non-GAAP net income available to common stockholders	\$48,584	\$42,069	\$89,475	\$76,859
GAAP earnings per common share—diluted	\$1.06	\$1.06	\$1.96	\$1.85
Less: gains on sales of certain available-for-sale securities (1)	—	(0.11)	—	(0.11)
Tax impact of gains on sales of certain available-for-sale securities	—	0.05	—	0.04
Less: gains on the sale of certain assets related to our equity management services business (2)	—	(0.10)	—	(0.10)
Tax impact of gains on the sale of certain assets related to our equity management services business	—	0.04	—	0.04
Non-GAAP earnings per common share—diluted	\$1.06	\$0.94	\$1.96	\$1.72
Weighted average diluted common shares outstanding	45,684,205	44,711,895	45,537,349	44,572,656

(1) Gains on the sale of \$316 million in certain available-for-sale securities in the second quarter of 2012.

(2) Net gains of \$4.2 million from the sale of certain assets related to our equity management services business in the second quarter of 2012.

Critical Accounting Policies and Estimates

The accompanying management's discussion and analysis of results of operations and financial condition is based upon our unaudited interim consolidated financial statements, which have been prepared in accordance with GAAP. The preparation of these financial statements in accordance with GAAP requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosure of

contingent assets and liabilities. Management evaluates estimates and assumptions on an ongoing basis. Management bases its estimates on historical experiences and various other factors and assumptions that are believed to be reasonable under the circumstances. Actual results may differ materially from these estimates under different assumptions or conditions.

There have been no significant changes during the six months ended June 30, 2013 to the items that we disclosed as our critical accounting policies and estimates in “Management’s Discussion and Analysis of Financial Condition and Results of Operations” under Part II, Item 7 of our 2012 Form 10-K.

Table of Contents

Results of Operations

Net Interest Income and Margin (Fully Taxable Equivalent Basis)

Net interest income is defined as the difference between interest earned on loans, available-for-sale securities and short-term investment securities, and interest paid on funding sources. Net interest income is our principal source of revenue. Net interest margin is defined as the amount of annualized net interest income, on a fully taxable equivalent basis, expressed as a percentage of average interest-earning assets. Net interest income and net interest margin are presented on a fully taxable equivalent basis to consistently reflect income from taxable loans and securities and tax-exempt securities based on the federal statutory tax rate of 35.0 percent.

Analysis of Net Interest Income Changes Due to Volume and Rate (Fully Taxable Equivalent Basis)

Net interest income is affected by changes in the amount and mix of interest-earning assets and interest-bearing liabilities, referred to as “volume change.” Net interest income is also affected by changes in yields earned on interest-earning assets and rates paid on interest-bearing liabilities, referred to as “rate change.” The following table sets forth changes in interest income for each major category of interest-earning assets and interest expense for each major category of interest-bearing liabilities. The table also reflects the amount of simultaneous changes attributable to both volume and rate changes for the years indicated. For this table, changes that are not solely due to either volume or rate are allocated in proportion to the percentage changes in average volume and average rate.

(Dollars in thousands)	2013 Compared to 2012 Three months ended June 30, increase (decrease) due to change in			2013 Compared to 2012 Six months ended June 30, increase (decrease) due to change in		
	Volume	Rate	Total	Volume	Rate	Total
Interest income:						
Federal Reserve deposits, federal funds sold, securities purchased under agreements to resell and other short-term investment securities	\$ (200)	\$ 22	\$ (178)	\$ (524)	\$ 27	\$ (497)
Available-for-sale securities (taxable)	(2,025)	2,610	585	(572)	(466)	(1,038)
Available-for-sale securities (non-taxable)	(134)	(8)	(142)	(268)	(29)	(297)
Loans, net of unearned income	26,802	(8,952)	17,850	53,763	(21,630)	32,133
Increase (decrease) in interest income, net	24,443	(6,328)	18,115	52,399	(22,098)	30,301
Interest expense:						
NOW deposits	37	6	43	58	23	81
Money market deposits	396	92	488	801	253	1,054
Money market deposits in foreign offices	3	(1)	2	(6)	(1)	(7)
Time deposits	22	(34)	(12)	43	(62)	(19)
Sweep deposits in foreign offices	(50)	—	(50)	(68)	—	(68)
Total increase in deposits expense	408	63	471	828	213	1,041
Short-term borrowings	(163)	96	(67)	(93)	43	(50)
5.375% Senior Notes	6	1	7	2	11	13
Junior Subordinated Debentures	—	1	1	(7)	8	1
5.70% Senior Notes	(360)	—	(360)	(863)	—	(863)
6.05% Subordinated Notes	(2)	(6)	(8)	(5)	(17)	(22)
Other long-term debt	(26)	—	(26)	(94)	—	(94)
Total (decrease) increase in borrowings expense	(545)	92	(453)	(1,060)	45	(1,015)
(Decrease) increase in interest expense, net	(137)	155	18	(232)	258	26
Increase (decrease) in net interest income	\$ 24,580	\$ (6,483)	\$ 18,097	\$ 52,631	\$ (22,356)	\$ 30,275

Table of Contents

Net Interest Income (Fully Taxable Equivalent Basis)

Three months ended June 30, 2013 and 2012

Net interest income increased by \$18.1 million to \$170.5 million for the three months ended June 30, 2013, compared to \$152.4 million for the comparable 2012 period. Overall, we saw an increase in our net interest income primarily due to strong growth in average loan balances, partially offset by lower overall loan yield.

The main factors affecting interest income and interest expense for the three months ended June 30, 2013, compared to the comparable 2012 period are discussed below:

Interest income for the three months ended June 30, 2013 increased by \$18.1 million primarily due to:

A \$17.9 million increase in interest income on loans to \$131.8 million for the three months ended June 30, 2013, compared to \$113.9 million for the comparable 2012 period. \$26.8 million of this increase was driven by an increase in average loan balances of \$1.8 billion, partially offset by a decrease of \$9.0 million from lower overall loan yield.

Overall loan yield decreased 47 basis points to 5.86 percent for the three months ended June 30, 2013, compared to 6.33 percent for the comparable 2012 period. The decrease in overall loan yield was reflective of a continued change in the mix of our loans that are indexed to the national Prime rate instead of the SVB Prime rate. Additionally, the loan yield was impacted by our success in growing our later stage client portfolio, which typically is benchmarked to the three-month LIBOR and bears lower credit risk and therefore lower relative yield.

A \$0.4 million increase in interest income on available-for-sale securities to \$45.9 million for the three months ended June 30, 2013, compared to \$45.5 million for the comparable 2012 period. The increase was reflective of a 10 basis points increase in the overall yield of our available-for-sale securities portfolio, partially offset by a decrease related to a \$506 million decrease in average balances. The increase of 10 basis points in the overall yield was comprised of an increase of 32 basis points from lower premium amortization expense, partially offset by a 22 basis point decrease in coupon yields. Premium amortization expense decreased by \$8.9 million to \$6.5 million for the three months ended June 30, 2013, compared to \$15.4 million for the comparable 2012 period. As of June 30, 2013, the remaining unamortized premium balance on our available-for-sale securities portfolio was \$100 million. The decrease in coupon yields was driven by paydowns of higher-yielding securities.

Interest expense for the three months ended June 30, 2013 remained flat at \$7.9 million. The items impacting interest expense were as follows:

An increase in interest expense from interest-bearing deposits of \$0.5 million, mainly attributable to growth in our average interest-bearing deposits of \$213 million.

A decrease in interest expense of \$0.4 million related to our long-term debt, mainly attributable to the repayment of our 5.70% Senior Notes, which matured on June 1, 2012.

Six months ended June 30, 2013 and 2012

Net interest income increased by \$30.3 million to \$334.1 million for the six months ended June 30, 2013, compared to \$303.8 million for the comparable 2012 period. Overall, we saw an increase in our net interest income primarily due to strong growth in average loan balances, partially offset by lower overall loan yield.

The main factors affecting interest income and interest expense for the six months ended June 30, 2013, compared to the comparable 2012 period are discussed below:

Interest income for the six months ended June 30, 2013 increased by \$30.3 million primarily due to:

A \$32.1 million increase in interest income on loans to \$255.5 million for the six months ended June 30, 2013, compared to \$223.4 million for the comparable 2012 period. \$53.8 million of this increase was driven by an increase in average loan balances of \$1.8 billion, partially offset by a decrease of \$21.6 million from lower overall loan yield.

Overall loan yield decreased 58 basis points to 5.82 percent for the six months ended June 30, 2013, compared to 6.40 percent for the comparable 2012 period. The decrease in overall loan yield was reflective of a continued change in the mix of our loans that are indexed to the national Prime rate instead of the SVB Prime rate. Additionally, the loan yield was impacted by our success in growing our later stage client portfolio, which typically is benchmarked to the three-month LIBOR and bears lower credit risk and therefore lower relative yield.

A \$1.3 million decrease in interest income on available-for-sale securities to \$92.9 million for the six months ended June 30, 2013, compared to \$94.2 million for the comparable 2012 period. The decrease was reflective of a \$59.3 million decline in average balances and a 1 basis point decrease in the overall yield of our available-

Table of Contents

for-sale securities portfolio. The decrease of 1 basis point in the overall yield was comprised of a 20 basis point decrease in coupon yields, partially offset by an increase of 19 basis points from lower premium amortization expense. The decrease in coupon yields was driven by paydowns of higher-yielding securities. Premium amortization expense decreased by \$10.4 million to \$14.9 million for the six months ended June 30, 2013, compared to \$25.3 million for the comparable 2012 period.

Interest expense for the six months ended June 30, 2013 remained flat at \$15.7 million. The items impacting interest expense were as follows:

An increase in interest expense from interest-bearing deposits of \$1.0 million, mainly attributable to growth in our average interest-bearing deposits of \$336 million.

A decrease in interest expense of \$1.0 million related to our long-term debt, mainly attributable to the repayment of our 5.70% Senior Notes, which matured on June 1, 2012.

Net Interest Margin (Fully Taxable Equivalent Basis)

Our net interest margin increased by 18 basis points to 3.40 percent for the three months ended June 30, 2013, compared to 3.22 percent for the comparable 2012 period. The increase in our net interest margin was primarily reflective of a favorable shift in the mix of our interest-earning assets (higher average loan balances, lower average balances of cash and available-for-sale securities) and lower premium amortization expense on available-for-sale securities, partially offset by lower overall loan yield. Our loan portfolio (higher-yielding assets) comprised 44.8 percent of our average interest-earning assets during the three months ended June 30, 2013, compared to 38.0 percent for the comparable 2012 period.

Our net interest margin increased by 6 basis points to 3.32 percent for the six months ended June 30, 2013, compared to 3.26 percent for the comparable 2012 period. The increase in our net interest margin was primarily reflective of a favorable shift in the mix of our interest-earning assets (higher average loan balances, lower average balances of cash and available-for-sale securities) and lower premium amortization expense on available-for-sale securities, partially offset by lower overall loan yield. Our loan portfolio (higher-yielding assets) comprised 43.7 percent of our average interest-earning assets during the six months ended June 30, 2013, compared to 37.4 percent for the comparable 2012 period.

Average Balances, Yields and Rates Paid (Fully Taxable Equivalent Basis)

The average yield earned on interest-earning assets is the amount of annualized fully taxable equivalent interest income expressed as a percentage of average interest-earning assets. The average rate paid on funding sources is the amount of annualized interest expense expressed as a percentage of average funding sources. The following tables set forth average assets, liabilities, noncontrolling interests and SVBFG stockholders' equity, interest income, interest expense, annualized yields and rates, and the composition of our annualized net interest margin for the three and six months ended June 30, 2013 and 2012:

Table of Contents

Average Balances, Rates and Yields for the Three Months Ended June 30, 2013 and 2012

(Dollars in thousands)	Three months ended June 30, 2013			2012		
	Average Balance	Interest Income/ Expense	Yield/ Rate	Average Balance	Interest Income/ Expense	Yield/ Rate
Interest-earning assets:						
Federal Reserve deposits, federal funds sold, securities purchased under agreements to resell and other short-term investment securities (1)	\$693,297	\$734	0.42 %	\$885,173	\$912	0.41 %
Available-for-sale securities: (2)						
Taxable	10,342,873	44,657	1.73	10,839,571	44,072	1.64
Non-taxable (3)	82,943	1,242	6.01	92,123	1,384	6.04
Total loans, net of unearned income (4) (5)	9,022,173	131,785	5.86	7,237,182	113,935	6.33
Total interest-earning assets	20,141,286	178,418	3.55	19,054,049	160,303	3.39
Cash and due from banks	299,886			275,921		
Allowance for loan losses	(118,635)			(106,019)		
Other assets (6)	1,770,761			1,666,925		
Total assets	\$22,093,298			\$20,890,876		
Funding sources:						
Interest-bearing liabilities:						
NOW deposits	\$140,725	\$122	0.35 %	\$97,675	\$79	0.33 %
Money market deposits	3,220,618	1,552	0.19	2,676,432	1,064	0.16
Money market deposits in foreign offices	133,084	32	0.10	120,323	30	0.10
Time deposits	179,361	169	0.38	158,743	181	0.46
Sweep deposits in foreign offices	1,682,901	210	0.05	2,090,460	260	0.05
Total interest-bearing deposits	5,356,689	2,085	0.16	5,143,633	1,614	0.13
Short-term borrowings	24,019	43	0.72	221,863	110	0.20
5.375% Senior Notes	348,066	4,823	5.56	347,860	4,816	5.57
Junior Subordinated Debentures	55,138	832	6.05	55,313	831	6.04
5.70% Senior Notes	—	—	—	95,322	360	1.52
6.05% Subordinated Notes	53,766	119	0.89	54,900	127	0.93
Other long-term debt	—	—	—	494	26	21.17
Total interest-bearing liabilities	5,837,678	7,902	0.54	5,919,385	7,884	0.54
Portion of noninterest-bearing funding sources	14,303,608			13,134,664		
Total funding sources	20,141,286	7,902	0.16	19,054,049	7,884	0.17
Noninterest-bearing funding sources:						
Demand deposits	13,257,481			12,264,003		
Other liabilities	290,381			286,814		
SVBFG stockholders' equity	1,924,902			1,707,321		
Noncontrolling interests	782,856			713,353		
Portion used to fund interest-earning assets	(14,303,608)			(13,134,664)		
Total liabilities, noncontrolling interest, and SVBFG stockholders' equity	\$22,093,298			\$20,890,876		
Net interest income and margin		\$170,516	3.40 %		\$152,419	3.22 %
Total deposits	\$18,614,170			\$17,407,636		

Reconciliation to reported net interest
income:

Adjustments for taxable equivalent basis	(435)	(485)
Net interest income, as reported	\$170,081	\$151,934

(1) Includes average interest-earning deposits in other financial institutions of \$157 million and \$289 million for the three months ended June 30, 2013 and 2012, respectively. For the three months ended June 30, 2013 and 2012, balances also include \$404 million and \$395 million, respectively, deposited at the Federal Reserve Bank, earning interest at the Federal Funds target rate.

(2) Yields on available-for-sale securities are based on amortized cost, and therefore do not give effect to unrealized changes in fair value that are reflected in other comprehensive income.

(3) Interest income on non-taxable available-for-sale securities is presented on a fully taxable-equivalent basis using the federal statutory income tax rate of 35.0 percent for all periods presented.

(4) Nonaccrual loans are reflected in the average balances of loans.

(5) Interest income includes loan fees of \$20.3 million and \$20.5 million for the three months ended June 30, 2013 and 2012, respectively.

(6) Average investment securities of \$1.4 billion and \$1.3 billion for the three months ended June 30, 2013 and 2012, respectively, were classified as other assets as they were noninterest-earning assets. These investments primarily consisted of non-marketable securities.

Table of Contents

Average Balances, Rates and Yields for the Six Months Ended June 30, 2013 and 2012

(Dollars in thousands)	Six months ended June 30, 2013			2012		
	Average Balance	Interest Income/ Expense	Yield/ Rate	Average Balance	Interest Income/ Expense	Yield/ Rate
Interest-earning assets:						
Federal Reserve deposits, federal funds sold, securities purchased under agreements to resell and other short-term investment securities (1)	\$757,501	\$1,453	0.39 %	\$1,028,291	\$1,950	0.38 %
Available-for-sale securities: (2)						
Taxable	10,572,031	90,409	1.72	10,622,524	91,447	1.73
Non-taxable (3)	83,374	2,471	5.98	92,179	2,768	6.04
Total loans, net of unearned income (4) (5)	8,852,488	255,529	5.82	7,020,765	223,396	6.40
Total interest-earning assets	20,265,394	349,862	3.48	18,763,759	319,561	3.43
Cash and due from banks	289,590			297,248		
Allowance for loan losses	(117,069)			(99,929)		
Other assets 6(	1,765,402			1,600,631		
Total assets	\$22,203,317			\$20,561,709		
Funding sources:						
Interest-bearing liabilities:						
NOW deposits	\$138,095	\$239	0.35 %	\$101,086	\$158	0.31 %
Money market deposits	3,132,310	3,047	0.20	2,573,607	1,993	0.16
Money market deposits in foreign offices	124,420	60	0.10	136,452	67	0.10
Time deposits	175,900	342	0.39	155,682	361	0.47
Sweep deposits in foreign offices	1,807,008	448	0.05	2,074,873	516	0.05
Total interest-bearing deposits	5,377,733	4,136	0.16	5,041,700	3,095	0.12
Short-term borrowings	49,339	71	0.29	124,639	121	0.20
5.375% Senior Notes	348,040	9,644	5.59	347,835	9,631	5.57
Junior Subordinated Debentures	55,159	1,664	6.08	55,335	1,663	6.04
5.70% Senior Notes	—	—	—	119,403	863	1.45
6.05% Subordinated Notes	54,023	232	0.87	55,076	254	0.93
Other long-term debt	—	—	—	967	94	19.55
Total interest-bearing liabilities	5,884,294	15,747	0.54	5,744,955	15,721	0.55
Portion of noninterest-bearing funding sources	14,381,100			13,018,804		
Total funding sources	20,265,394	15,747	0.16	18,763,759	15,721	0.17
Noninterest-bearing funding sources:						
Demand deposits	13,321,635			12,145,000		
Other liabilities	324,954			306,746		
SVBFG stockholders' equity	1,895,768			1,665,789		
Noncontrolling interests	776,666			699,219		
Portion used to fund interest-earning assets	(14,381,100)			(13,018,804)		
Total liabilities, noncontrolling interest, and SVBFG stockholders' equity	\$22,203,317			\$20,561,709		
Net interest income and margin		\$334,115	3.32 %		\$303,840	3.26 %
Total deposits	\$18,699,368			\$17,186,700		

Reconciliation to reported net interest
income:

Adjustments for taxable equivalent basis	(865)	(969)
Net interest income, as reported	\$333,250	\$302,871

(1) Includes average interest-earning deposits in other financial institutions of \$167 million and \$311 million for the six months ended June 30, 2013 and 2012, respectively. For the six months ended June 30, 2013 and 2012, balances also include \$389 million and \$495 million, respectively, deposited at the Federal Reserve Bank, earning interest at the Federal Funds target rate.

(2) Yields on available-for-sale securities are based on amortized cost, and therefore do not give effect to unrealized changes in fair value that are reflected in other comprehensive income.

(3) Interest income on non-taxable available-for-sale securities is presented on a fully taxable-equivalent basis using the federal statutory income tax rate of 35.0 percent for all periods presented.

(4) Nonaccrual loans are reflected in the average balances of loans.

(5) Interest income includes loan fees of \$37.1 million and \$37.6 million for the six months ended June 30, 2013 and 2012, respectively.

(6) Average investment securities of \$1.4 billion and 1.2 billion for the six months ended June 30, 2013 and 2012, respectively, were classified as other assets as they were noninterest-earning assets. These investments primarily consisted of non-marketable securities.

Table of Contents

Provision for Loan Losses

Our provision for loan losses is based on our evaluation of the existing allowance for loan losses in relation to total gross loans using historical and other objective information, and on our qualitative assessment of the inherent and identified credit risks of the loan portfolio. The following table summarizes our allowance for loan losses for the three and six months ended June 30, 2013 and 2012:

(Dollars in thousands)	Three months ended June 30,		Six months ended June 30,		
	2013	2012	2013	2012	
Allowance for loan losses, beginning balance	\$ 112,205	\$ 100,922	\$ 110,651	\$ 89,947	
Provision for loan losses	18,572	7,999	24,385	22,528	
Gross loan charge-offs	(15,375)	(14,130)	(21,001)	(21,120)	
Loan recoveries	4,169	3,375	5,536	6,811	
Allowance for loan losses, ending balance	\$ 119,571	\$ 98,166	\$ 119,571	\$ 98,166	
Provision for loan losses as a percentage of period-end total gross loans (annualized)	0.77	% 0.41	% 0.51	% 0.58	%
Gross loan charge-offs as a percentage of average total gross loans (annualized)	0.68	0.78	0.47	0.60	
Net loan charge-offs as a percentage of average total gross loans (annualized)	0.49	0.59	0.35	0.41	
Allowance for loan losses as a percentage of period-end total gross loans	1.23	1.25	1.23	1.25	
Period-end total gross loans	\$ 9,705,464	\$ 7,857,468	\$ 9,705,464	\$ 7,857,468	
Average total gross loans	9,100,420	7,297,446	8,929,012	7,079,284	

Our provision for loan losses was \$18.6 million for the three months ended June 30, 2013, compared to a provision of \$8.0 million for the comparable 2012 period. The provision of \$18.6 million for the three months ended June 30, 2013 was primarily driven by \$8.8 million for period-end loan growth, as well as to provide for net charge-offs and a modest increase in our reserve for impaired loans. The provision of \$8.0 million for the three months ended June 30, 2012 was primarily attributable to period-end loan growth. Gross loan charge-offs of \$15.4 million for the three months ended June 30, 2013 were primarily from our other commercial loan and hardware portfolios. Loan recoveries of \$4.2 million for the three months ended June 30, 2013 were largely driven by a single recovery from our other commercial loan portfolio.

Our provision for loan losses was \$24.4 million for the six months ended June 30, 2013, compared to a provision of \$22.5 million for the comparable 2012 period. The provision of \$24.4 million for the six months ended June 30, 2013 was primarily driven by net charge-offs of \$15.5 million and period-end loan growth. The provision of \$22.5 million for the six months ended June 30, 2012 was primarily driven by net charge-offs of \$14.3 million and period-end loan growth.

See “Consolidated Financial Condition—Credit Quality and Allowance for Loan Losses” below and Note 6—“Loans and Allowance for Loan Losses” of the “Notes to Interim Consolidated Financial Statements (unaudited)” under Part I, Item 1 of this report for further details on our allowance for loan losses.

Table of Contents

Noninterest Income

A summary of noninterest income for the three and six months ended June 30, 2013 and 2012 is as follows:

(Dollars in thousands)	Three months ended June 30,			Six months ended June 30,			
	2013	2012	% Change	2013	2012	% Change	
Core fee income:							
Foreign exchange fees	\$ 12,778	\$ 12,031	6.2	% \$ 26,226	\$ 24,134	8.7	%
Deposit service charges	8,907	8,369	6.4	17,700	16,465	7.5	
Credit card fees	7,609	6,169	23.3	15,057	11,837	27.2	
Letters of credit and standby letters of credit income	3,654	3,296	10.9	7,089	6,932	2.3	
Client investment fees	3,524	3,375	4.4	6,999	6,272	11.6	
Total core fee income (1)	36,472	33,240	9.7	73,071	65,640	11.3	
Gains on investment securities, net	40,561	25,809	57.2	67,999	33,648	102.1	
Gains on derivative instruments, net	8,976	8,713	3.0	20,016	14,689	36.3	
Other	12,230	12,664	(3.4	) 15,757	25,742	(38.8)
Total noninterest income	\$ 98,239	\$ 80,426	22.1	\$ 176,843	\$ 139,719	26.6	

Core fee income represents noninterest income, but excludes certain line items where performance is typically subject to market or other conditions beyond our control. We do not provide our outlook for the expected full year (1) results for these excluded items, which include gains on investment securities, net, gains on derivative instruments, net, and other noninterest income items. The following table provides a reconciliation of GAAP noninterest income to non-GAAP core fee income:

(Dollars in thousands)	Three months ended June 30,			Six months ended June 30,			
	2013	2012	% Change	2013	2012	% Change	
GAAP noninterest income (as reported)	\$ 98,239	\$ 80,426	22.1	% \$ 176,843	\$ 139,719	26.6	%
Less: gains on investment securities, net	40,561	25,809	57.2	67,999	33,648	102.1	
Less: gains on derivative instruments, net	8,976	8,713	3.0	20,016	14,689	36.3	
Less: other noninterest income	12,230	12,664	(3.4	) 15,757	25,742	(38.8)
Non-GAAP core fee income	\$ 36,472	\$ 33,240	9.7	\$ 73,071	\$ 65,640	11.3	

Included in net income is income and expense attributable to noncontrolling interests. We recognize, as part of our investment funds management business through SVB Capital, the entire income or loss from funds where we own significantly less than 100% of the investment. We are required under GAAP to consolidate 100% of the results of entities that we are deemed to control, even though we may own less than 100% of such entities. The relevant amounts attributable to investors other than us are reflected under "Net Income Attributable to Noncontrolling Interests" on our statements of income. The non-GAAP tables presented below, for noninterest income and net gains on investment securities, all exclude noncontrolling interests. We believe these non-GAAP financial measures, when taken together with the corresponding GAAP financial measures, provide meaningful supplemental information regarding our performance by excluding certain items that represent income attributable to investors other than us and our subsidiaries. Our management uses, and believes that investors benefit from referring to, these non-GAAP financial measures in assessing our operating results and when planning, forecasting and analyzing future periods. However, these non-GAAP financial measures should be considered in addition to, not as a substitute for or preferable to, financial measures prepared in accordance with GAAP.

Table of Contents

The following table provides a summary of non-GAAP noninterest income, net of noncontrolling interests:

Non-GAAP noninterest income, net of noncontrolling interests (Dollars in thousands)	Three months ended June 30,			Six months ended June 30,			
	2013	2012	% Change	2013	2012	% Change	
GAAP noninterest income (as reported)	\$98,239	\$80,426	22.1	% \$176,843	\$139,719	26.6	%
Less: income attributable to noncontrolling interests, including carried interest	30,751	13,384	129.8	53,241	21,302	149.9	
Non-GAAP noninterest income, net of noncontrolling interests	\$67,488	\$67,042	0.7	123,602	118,417	4.4	
Less: gains on sales of certain available-for-sale securities	—	4,955	(100.0)	—	4,955	(100.0)	
Less: net gains on the sale of certain assets related to our equity management services business	—	4,243	(100.0)	—	4,243	(100.0)	
Non-GAAP noninterest income, net of noncontrolling interests and excluding gains on sales of certain assets	\$67,488	\$57,844	16.7	\$123,602	\$109,219	13.2	
Gains on Investment Securities, Net							

Net gains on investment securities include both gains from our non-marketable and marketable securities, as well as gains from sales of our available-for-sale securities portfolio, when applicable.

Our available-for-sale securities portfolio is managed to optimize portfolio yield over the long-term in a manner consistent with our liquidity, credit diversification, and asset/liability strategies. Though infrequent, the sale of investments from our available-for-sale portfolio results in net gains or losses on investment securities. During the three months ended June 30, 2012, we had gains of \$5.0 million from the sale of certain available-for-sale securities. We experience variability in the performance of our non-marketable and marketable investments from quarter to quarter, which results in net gains or losses on investment securities. This variability is due to a number of factors, including changes in the values of our investments, changes in the amount of distributions or liquidity events and general economic and market conditions. Such variability may lead to volatility in the gains from investment securities and as such our results for a particular period are not necessarily indicative of our expected performance in a future period.

For the three months ended June 30, 2013, we had net gains on investment securities of \$40.6 million, compared to \$25.8 million for the comparable 2012 period. Gains on investment securities, net of noncontrolling interests, were \$9.5 million for the three months ended June 30, 2013, compared to \$11.3 million for the comparable 2012 period. As discussed above, the gains of \$11.3 million for the three months ended June 30, 2012 included gains of \$5.0 million from the sale of certain available-for-sale securities.

The gains, net of noncontrolling interests, of \$9.5 million for the three months ended June 30, 2013 were primarily driven by the following:

- Gains of \$3.6 million from our managed funds of funds, primarily related to unrealized valuation increases and carried interest from three of our funds of funds.

- Gains of \$3.4 million from our strategic and other investments, primarily related to unrealized valuation increases from certain fund investments, as well as gains from our proportionate share of profits from certain equity method investments.

- Gains of \$1.8 million from our investments in debt funds, driven by our proportionate share of unrealized valuation increases from the investments within the funds.

For the six months ended June 30, 2013, we had net gains on investment securities of \$68.0 million, compared to \$33.6 million for the comparable 2012 period. Gains on investment securities, net of noncontrolling interests, were

\$14.6 million for the six months ended June 30, 2013, compared to \$11.8 million for the comparable 2012 period. The gains, net of noncontrolling interests, of \$14.6 million for the six months ended June 30, 2013 were primarily driven by the following:

• Gains of \$5.6 million from our managed funds of funds, primarily related to unrealized valuation increases and carried interest from three of our funds of funds.

Table of Contents

Gains of \$4.4 million from our strategic and other investments, primarily related to unrealized valuation increases from certain fund investments, as well as gains from our proportionate share of profits from certain equity method investments.

Gains of \$3.6 million from our investments in debt funds, driven by our proportionate share of unrealized valuation increases from the investments within the funds.

The following tables provide a summary of non-GAAP net gains on investment securities, net of noncontrolling interests, for the three and six months ended June 30, 2013 and 2012:

(Dollars in thousands)	Managed Funds of Funds	Managed Direct Venture Funds	Debt Funds	Available- For-Sale Securities	Strategic and Other Investments	Total
Three months ended June 30, 2013						
Total gains on investment securities, net	\$33,626	\$987	\$1,799	\$775	\$3,374	\$40,561
Less: income (losses) attributable to noncontrolling interests, including carried interest	30,021	1,047	(1)	—	—	31,067
Non-GAAP net gains (losses) on investment securities, net of noncontrolling interests	\$3,605	\$(60)	\$1,800	\$775	\$3,374	\$9,494
Three months ended June 30, 2012						
Total gains on investment securities, net	\$14,464	\$1,059	\$2,503	\$4,567	\$3,216	\$25,809
Less: income attributable to noncontrolling interests, including carried interest	13,286	1,201	15	—	—	14,502
Non-GAAP net gains (losses) on investment securities, net of noncontrolling interests	1,178	(142)	2,488	4,567	3,216	11,307
Less: gain on sales of certain available-for-sale securities	—	—	—	4,955	—	4,955
Non-GAAP net gains (losses) on investment securities, net of noncontrolling interests and excluding gains on sales of certain available-for-sale securities	\$1,178	\$(142)	\$2,488	\$(388)	\$3,216	\$6,352
Six months ended June 30, 2013						
Total gains on investment securities, net	\$56,428	\$2,843	\$3,552	\$730	\$4,446	\$67,999
Less: income (losses) attributable to noncontrolling interests, including carried interest	50,823	2,543	(3)	—	—	53,363
Non-GAAP net gains on investment securities, net of noncontrolling interests	\$5,605	\$300	\$3,555	\$730	\$4,446	\$14,636
Six months ended June 30, 2012						
Total gains (losses) on investment securities, net	\$26,769	\$(3,623)	\$3,384	\$3,693	\$3,425	\$33,648
Less: income (losses) attributable to noncontrolling interests, including carried interest	24,568	(2,758)	30	—	—	21,840
Non-GAAP net gains (losses) on investment securities, net of noncontrolling interests	2,201	(865)	3,354	3,693	3,425	11,808
Less: gain on sales of certain available-for-sale securities	—	—	—	4,955	—	4,955
Non-GAAP net gains (losses) on investment securities, net of noncontrolling interests and	\$2,201	\$(865)	\$3,354	\$(1,262)	\$3,425	\$6,853

excluding gains on sales of certain
available-for-sale securities

Foreign Exchange Fees

Foreign exchange fees were \$12.8 million and \$26.2 million for the three and six months ended June 30, 2013, respectively, compared to \$12.0 million and \$24.1 million for the comparable 2012 periods. The increases were primarily due to improved business conditions for our clients, which has resulted in an increase in the number of trades and commissioned notional volumes.

64

Table of Contents

Gains on Derivative Instruments, Net

A summary of gains on derivative instruments, net, for the three and six months ended June 30, 2013 and 2012 is as follows:

(Dollars in thousands)	Three months ended June 30,			Six months ended June 30,		
	2013	2012	% Change	2013	2012	% Change
Equity warrant assets (1)						
Gains on exercises, net	\$1,611	\$2,219	(27.4)%	\$2,425	\$5,160	(53.0)%
Cancellations and expirations	(118)	(603)	(80.4)	(222)	(1,172)	(81.1)
Changes in fair value	5,697	3,260	74.8	8,492	7,823	8.6
Net gains on equity warrant assets	7,190	4,876	47.5	10,695	11,811	(9.4)
Gains on foreign exchange forward contracts, net:						
Gains on client foreign exchange forward contracts, net (2)	1,013	1,330	(23.8)	1,810	2,395	(24.4)
Gains on internal foreign exchange forward contracts, net (3)	712	2,993	(76.2)	6,912	942	NM
Total gains on foreign exchange forward contracts, net	1,725	4,323	(60.1)	8,722	3,337	161.4
Change in fair value of interest rate swaps	(33)	108	(130.6)	27	497	(94.6)
Net gains (losses) on other derivatives (4)	94	(594)	(115.8)	572	(956)	(159.8)
Gains on derivative instruments, net	\$8,976	\$8,713	3.0	\$20,016	\$14,689	36.3

NM—Not meaningful

(1) At June 30, 2013, we held warrants in 1,302 companies, compared to 1,215 companies at June 30, 2012.

(2) Represents the net gains for foreign exchange forward contracts executed on behalf of clients.

(3) Represents the change in the fair value of foreign exchange forward contracts used to economically reduce our foreign exchange exposure related to certain foreign currency denominated instruments.

(4) Primarily represents the change in fair value of loan conversion options held by SVB Financial. As of June 30, 2013, the loan conversion options related to five clients.

Net gains on derivative instruments were \$9.0 million for the three months ended June 30, 2013, compared to net gains of \$8.7 million for the comparable 2012 period. The increase in net gains on derivative instruments was primarily attributable to the following:

Net gains on equity warrant assets of \$7.2 million for the three months ended June 30, 2013, compared to \$4.9 million for the comparable 2012 period. The increase was primarily reflective of net gains from warrant valuations of \$5.7 million for the three months ended June 30, 2013, compared to \$3.3 million for the comparable period 2012 period. The net gains from warrant valuations of \$5.7 million for the three months ended June 30, 2013 primarily related to our private warrant portfolio. Net gains from the exercise of equity warrant assets were \$1.6 million for the three months ended June 30, 2013, compared to \$2.2 million for the comparable period.

Net gains of \$0.7 million on foreign exchange forward contracts hedging certain of our foreign currency denominated instruments for the three months ended June 30, 2013, compared to net gains of \$3.0 million for the comparable 2012 period. The gains for both periods were primarily attributable to the strengthening of the U.S. Dollar against the Euro and Pound Sterling, and were offset by losses of \$0.6 million and \$3.4 million, respectively, from the revaluation of foreign currency denominated instruments that are included in the line item "Other" within noninterest income as noted below.

Net gains on derivative instruments were \$20.0 million for the six months ended June 30, 2013, compared to net gains of \$14.7 million for the comparable 2012 period. The increase in net gains on derivative instruments was primarily attributable to the following:

Net gains of \$6.9 million on foreign exchange forward contracts hedging certain of our foreign currency denominated instruments for the six months ended June 30, 2013, compared to net gains of \$0.9 million for the comparable 2012 period. The gains for both periods were primarily attributable to the strengthening of the U.S. Dollar against the Euro and Pound Sterling, and were offset by losses of \$7.7 million and \$1.5 million, respectively, from the revaluation of

Table of Contents

foreign currency denominated instruments that are included in the line item "Other" within noninterest income as noted below.

Net gains on equity warrant assets of \$10.7 million for the six months ended June 30, 2013, compared to net gains of \$11.8 million for the comparable 2012 period. The decrease was primarily reflective of net gains from the exercise of equity warrant assets of \$2.4 million for the six months ended June 30, 2013, compared to net gains of \$5.2 million for the comparable period. Net gains from warrant valuations were \$8.5 million for the six months ended June 30, 2013, compared to \$7.8 million for the comparable period 2012 period. The net gains from warrant valuations of \$8.5 million for the six months ended June 30, 2013 primarily related to our private warrant portfolio.

Credit Card Fees

Credit card fees were \$7.6 million and \$15.1 million for the three and six months ended June 30, 2013, respectively, compared to \$6.2 million and \$11.8 million for the comparable 2012 periods. The increases were primarily due to an increase in client volumes and the addition of new credit card clients.

Client Investment Fees

Client investment fees were \$3.5 million and \$7.0 million for the three and six months ended June 30, 2013, respectively, compared to \$3.4 million and \$6.3 million for the comparable 2012 periods. The increases were primarily due to an increase in average client investment funds driven by our clients' increased utilization of our off-balance sheet sweep product. The increases in average balances were partially offset by historically low yields on certain products. The following table summarizes average client investment funds for the three and six months ended June 30, 2013 and 2012:

(Dollars in millions)	Three months ended June 30,			Six months ended June 30,		
	2013	2012	% Change	2013	2012	% Change
Client directed investment assets (1)	\$6,847	\$7,133	(4.0)%	6,872	7,344	(6.4)%
Client investment assets under management	11,498	10,472	9.8	11,403	10,229	11.5
Sweep money market funds	4,856	2,259	115.0	4,570	1,800	153.9
Total average client investment funds (2)	\$23,201	\$19,864	16.8	22,845	19,373	17.9

(1) Comprised of mutual funds and Repurchase Agreement Program assets.

(2) Client investment funds are maintained at third party financial institutions and are not recorded on our balance sheet.

The following table summarizes period-end client investment funds at June 30, 2013 and December 31, 2012:

(Dollars in millions)	June 30,	December 31,	% Change
	2013	2012	
Client directed investment assets	6,978	7,604	(8.2)%
Client investment assets under management	11,770	10,824	8.7
Sweep money market funds	5,254	4,085	28.6
Total period-end client investment funds	24,002	22,513	6.6

Table of Contents

Other Noninterest Income

A summary of other noninterest income for the three and six months ended June 30, 2013 and 2012 is as follows:

(Dollars in thousands)	Three months ended June 30,			Six months ended June 30,		
	2013	2012	% Change	2013	2012	% Change
Unused commitment fees	\$3,371	\$3,678	(8.3)%	\$6,847	\$6,733	1.7 %
Fund management fees	2,940	3,124	(5.9)	5,709	5,952	(4.1)
Service-based fee income (1)	2,001	2,172	(7.9)	3,805	4,546	(16.3)
Net gains on the sale of certain assets related to our equity management services business	—	4,243	(100.0)	—	4,243	(100.0)
Loan syndication fees	750	1,375	(45.5)	750	1,500	(50.0)
Losses on revaluation of foreign currency instruments (2)	(586)	(3,367)	(82.6)	(7,650)	(1,482)	NM
Currency revaluation gains (losses) (3)	80	(1,548)	(105.2)	25	(933)	(102.7)
Other	3,674	2,987	23.0	6,271	5,183	21.0
Total other noninterest income	\$12,230	\$12,664	(3.4)	\$15,757	\$25,742	(38.8)

NM—Not meaningful

(1) Includes income from SVB Analytics.

(2) Represents the revaluation of foreign currency denominated financial instruments issued and held by us, primarily loans, deposits and cash.

(3) Primarily represents the revaluation of foreign currency denominated investments in certain funds. Included in these amounts are gains of \$0.3 million and \$0.1 million for the three and six months ended June 30, 2013, respectively, attributable to noncontrolling interests calculated based on the ownership percentages of the noncontrolling interests. This compares to losses of \$1.3 million and \$0.8 million for the comparable 2012 periods.

Other noninterest income was \$12.2 million and \$15.8 million for the three and six months ended June 30, 2013, compared to \$12.7 million and \$25.7 million for the comparable 2012 periods. The decrease of \$0.4 million for the three month period was primarily due to the following:

• Net gains of \$4.2 million from the sale of certain assets related to our equity management services business in the second quarter of 2012.

• A decrease of \$0.6 million in loan syndication fees attributable to higher levels of completed deals in the second quarter of 2012.

• Losses on the revaluation of foreign currency instruments of \$0.6 million for the three months ended June 30, 2013, compared to losses of \$3.4 million for the comparable 2012 period. The losses for both periods were primarily attributable to the strengthening of the U.S. Dollar against the Euro and Pound Sterling, and were offset by gains of \$0.7 million and \$3.0 million, respectively, on internal foreign exchange forward contracts economically hedging certain of these instruments, which are included within noninterest income on the line item "gains on derivative instruments" as noted above.

• Currency revaluation gains of \$0.1 million for the three months ended June 30, 2013, compared to net losses of \$1.5 million for the comparable 2012 period. The net losses of \$1.5 million for the three months ended June 30, 2012 were primarily due to the strengthening of the U.S. Dollar against the Indian Rupee.

The decrease \$10.0 million for the six month period was primarily due to the following:

• Losses on the revaluation of foreign currency instruments of \$7.7 million for the six months ended June 30, 2013, compared to losses of \$1.5 million for the comparable 2012 period. The losses for both periods were primarily attributable to the strengthening of the U.S. Dollar against the Euro and Pound Sterling, and were offset by gains of \$6.9 million and \$0.9 million, respectively, on internal foreign exchange forward contracts economically hedging certain of these instruments, which are included within noninterest income on the line item "gains on derivative instruments" as noted above.

Net gains of \$4.2 million from the sale of certain assets related to our equity management services business in the second quarter of 2012.

67

Table of Contents

Noninterest Expense

A summary of noninterest expense for the three and six months ended June 30, 2013 and 2012 is as follows:

(Dollars in thousands)	Three months ended June 30,			Six months ended June 30,			
	2013	2012	% Change	2013	2012	% Change	
Compensation and benefits	\$84,742	\$80,385	5.4	% \$173,446	\$164,122	5.7	%
Professional services	16,633	16,514	0.7	33,793	31,121	8.6	
Premises and equipment	11,402	9,419	21.1	22,127	16,983	30.3	
Business development and travel	7,783	7,159	8.7	16,055	14,905	7.7	
Net occupancy	5,795	5,378	7.8	11,562	11,001	5.1	
FDIC assessments	2,853	2,731	4.5	6,235	5,229	19.2	
Correspondent bank fees	3,049	2,840	7.4	6,104	5,528	10.4	
Provision for unfunded credit commitments	1,347	1,922	(29.9)	) 3,361	1,664	102.0	
Other	9,688	9,418	2.9	19,623	17,225	13.9	
Total noninterest expense	\$143,292	\$135,766	5.5	\$292,306	\$267,778	9.2	

Included in noninterest expense is expense attributable to noncontrolling interests. See below for a summary of non-GAAP noninterest expense and non-GAAP operating efficiency ratio, both of which exclude noncontrolling interests.

Non-GAAP Noninterest Expense

We use and report non-GAAP noninterest expense, non-GAAP taxable equivalent revenue and non-GAAP operating efficiency ratio, which excludes noncontrolling interests. We believe these non-GAAP financial measures, when taken together with the corresponding GAAP financial measures, provide meaningful supplemental information regarding our performance by: (i) excluding certain items that represent expenses attributable to investors other than us and our subsidiaries, or certain items that do not occur every reporting period; or (ii) providing additional information used by management that is not otherwise required by GAAP or other applicable requirements. Our management uses, and believes that investors benefit from referring to, these non-GAAP financial measures in assessing our operating results and when planning, forecasting and analyzing future periods. However, these non-GAAP financial measures should be considered in addition to, not as a substitute for or preferable to, financial measures prepared in accordance with GAAP. The table below provides a summary of non-GAAP noninterest expense and non-GAAP operating efficiency ratio, both net of noncontrolling interests:

Non-GAAP operating efficiency ratio, net of noncontrolling interests (Dollars in thousands, except ratios)	Three months ended June 30,			Six months ended June 30,			
	2013	2012	% Change	2013	2012	% Change	
GAAP noninterest expense	\$143,292	\$135,766	5.5	% \$292,306	\$267,778	9.2	%
Less: amounts attributable to noncontrolling interests	2,867	3,947	(27.4)	) 5,727	6,765	(15.3))
Non-GAAP noninterest expense, net of noncontrolling interests	\$140,425	\$131,819	6.5	\$286,579	\$261,013	9.8	
GAAP taxable equivalent net interest income	\$170,516	\$152,419	11.9	\$334,115	\$303,840	10.0	
Less: income attributable to noncontrolling interests	20	38	(47.4)	) 44	81	(45.7))
Non-GAAP taxable equivalent net interest income, net of noncontrolling interests	170,496	152,381	11.9	334,071	303,759	10.0	

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Non-GAAP noninterest income, net of noncontrolling interests	67,488	57,844	16.7	123,602	109,219	13.2
Non-GAAP taxable equivalent revenue, net of noncontrolling interests	\$237,984	\$210,225	13.2	\$457,673	\$412,978	10.8
Non-GAAP operating efficiency ratio (1)	59.01	% 62.70	% (5.9)	62.62	% 63.20	% (0.9)

68

Table of Contents

(1) The non-GAAP operating efficiency ratio is calculated by dividing non-GAAP noninterest expense by non-GAAP total taxable-equivalent income.

Compensation and Benefits Expense

The following table provides a summary of our compensation and benefits expense:

(Dollars in thousands)	Three months ended June 30,			Six months ended June 30,			
	2013	2012	% Change	2013	2012	% Change	
Compensation and benefits							
Salaries and wages	\$39,209	\$37,501	4.6	\$78,532	\$75,621	3.8	%
Incentive compensation & ESOP	21,660	20,838	3.9	43,853	41,985	4.4	
Other employee benefits (1)	23,873	22,046	8.3	51,061	46,516	9.8	
Total compensation and benefits	\$84,742	\$80,385	5.4	\$173,446	\$164,122	5.7	
Period-end full-time equivalent employees	1,657	1,562	6.1	1,657	1,562	6.1	
Average full-time equivalent employees	1,657	1,566	5.8	1,656	1,561	6.1	

(1) Other employee benefits includes employer payroll taxes, group health and life insurance, share-based compensation, 401(k), warrant and retention plans, agency fees and other employee related expenses.

Compensation and benefits expense was \$84.7 million for the three months ended June 30, 2013, compared to \$80.4 million for the comparable 2012 period. The key changes in factors affecting compensation and benefits expense were as follows:

An increase of \$1.8 million in other employee benefits, primarily due to an increase in group health and life insurance expenses, as well as from an increase in the number of average FTEs, which increased by 91 to 1,657 FTEs for the three months ended June 30, 2013, compared to 1,566 FTEs for the comparable 2012 period. The increase in headcount was primarily to support our product development, operational and sales and advisory teams, as well as to support our commercial banking operations and initiatives.

An increase of \$1.7 million in salaries and wages expense, primarily due to merit increases effective March 2013 and an increase in the number of average FTEs.

An increase of \$0.8 million in incentive compensation and ESOP/profit sharing expenses, primarily reflective of an increase in the number of average FTEs.

Compensation and benefits expense was \$173.4 million for the six months ended June 30, 2013, compared to \$164.1 million for the comparable 2012 period. The key changes in factors affecting compensation and benefits expense were as follows:

An increase of \$4.5 million in other employee benefits, primarily due to an increase in group health and life insurance expenses, as well as from an increase in the number of average FTEs, which increased by 95 to 1,656 average FTEs for the six months ended June 30, 2013, compared to 1,561 average FTEs for the comparable 2012 period.

An increase of \$2.9 million in salaries and wages expense, primarily due to merit increases effective March 2013 and an increase in the number of average FTEs.

An increase of \$1.9 million in incentive compensation and ESOP/profit sharing expenses, primarily reflective of an increase in the number of average FTEs.

Our variable compensation plans primarily consist of our Incentive Compensation Plan, Direct Drive Incentive Compensation Plan, 401(k) and ESOP Plan, Retention Program and Warrant Incentive Plan. Total costs incurred under these plans were \$25.2 million and \$53.0 million for the three and six months ended June 30, 2013, respectively, compared to \$23.8 million and \$51.6 million for the comparable 2012 periods. These amounts are included in total compensation and benefits expense discussed above.

Table of Contents**Professional Services**

Professional services expense was \$16.6 million and \$33.8 million for the three and six months ended June 30, 2013, respectively, compared to \$16.5 million and \$31.1 million for the comparable 2012 periods. The increase for the six month period was primarily due to increased consulting fees related to our ongoing business and IT infrastructure initiatives.

Premises and Equipment

Premises and equipment expense was \$11.4 million and \$22.1 million for the three and six months ended June 30, 2013, respectively, compared to \$9.4 million and \$17.0 million for the comparable 2012 periods. The increases were primarily due to increased spending to enhance and maintain our IT infrastructure.

Provision for Unfunded Credit Commitments

We recorded a provision for unfunded credit commitments of \$1.3 million for the three months ended June 30, 2013, compared to \$1.9 million for the comparable 2012 period. The provision of \$1.3 million for the three months ended June 30, 2013 was primarily due to an increase in unfunded credit commitment balances \$615 million from March 31, 2013 to June 30, 2013.

We recorded a provision for unfunded credit commitments of \$3.4 million for the six months ended June 30, 2013, compared to \$1.7 million for the comparable 2012 period. The provision for the six months ended June 30, 2013 was primarily reflective of an increase in unfunded credit commitments of \$1.2 billion from December 31, 2012 to June 30, 2013.

Other Noninterest Expense

A summary of other noninterest expense for the three and six months ended June 30, 2013 and 2012 is as follows:

(Dollars in thousands)	Three months ended June 30,			Six months ended June 30,		
	2013	2012	% Change	2013	2012	% Change
Telephone	\$1,512	\$1,547	(2.3)%	\$3,069	\$3,331	(7.9)%
Client services	1,856	1,739	6.7	3,791	2,992	26.7
Data processing services	1,882	1,310	43.7	3,794	2,715	39.7
Tax credit fund amortization	1,338	962	39.1	2,655	2,020	31.4
Postage and supplies	680	628	8.3	1,218	1,253	(2.8)
Dues and publications	445	557	(20.1)	903	1,031	(12.4)
Other	1,975	2,675	(26.2)	4,193	3,883	8.0
Total other noninterest expense	\$9,688	\$9,418	2.9	\$19,623	\$17,225	13.9

Net Income Attributable to Noncontrolling Interests

Included in net income is income and expense attributable to noncontrolling interests. The relevant amounts attributable to investors other than us are reflected under "Net Income Attributable to Noncontrolling Interests" on our statements of income.

In the table below, noninterest income consists primarily of investment gains and losses from our consolidated funds. Noninterest expense is primarily related to management fees paid by our managed funds to SVB Financial's subsidiaries as the funds' general partners. A summary of net income attributable to noncontrolling interests for the three and six months ended June 30, 2013 and 2012, respectively, is as follows:

(Dollars in thousands)	Three months ended June 30,			Six months ended June 30,		
	2013	2012	% Change	2013	2012	% Change
Net interest income (1)	\$(20)	\$(38)	(47.4)%	\$(44)	\$(81)	(45.7)%
Noninterest income (1)	(31,498)	(11,210)	181.0	(54,786)	(17,842)	NM
Noninterest expense (1)	2,867	3,947	(27.4)	5,727	6,765	(15.3)
Carried interest (2)	747	(2,174)	(134.4)	1,545	(3,460)	(144.7)
Net income attributable to noncontrolling interests	\$(27,904)	\$(9,475)	194.5	\$(47,558)	\$(14,618)	NM

NM—Not meaningful

(1) Represents noncontrolling interests' share in net interest income, noninterest income and noninterest expense.

70

Table of Contents

(2) Represents the preferred allocation of income earned by the general partners or limited partners of certain consolidated funds.

Income Taxes

Our effective income tax expense rate was 38.2 percent for the three months ended June 30, 2013, compared to 39.8 percent for the comparable 2012 period. Our effective income tax expense rate 38.7 percent for the six months ended June 30, 2013, compared to 40.2 percent for the comparable 2012 period. The decreases in the tax rates were primarily attributable to higher low-income housing credits and higher income generated from states with lower state tax rates. Our effective tax rate is calculated by dividing income tax expense by the sum of income before income tax expense and the net income attributable to noncontrolling interests.

Operating Segment Results

We have three segments for which we report our financial information: Global Commercial Bank, SVB Private Bank and SVB Capital.

We report segment information based on the “management” approach. The management approach designates the internal reporting used by management for making decisions and assessing performance as the source of our reporting segments. Please refer to Note 10—“Segment Reporting” of the “Notes to Interim Consolidated Financial Statements (unaudited)” under Part I, Item 1 of this report for additional details.

Our primary source of revenue is from net interest income, which is primarily the difference between interest earned on loans, net of FTP, and interest paid on deposits, net of FTP. Accordingly, our segments are reported using net interest income, net of FTP. FTP is an internal measurement framework designed to assess the financial impact of a financial institution’s sources and uses of funds. It is the mechanism by which an earnings credit is given for deposits raised, and an earnings charge is made for funded loans.

We also evaluate performance based on provision for loan losses, noninterest income and noninterest expense, which are presented as components of segment operating profit or loss. In calculating each operating segment’s noninterest expense, we consider the direct costs incurred by the operating segment as well as certain allocated direct costs. As part of this review, we allocate certain corporate overhead costs to a corporate account. We do not allocate income taxes to our segments. Additionally, our management reporting model is predicated on average asset balances; therefore, period-end asset balances are not presented for segment reporting purposes.

Changes in an individual client’s primary relationship designation have resulted, and in the future may result, in the inclusion of certain clients in different segments in different periods. The following is our reportable segment information for the three and six months ended June 30, 2013 and 2012:

Global Commercial Bank

(Dollars in thousands)	Three months ended June 30,			Six months ended June 30,		
	2013	2012	% Change	2013	2012	% Change
Net interest income	\$154,586	\$146,420	5.6	\$303,522	\$289,684	4.8
Provision for loan losses	(18,190)	(8,923)	103.9	(24,397)	(22,159)	10.1
Noninterest income	48,361	52,494	(7.9)	94,902	92,422	2.7
Noninterest expense	(102,283)	(98,686)	3.6	(207,861)	(195,129)	6.5
Income before income tax expense	\$82,474	\$91,305	(9.7)	\$166,166	\$164,818	0.8
Total average loans, net of unearned income	\$8,203,231	\$6,479,544	26.6	\$8,036,833	\$6,255,450	28.5
Total average assets	20,364,334	19,022,506	7.1	20,413,630	18,789,624	8.6
Total average deposits	18,137,218	17,131,816	5.9	18,219,590	16,916,965	7.7

Three months ended June 30, 2013 compared to the three months ended June 30, 2012

Income before income tax expense from our Global Commercial Bank (“GCB”) decreased by \$8.8 million for the three months ended June 30, 2013, primarily driven by a higher provision for loan losses due to strong period-end loan growth and a decrease in noninterest income related to the sale of certain assets related to our equity management services business in the second quarter of 2012. These decreases were partially offset by an increase in net interest

income driven by growth in average

71

Table of Contents

loans. The key components of GCB's performance for the three months ended June 30, 2013 compared to the comparable 2012 period are discussed below:

Net interest income from our GCB increased by \$8.2 million for the three months ended June 30, 2013, primarily due to a \$15.2 million increase in loan interest income resulting mainly from an increase in average loan balances, partially offset by lower loan yields. Additionally, GCB had a \$2.2 million increase in the FTP earned for deposits due to average deposit growth. These increases were partially offset by a \$10.0 million decrease in the FTP earned for deposits from decreases in certain short-term market interest rates.

GCB had a provision for loan losses of \$18.2 million for the three months ended June 30, 2013, compared to \$8.9 million for the comparable 2012 period. The provision of \$18.2 million for the three months ended June 30, 2013 was primarily attributable to period-end loan growth, as well as to provide for net charge-offs and a modest increase in our reserve for impaired loans. The provision of \$8.9 million for the three months ended June 30, 2012 was primarily attributable to period-end loan growth.

Noninterest income decreased by \$4.1 million for the three months ended June 30, 2013, primarily related to net gains of \$4.2 million from the sale of certain assets related to our equity management services business in the second quarter of 2012, as well as from lower gains on debt fund investments. These decreases were partially offset by higher credit card fees and foreign exchange fees. The increase in credit card fees was primarily due to increases in client volumes and the addition of new credit card clients. The increase in foreign exchange fees was primarily due to improved business conditions for our clients, which has resulted in an increase in the number of trades and commissioned notional volumes.

Noninterest expense increased by \$3.6 million for the three months ended June 30, 2013, primarily due to increases in compensation and benefits and premises and equipment expenses. The increase in compensation and benefits expense was primarily due to an increase in the average number of FTEs at GCB, which increased by 83 to 1,319 FTEs for the three months ended June 30, 2013, compared to 1,236 FTEs for the comparable 2012 period, as well as merit increases. The increase in average FTEs was attributable to increases in positions for product development, operational and sales and advisory, as well as to support our commercial banking operations and initiatives. The increase in premises and equipment expense was primarily due to increased spending to enhance and maintain our IT infrastructure.

Six months ended June 30, 2013 compared to the six months ended June 30, 2012

Income before income tax expense from our GCB increased by \$1.3 million for the six months ended June 30, 2013, primarily driven by an increase in net interest income driven by growth in average loans, partially offset by an increase in noninterest expense driven by growth in average FTEs. The key components of GCB's performance for the six months ended June 30, 2013 compared to the comparable 2012 period are discussed below:

Net interest income from GCB increased by \$13.8 million for the six months ended June 30, 2013, primarily due to a \$29.4 million increase in loan interest income resulting mainly from an increase in average loan balances, partially offset by lower loan yields. Additionally, GCB had a \$5.9 million increase in the FTP earned for deposits due to average deposit growth. These increases were partially offset by a \$21.9 million decrease in the FTP earned for deposits from decreases in certain short-term market interest rates.

GCB had a provision for loan losses of \$24.4 million for the six months ended June 30, 2013, compared to \$22.2 million for the comparable 2012 period. The provision of \$24.4 million for the six months ended June 30, 2013 was primarily due to period-end loan growth, as well as to provide for net charge-offs and a modest increase in our reserve for impaired loans. The provision of \$22.2 million for the six months ended June 30, 2012 was primarily due to net loan charge-offs of \$14.3 million, of which \$7.1 million related to a single nonperforming hardware loan that was specifically reserved for in the first quarter of 2012, as well as from period-end loan growth.

Noninterest income increased by \$2.5 million for the six months ended June 30, 2013, primarily due to an increase in credit card fees and foreign exchange fees, partially offset by gains of \$4.2 million on the sale of certain assets related to our equity management services business in the second quarter of 2012. The increase in credit card fees was primarily due to an increase in client volumes and the addition of new credit card clients. The increase in foreign exchange fees was primarily due to improved business conditions for our clients, which resulted in an increase in the number of trades and commissioned notional volumes.

Noninterest expense increased by \$12.7 million for the six months ended June 30, 2013, primarily due to increases in compensation and benefits and premises and equipment expenses. The increase in compensation and benefits expense was primarily due to an increase in the average number of FTEs at GCB, which increased by 92 to 1,319 for the six months ended June 30, 2013, compared to 1,227 for the comparable 2012 period, as well as from merit increases. The increase in premises and equipment was primarily due to increased spending to enhance and maintain our IT infrastructure.

Table of Contents

SVB Private Bank

(Dollars in thousands)	Three months ended June 30,			Six months ended June 30,		
	2013	2012	% Change	2013	2012	% Change
Net interest income	\$5,927	\$5,516	7.5 %	\$12,031	\$10,481	14.8 %
Reduction of (provision for) loan losses	(382)	924	(141.3)	12	(369)	(103.3)
Noninterest income	253	151	67.5	487	308	58.1
Noninterest expense	(3,461)	(3,223)	7.4	(6,922)	(6,349)	9.0
Income before income tax expense	\$2,337	\$3,368	(30.6)	\$5,608	\$4,071	37.8
Total average loans, net of unearned income	\$871,746	\$742,130	17.5	\$858,351	\$740,049	16.0
Total average assets	885,259	747,445	18.4	869,682	744,703	16.8
Total average deposits	472,613	253,482	86.4	471,648	246,991	91.0

Three months ended June 30, 2013 compared to the three months ended June 30, 2012

Net interest income from SVB Private Bank increased by \$0.4 million for the three months ended June 30, 2013, primarily due to an increase in the FTP earned for deposits due to average deposit growth and an increase in loan interest income from an increase in average loan balances. These increases were partially offset by a decrease in the overall yield on our Private Bank loan portfolio, reflective of the current low interest rate environment.

SVB Private Bank had a provision for loan losses of \$0.4 million for the three months ended June 30, 2013, compared to a reduction of provision of \$0.9 million for the comparable 2012 period. The provision for the three months ended June 30, 2013 was primarily due to net charge-offs. The reduction of provision for the three months ended June 30, 2012 was primarily due to a reduction in the reserve for impaired loans, partially offset by period-end loan growth.

Six months ended June 30, 2013 compared to the six months ended June 30, 2012

Net interest income from SVB Private Bank increased by \$1.6 million for the six months ended June 30, 2013, primarily due to an increase in the FTP earned for deposits due to average deposit growth and an increase in loan interest income from an increase in average loan balances. These increases were partially offset by a decrease in the overall yield on our Private Bank loan portfolio, reflective of the current low interest rate environment.

SVB Private Bank had a reduction of provision for loan losses of \$12 thousand for the six months ended June 30, 2013, compared to a provision of \$0.4 million for the comparable 2012 period. The provision of \$0.4 million for the six months ended June 30, 2012 was primarily due to period-end loan growth, partially offset by a reduction in the reserve for impaired loans.

Noninterest expense increased by \$0.6 million for the six months ended June 30, 2013, primarily due to an increase in premises and equipment and advertising expenses to support the growth of SVB Private Bank.

SVB Capital

(Dollars in thousands)	Three months ended June 30,			Six months ended June 30,		
	2013	2012	% Change	2013	2012	% Change
Net interest income	\$3	\$9	(66.7)%	\$4	\$16	(75.0)%
Noninterest income	7,281	4,557	59.8	12,722	8,144	56.2
Noninterest expense	(2,757)	(2,872)	(4.0)	(5,143)	(5,408)	(4.9)
Income before income tax expense	\$4,527	\$1,694	167.2	\$7,583	\$2,752	175.5
Total average assets	\$269,771	\$251,295	7.4	\$254,343	\$254,835	(0.2)

SVB Capital's components of noninterest income primarily include net gains and losses on marketable and non-marketable securities, carried interest and fund management fees. All components of income before income tax expense discussed below are net of noncontrolling interests.

We experience variability in the performance of SVB Capital from quarter to quarter due to a number of factors, including changes in the values of our funds' underlying investments, changes in the amount of distributions and general economic and market conditions. Such variability may lead to volatility in the gains and losses from investment securities and cause our results to differ from period to period. Results for a particular period may not be indicative of future performance.

Table of Contents

Three months ended June 30, 2013 compared to the three months ended June 30, 2012

Noninterest income increased by \$2.7 million to \$7.3 million for the three months ended June 30, 2013, primarily due to higher net gains on investment securities. SVB Capital's components of noninterest income primarily include the following:

Net gains on investment securities of \$4.2 million for the three months ended June 30, 2013, compared to net gains of \$1.7 million for the comparable 2012 period. The net gains on investment securities of \$4.2 million for the three months ended June 30, 2013 were primarily driven by unrealized valuation increases and carried interest from three of our managed funds of funds.

Fund management fees of \$2.9 million for three months ended June 30, 2013, compared to \$3.1 million for the comparable 2012 period.

Six months ended June 30, 2013 compared to the six months ended June 30, 2012

Noninterest income increased by \$4.6 million to \$12.7 million for the six months ended June 30, 2013, primarily due to higher net gains on investment securities. SVB Capital's components of noninterest income primarily include the following:

Net gains on investment securities of \$7.2 million for the six months ended June 30, 2013, compared to net gains of \$2.3 million for the comparable 2012 period. The net gains on investment securities of \$7.2 million for the six months ended June 30, 2013 were primarily driven by unrealized valuation increases and carried interest from three of our managed funds of funds.

Fund management fees of \$5.7 million for the six months ended June 30, 2013, compared to \$6.0 million for the comparable 2012 period.

Consolidated Financial Condition

Our total assets were \$22.2 billion at June 30, 2013, a decrease of \$612 million, or 2.7 percent, compared to \$22.8 billion at December 31, 2012. This decrease was primarily driven by a decrease in deposits. Below is a summary of the individual components of total assets.

Cash and Cash Equivalents

Cash and cash equivalents totaled \$873 million at June 30, 2013, a decrease of \$136 million, or 13.5 percent, compared to \$1.0 billion at December 31, 2012. The decrease was primarily driven by the funding of loan growth at period-end.

As of June 30, 2013 and December 31, 2012, \$200 million and \$72 million, respectively, of our cash and due from banks was deposited at the Federal Reserve Bank and was earning interest at the Federal Funds target rate, and interest-earning deposits in other financial institutions were \$234 million and \$283 million, respectively.

Investment Securities

Investment securities totaled \$11.3 billion at June 30, 2013, a decrease of \$1.2 billion, or 9.8 percent, compared to \$12.5 billion at December 31, 2012. Our investment securities portfolio consists of both an available-for-sale securities portfolio, which represents interest-earning investment securities, and a non-marketable securities portfolio, which primarily represents investments managed as part of our funds management business. The decrease of \$1.2 billion included a decrease of \$1.3 billion in available-for-sale securities, offset by an increase of \$71 million in non-marketable securities. The major components of the change are explained below.

Available-for-Sale Securities

Our available-for-sale securities portfolio is a fixed income investment portfolio that is managed to optimize portfolio yield over the long-term consistent with our liquidity, credit diversification and asset/liability strategies.

Available-for-sale securities were \$10.0 billion at June 30, 2013, a decrease of \$1.3 billion, or 11.5 percent, compared to \$11.3 billion at December 31, 2012. The decrease was primarily due to paydowns, scheduled maturities and called maturities of \$1.3 billion, as well as a decrease of \$195 million in the fair value of our portfolio resulting from significant increases in period-end market interest rates. These decreases were partially offset by purchases of new investments of \$220 million. The paydowns of securities of \$1.3 billion were comprised of \$1.0 billion in fixed-rate securities and \$331 million in variable-rate securities. The purchases of new investments of \$220 million were primarily comprised of fixed-rate agency-issued mortgage securities.

Portfolio duration is a standard measure used to approximate changes in the market value of fixed income instruments due to a change in market interest rates. The measure is an estimate based on the level of current market interest rates, expectations for changes in the path of forward rates and the effect of forward rates on mortgage prepayment speed assumptions. As such, portfolio duration will fluctuate with changes in market interest rates. Changes in portfolio duration are also impacted

74

Table of Contents

by changes in the mix of longer versus shorter term-to-maturity securities. At June 30, 2013, our estimated portfolio duration was 2.7 years, compared to 2.2 years at December 31, 2012.

Non-Marketable Securities

Our non-marketable securities portfolio primarily represents investments in venture capital funds, debt funds and private portfolio companies. A majority of these investments are managed through our SVB Capital funds business in funds of funds and direct venture funds. Included in our non-marketable securities carried under fair value accounting are amounts that are attributable to noncontrolling interests. We are required under GAAP to consolidate 100% of these investments that we are deemed to control, even though we may own less than 100% of such entities. See below for a summary of the carrying value (as reported) of non-marketable securities compared to the amounts attributable to SVBFG.

Non-marketable securities were \$1.3 billion at June 30, 2013, an increase of \$71 million, or 6.0 percent, compared to \$1.2 billion at December 31, 2012. The increase was primarily attributable to additional capital calls for fund investments. The following table summarizes the carrying value (as reported) of nonmarketable securities compared to the amounts attributable to SVBFG (which generally represents the carrying value times our ownership percentage) at June 30, 2013 and December 31, 2012:

(Dollars in thousands)	June 30, 2013		December 31, 2012	
	Carrying value (as reported)	Amount attributable to SVBFG	Carrying value (as reported)	Amount attributable to SVBFG
Non-marketable securities (fair value accounting):				
Venture capital and private equity fund investments (1)	\$741,522	\$ 78,258	\$665,921	\$ 75,893
Other venture capital investments (2)	123,493	8,566	127,091	8,962
Non-marketable securities (equity method accounting):				
Other investments	144,149	144,149	139,330	139,330
Low income housing tax credit funds	71,382	71,382	70,318	70,318
Non-marketable securities (cost method accounting):				
Venture capital and private equity fund investments	156,391	156,391	161,884	161,884
Other investments	18,488	18,488	19,721	19,721
Total non-marketable securities	\$1,255,425	\$ 477,234	\$1,184,265	\$ 476,108

The following table shows the amounts of venture capital and private equity fund investments held by the (1) following consolidated funds and amounts attributable to SVBFG for each fund at June 30, 2013 and December 31, 2012:

(Dollars in thousands)	June 30, 2013		December 31, 2012	
	Carrying value (as reported)	Amount attributable to SVBFG	Carrying value (as reported)	Amount attributable to SVBFG
SVB Strategic Investors Fund, LP	\$32,111	\$ 4,033	\$32,850	\$ 4,126
SVB Strategic Investors Fund II, LP	93,110	7,981	91,294	7,825
SVB Strategic Investors Fund III, LP	223,568	13,125	209,696	12,311
SVB Strategic Investors Fund IV, LP	198,734	9,937	169,931	8,497
Strategic Investors Fund V Funds	69,110	227	40,622	112
Strategic Investors Fund VI Funds	1,321	2	—	—
SVB Capital Preferred Return Fund, LP	56,140	13,241	53,643	12,652
SVB Capital—NT Growth Partners, LP	60,775	24,101	60,120	23,842
SVB Capital Partners II, LP	1,098	56	1,303	66

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Other private equity fund	5,555	5,555	6,462	6,462
Total venture capital and private equity fund investments	\$741,522	\$78,258	\$665,921	\$75,893

(2) The following table shows the amounts of other venture capital investments held by the following consolidated funds and amounts attributable to SVBFG for each fund at June 30, 2013 and December 31, 2012:

75

Table of Contents

(Dollars in thousands)	June 30, 2013		December 31, 2012	
	Carrying value (as reported)	Amount attributable to SVBFG	Carrying value (as reported)	Amount attributable to SVBFG
Silicon Valley BancVentures, LP	\$39,680	\$ 4,244	\$43,493	\$ 4,652
SVB Capital Partners II, LP	79,913	4,058	79,761	4,051
SVB Capital Shanghai Yangpu Venture Capital Fund	3,900	264	3,837	259
Total other venture capital investments	\$123,493	\$ 8,566	\$127,091	\$ 8,962

Loans

Loans, net of unearned income were \$9.6 billion at June 30, 2013, an increase of \$675 million, or 7.5 percent, compared to \$8.9 billion at December 31, 2012. Unearned income was \$83 million at June 30, 2013, compared to \$77 million at December 31, 2012. Total gross loans were \$9.7 billion at June 30, 2013, an increase of \$681 million, or 7.5 percent, compared to \$9.0 billion at December 31, 2012. The increase came primarily from later stage clients in our software portfolio, as well as from our venture capital/private equity portfolio for capital call lines of credit. The breakdown of total gross loans and total loans as a percentage of total gross loans by category is as follows:

(Dollars in thousands)	June 30, 2013		December 31, 2012		
	Amount	Percentage	Amount	Percentage	
Commercial loans:					
Software	\$3,593,954	37.0	% \$3,293,899	36.5	%
Hardware	1,217,612	12.5	1,129,484	12.5	
Venture capital/private equity	1,942,664	20.0	1,749,903	19.4	
Life science	1,095,581	11.3	1,076,792	11.9	
Premium wine	143,990	1.5	144,937	1.6	
Other	312,618	3.3	318,588	3.5	
Total commercial loans	8,306,419	85.6	7,713,603	85.5	
Real estate secured loans:					
Premium wine	467,065	4.8	414,347	4.6	
Consumer loans	778,310	8.0	685,493	7.6	
Total real estate secured loans	1,245,375	12.8	1,099,840	12.2	
Construction loans	66,774	0.7	65,726	0.7	
Consumer loans	86,896	0.9	145,079	1.6	
Total gross loans	\$9,705,464	100.0	% \$9,024,248	100.0	%

Table of Contents

Loan Concentration

The following table provides a summary of loans by size and category. The breakout of the categories is based on total client balances (individually or in the aggregate) as of June 30, 2013:

June 30, 2013

(Dollars in thousands)	Less than Five Million	Five to Ten Million	Ten to Twenty Million	Twenty to Thirty Million	Thirty Million or More	Total
Commercial loans:						
Software	\$1,060,729	\$524,527	\$720,011	\$741,961	\$546,726	\$3,593,954
Hardware	308,475	234,093	120,921	296,772	257,351	1,217,612
Venture capital/private equity	315,110	195,867	341,281	273,490	816,916	1,942,664
Life science	309,820	286,338	172,861	143,200	183,362	1,095,581
Premium wine (1)	64,123	28,720	31,176	19,971	—	143,990
Other	117,374	66,708	21,243	76,668	30,625	312,618
Commercial loans	2,175,631	1,336,253	1,407,493	1,552,062	1,834,980	8,306,419
Real estate secured loans:						
Premium wine (1)	117,608	113,555	127,801	76,601	31,500	467,065
Consumer loans (2)	657,369	67,560	33,381	20,000	—	778,310
Real estate secured loans	774,977	181,115	161,182	96,601	31,500	1,245,375
Construction loans	15,413	51,361	—	—	—	66,774
Consumer loans (2)	24,456	18,588	780	3,072	40,000	86,896
Total gross loans	\$2,990,477	\$1,587,317	\$1,569,455	\$1,651,735	\$1,906,480	\$9,705,464

(1) Premium wine clients can have loan balances included in both commercial loans and real estate secured loans, the total of which are used for the breakout of the above categories.

(2) Consumer loan clients have loan balances included in both real estate secured loans and other consumer loans, the total of which are used for the breakout of the above categories.

At June 30, 2013, gross loans (individually or in the aggregate) totaling \$3.6 billion, or 36.7 percent of our portfolio, were equal to or greater than \$20 million to any single client. These loans represented 112 clients, and of these loans, none were on nonaccrual status as of June 30, 2013.

The following table provides a summary of loans by size and category. The breakout of the categories is based on total client balances (individually or in the aggregate) as of December 31, 2012:

December 31, 2012

(Dollars in thousands)	Less than Five Million	Five to Ten Million	Ten to Twenty Million	Twenty to Thirty Million	Thirty Million or More	Total
Commercial loans:						
Software	\$991,011	\$575,721	\$601,400	\$731,840	\$393,927	\$3,293,899
Hardware	295,981	203,813	176,854	229,913	222,923	1,129,484
Venture capital/private equity	298,299	194,717	285,914	301,061	669,912	1,749,903
Life science	280,100	221,399	223,104	200,056	152,133	1,076,792
Premium wine (1)	71,472	24,986	41,979	6,500	—	144,937
Other	89,703	56,078	55,608	54,620	62,579	318,588
Commercial loans	2,026,566	1,276,714	1,384,859	1,523,990	1,501,474	7,713,603
Real estate secured loans:						
Premium wine (1)	101,501	110,080	128,950	42,316	31,500	414,347
Consumer loans (2)	563,319	78,531	43,643	—	—	685,493
Real estate secured loans	664,820	188,611	172,593	42,316	31,500	1,099,840

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Construction loans	17,182	33,928	14,616	—	—	65,726
Consumer loans (2)	29,436	46,152	24,491	—	45,000	145,079
Total gross loans	\$2,738,004	\$1,545,405	\$1,596,559	\$1,566,306	\$1,577,974	\$9,024,248

77

Table of Contents

- (1) Premium wine clients can have loan balances included in both commercial loans and real estate secured loans, the total of which are used for the breakout of the above categories.
- (2) Consumer loan clients have loan balances included in both real estate secured loans and other consumer loans, the total of which are used for the breakout of the above categories.

At December 31, 2012, gross loans (individually or in the aggregate) totaling \$3.1 billion, or 34.8 percent of our portfolio, were equal to or greater than \$20 million to any single client. These loans represented 102 clients, and of these loans, none were on nonaccrual status as of December 31, 2012.

The credit profile of our clients varies across our loan portfolio, based on the nature of the lending we do for different market segments. Our technology and life sciences loan portfolio includes loans to clients at all stages of their life cycles, beginning with our SVB Accelerator practice, which serves our emerging or early-stage clients. Loans provided to early-stage clients represent a relatively small percentage of our overall portfolio at 9.3 percent of total gross loans at June 30, 2013, compared to 8.8 percent at December 31, 2012. Typically these loans are made to companies with modest or negative cash flows and no established record of profitable operations. Repayment of these loans may be dependent upon receipt by borrowers of additional equity financing from venture capitalists or others, or in some cases, a successful sale to a third party or a public offering. Venture capital firms may provide financing at lower levels, more selectively or on less favorable terms, which may have an adverse effect on our borrowers that are otherwise dependent on such financing to repay their loans to us. When repayment is dependent upon the next round of venture investment and there is an indication that further investment is unlikely or will not occur, it is often likely the company would need to be sold to repay debt in full. If reasonable efforts have not yielded a likely buyer willing to repay all debt at the close of the sale or on commercially viable terms, the account will most likely be deemed to be impaired.

At June 30, 2013, our lending to venture capital/private equity firms represented 20.0 percent of total gross loans, compared to 19.4 percent of total gross loans at December 31, 2012. Many of these clients have capital call lines of credit, the repayment of which is dependent on the payment of capital calls by the underlying limited partner investors in the funds managed by these firms.

At June 30, 2013, sponsor-led buyout loans represented 11.3 percent of total gross loans, compared to 11.8 percent of total gross loans at December 31, 2012. These loans are typically larger in nature and repayment is generally dependent upon the cash flows of the acquired company. However, these loans are typically highly-secured and therefore carry lower credit risk.

At June 30, 2013, our asset-based lending, which consists primarily of working capital lines and accounts receivable factoring represented 7.2 percent and 4.4 percent, respectively, of total gross loans, compared to 7.0 percent and 4.8 percent, respectively at December 31, 2012. The repayment of these arrangements is dependent on the financial condition, and payment ability, of third parties with whom our clients do business.

Approximately 42.0 percent of our outstanding total gross loan balances as of June 30, 2013 were to borrowers based in California compared to 38.5 percent as of December 31, 2012. Other than California, there are no states with balances greater than 10 percent.

See generally “Risk Factors–Credit Risks” set forth under Item 1A, Part I in our 2012 Form 10-K.

Credit Quality Indicators

As of June 30, 2013, our criticized and impaired loans represented 7.0 percent of our total gross loans. This compares to 6.6 percent at December 31, 2012. A majority of our criticized loans are from our SVB Accelerator portfolio, serving our emerging or early stage clients. Loans to early stage clients make up 9.3 percent of our loan portfolio. It is common for an emerging or early stage client’s remaining liquidity to fall temporarily below the threshold for a pass-rated credit during its capital-raising period for a new round of funding. This situation typically lasts only a few weeks and, in our experience, generally resolves itself with a subsequent round of venture funding. As a result, we expect that each of our early-stage clients will be managed through our criticized portfolio during a portion of their life cycle. Criticized loan levels will continue to vary but are expected to remain within the current range.

Credit Quality and Allowance for Loan Losses

Nonperforming assets consist of loans past due 90 days or more that are still accruing interest and loans on nonaccrual status. We measure all loans placed on nonaccrual status for impairment based on the fair value of the underlying

collateral or the net present value of the expected cash flows. The table below sets forth certain data and ratios between nonperforming loans, nonperforming assets and the allowance for loan losses:

78

Table of Contents

(Dollars in thousands)	June 30, 2013	December 31, 2012	
Gross nonperforming, past due, and restructured loans:			
Loans past due 90 days or more still accruing interest	\$1,861	\$19	
Impaired loans	41,159	38,279	
Performing TDRs	1,012	734	
Nonperforming loans as a percentage of total gross loans	0.42	% 0.42	%
Nonperforming assets as a percentage of total assets	0.19	0.17	
Allowance for loan losses	\$119,571	\$110,651	
As a percentage of total gross loans	1.23	% 1.23	%
As a percentage of total gross nonperforming loans	290.51	289.06	
Allowance for loan losses for impaired loans	\$10,353	\$6,261	
As a percentage of total gross loans	0.11	% 0.07	%
As a percentage of total gross nonperforming loans	25.15	16.36	
Allowance for loan losses for total gross performing loans	\$109,218	\$104,390	
As a percentage of total gross loans	1.13	% 1.16	%
As a percentage of total gross performing loans	1.13	1.16	
Total gross loans	\$9,705,464	\$9,024,248	
Total gross performing loans	9,664,305	8,985,969	
Reserve for unfunded credit commitments (1)	25,647	22,299	
As a percentage of total unfunded credit commitments	0.26	% 0.26	%
Total unfunded credit commitments (2)	\$9,785,736	\$8,610,791	

(1) The “Reserve for unfunded credit commitments” is included as a component of other liabilities. See “Provision for (1) Unfunded Credit Commitments” above for a discussion of the changes to the reserve.

(2) Includes unfunded loan commitments and letters of credit.

Our allowance for loan losses as a percentage of total gross loans remained flat at 1.23 percent for both June 30, 2013 and December 31, 2012. Our reserve percentage for performing loans decreased to 1.13 percent at June 30, 2013, compared to 1.16 percent at December 31, 2012 .

Our nonperforming loans were \$41.2 million at June 30, 2013, compared to \$38.3 million at December 31, 2012. The allowance for loan losses related to impaired loans was \$10.4 million at June 30, 2013 compared to \$6.3 million at December 31, 2012.

Average impaired loans for the three and six months ended June 30, 2013 were \$41.5 million and \$41.4 million, respectively, compared to \$35.3 million and \$36.6 million for the comparable 2012 periods. If the impaired loans had not been impaired, \$0.6 million and \$1.2 million in interest income would have been recorded for the three and six months ended June 30, 2013 and 2012, respectively, compared to \$0.5 million and \$1.1 million for the comparable 2012 periods.

Accrued Interest Receivable and Other Assets

A summary of accrued interest receivable and other assets at June 30, 2013 and December 31, 2012 is as follows:

(Dollars in thousands)	June 30, 2013	December 31, 2012	% Change	
Derivative assets, gross (1)	\$101,934	\$98,266	3.7	%
Accrued interest receivable	68,571	64,167	6.9	
Deferred tax assets	55,618	—	—	
FHLB and Federal Reserve Bank stock	40,532	39,806	1.8	
Foreign exchange spot contract assets, gross	66,824	42,653	56.7	
Accounts receivable	17,700	15,650	13.1	
Other assets	62,460	66,329	(5.8)

Total accrued interest receivable and other assets	\$413,639	\$326,871	26.5
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79

Table of Contents

(1) See “Derivatives” section below.

Deferred Tax Assets

Our deferred taxes moved to a net asset position at June 30, 2013, primarily due to a decrease in the fair value of our available-for-sale securities portfolio resulting from significant increases in period-end market interest rates.

Foreign Exchange Spot Contract Assets

Foreign exchange spot contract assets represent unsettled client trades at the end of the period. The increase of \$24 million was primarily due to increased client trade activity at period-end, and is consistent with the increase in foreign exchange spot contract liabilities (see “Other Liabilities” section below).

Derivatives

Derivative instruments are recorded as a component of other assets and other liabilities on the balance sheet. The following table provides a summary of derivative assets and liabilities, net at June 30, 2013 and December 31, 2012:

(Dollars in thousands)	June 30, 2013	December 31, 2012	% Change	
Assets:				
Equity warrant assets	\$76,584	\$74,272	3.1	%
Foreign exchange forward and option contracts	16,395	13,541	21.1	
Interest rate swaps	7,224	9,005	(19.8)
Loan conversion options	1,595	890	79.2	
Client interest rate derivatives	136	558	(75.6)
Total derivative assets	\$101,934	\$98,266	3.7	
Liabilities:				
Foreign exchange forward and option contracts	\$(11,298)	\$(12,847)	(12.1)
Client interest rate derivatives	(145)	(590)	(75.4)
Total derivative liabilities	\$(11,443)	\$(13,437)	(14.8)

Equity Warrant Assets

In connection with negotiating credit facilities and certain other services, we often obtain rights to acquire stock in the form of equity warrant assets in primarily private, venture-backed companies in the technology and life science industries. At June 30, 2013, we held warrants in 1,302 companies, compared to 1,270 companies at December 31, 2012. The change in fair value of equity warrant assets is recorded in gains on derivatives instruments, net, in noninterest income, a component of consolidated net income. The following table provides a summary of transactions and valuation changes for equity warrant assets for the three and six months ended June 30, 2013 and 2012:

(Dollars in thousands)	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
Balance, beginning of period	\$72,333	\$71,404	\$74,272	\$66,953
New equity warrant assets	3,941	4,546	6,444	7,154
Non-cash increases in fair value	5,697	3,260	8,492	7,823
Exercised equity warrant assets	(5,269)	(4,202)	(12,402)	(6,353)
Terminated equity warrant assets	(118)	(603)	(222)	(1,172)
Balance, end of period	\$76,584	\$74,405	\$76,584	\$74,405

Interest Rate Swaps

For information on our interest rate swaps, see Note 8—“Derivative Financial Instruments” of the “Notes to Interim Consolidated Financial Statements (unaudited)” under Part I, Item 1 of this report.

Table of Contents

Foreign Exchange Forward and Foreign Currency Option Contracts

We enter into foreign exchange forward contracts and foreign currency option contracts with clients involved in foreign activities, either as the purchaser or seller, depending upon the clients' need. For each forward or option contract entered into with our clients, we enter into an opposite way forward or option contract with a correspondent bank, which mitigates the risk of fluctuations in currency rates. We enter into forward contracts with correspondent banks to economically reduce our foreign exchange exposure related to certain foreign currency denominated loans. Revaluations of foreign currency denominated loans are recorded on the line item "Other" as part of noninterest income, a component of consolidated net income. We have not experienced nonperformance by a counterparty and therefore have not incurred related losses. Further, we anticipate performance by all counterparties. Our net exposure for foreign exchange forward and foreign currency option contracts at June 30, 2013 and December 31, 2012 amounted to \$5.1 million and \$0.7 million, respectively. For additional information on our foreign exchange forward contracts and foreign currency option contracts, see Note 8- "Derivative Financial Instruments" of the "Notes to the Consolidated Financial Statements" under Part I, Item I in this report.

Deposits

Deposits were \$18.7 billion at June 30, 2013, a decrease of \$486 million, or 2.5 percent, compared to \$19.2 billion at December 31, 2012. The decrease was driven by a decrease of \$662 million in noninterest-bearing demand deposits, partially offset by an increase of \$175 million in interest-bearing deposits. The decrease in noninterest-bearing deposits was primarily driven by our existing clients' increased utilization of our off-balance sheet sweep product, partially offset by strong levels of new client additions. At June 30, 2013, 29.3 percent of our total deposits were interest-bearing deposits, compared to 27.6 percent at December 31, 2012.

At June 30, 2013, the aggregate balance of time deposit accounts individually equal to or greater than \$100,000 totaled \$138 million, compared to \$133 million at December 31, 2012. At June 30, 2013, substantially all time deposit accounts individually equal to or greater than \$100,000 were scheduled to mature within one year. No material portion of our deposits has been obtained from a single depositor and the loss of any one depositor would not materially affect our business.

Short-Term Borrowings

Short-term borrowings were \$5.4 million at June 30, 2013, compared to \$166 million at December 31, 2012. The decrease was primarily due to overnight borrowings of \$160 million at December 31, 2012, which were repaid early in 2013. Overnight borrowings are utilized for daily cash management purposes and are a normal part of our liquidity management practices.

Long-Term Debt

At June 30, 2013, we had long-term debt of \$456 million, compared to \$458 million at December 31, 2012. At both June 30, 2013 and December 31, 2012, long-term debt included our 5.375% Senior Notes, 6.05% Subordinated Notes and 7.0% Junior Subordinated Debentures. For more information on our long-term debt, see Note 7- "Short-term Borrowings and Long-Term Debt" of the "Notes to Interim Consolidated Financial Statements (unaudited)" under Part I, Item 1 of this report.

Other Liabilities

A summary of other liabilities at June 30, 2013 and December 31, 2012 is as follows:

(Dollars in thousands)	June 30, 2013	December 31, 2012	% Change	
Foreign exchange spot contract liabilities, gross	\$102,973	\$57,868	77.9	%
Accrued compensation	54,551	94,209	(42.1))
Reserve for unfunded credit commitments	25,647	22,299	15.0	
Derivative liabilities, gross (1)	11,443	13,437	(14.8))
Deferred tax liabilities	—	25,580	(100.0))
Other	135,780	147,173	(7.7))
Total other liabilities	\$330,394	\$360,566	(8.4))

(1) See “Derivatives” section above.

81

Table of Contents

Foreign Exchange Spot Contract Liabilities

Foreign exchange spot contract liabilities represent unsettled client trades at the end of the period. The increase of \$45 million was primarily due to increased client trade activity at period-end, and is consistent with the increase in foreign exchange spot contract assets. (See "Accrued Interest Receivable and Other Assets" section above).

Accrued Compensation

Accrued compensation includes amounts for our Incentive Compensation Plans, Direct Drive Incentive Compensation Plan, Long-Term Cash Incentive Plan, Retention Program, Warrant Incentive Plan, ESOP/profit sharing and other compensation arrangements. The decrease of \$40 million was primarily the result of 2012 incentive compensation payouts during the first quarter of 2013, partially offset by additional accruals for the six months ended June 30, 2013.

Deferred Tax Liabilities

Our deferred taxes moved to a net asset position at June 30, 2013, primarily due to a decrease in the fair value of our available-for-sale securities portfolio resulting from significant increases in period-end market interest rates. See "Other Assets" above.

Noncontrolling Interests

Noncontrolling interests totaled \$824 million and \$775 million at June 30, 2013 and December 31, 2012, respectively. The increase of \$49 million was primarily due to net income attributable to noncontrolling interests of \$47.6 million for the six months ended June 30, 2013.

Fair Value Measurements

The following table summarizes our financial assets and liabilities that are measured at fair value on a recurring basis as of June 30, 2013 and December 31, 2012.

(Dollars in thousands)	June 30, 2013		December 31, 2012		
	Total Balance	Level 3	Total Balance	Level 3	
Assets carried at fair value	\$11,019,353	\$938,244	\$12,244,783	\$859,141	
As a percentage of total assets	49.7	% 4.2	% 53.8	% 3.8	%
Liabilities carried at fair value	\$11,443	\$—	\$13,437	\$—	
As a percentage of total liabilities	0.1	% —	% 0.1	% —	%
	Level 1 and 2	Level 3	Level 1 and 2	Level 3	
Percentage of assets measured at fair value	91.5	% 8.5	% 93.0	% 7.0	%

As of June 30, 2013, our available-for-sale securities, consisting primarily of agency-issued mortgage-backed securities and debentures issued by the U.S. government and its agencies, represented, totaled \$10.0 billion, or 91.1 percent of our portfolio of assets measured at fair value on a recurring basis, compared to \$11.3 billion, or 92.6 percent, as of December 31, 2012. These instruments were classified as Level 2 because their valuations were based on indicative prices corroborated by observable market quotes or valuation techniques with all significant inputs derived from or corroborated by observable market data. The fair value of our available-for-sale securities portfolio is sensitive to changes in levels of market interest rates and market perceptions of credit quality of the underlying securities. Market valuations and impairment analyses on assets in the available-for-sale securities portfolio are reviewed and monitored on a quarterly basis. Assets valued using Level 2 measurements also include equity warrant assets in shares of public company capital stock, marketable securities, interest rate swaps, foreign exchange forward and option contracts, loan conversion options and client interest rate derivatives.

Financial assets valued using Level 3 measurements consist of our investments in venture capital and private equity funds and direct equity investments in privately held companies, as well as equity warrant assets in shares of private company capital stock.

During the three and six months ended June 30, 2013, the Level 3 assets that are measured at fair value on a recurring basis experienced net realized and unrealized gains of \$39.3 million and \$65.4 million (which is inclusive of noncontrolling interest), respectively, primarily due to valuation increases in underlying fund investments in our managed funds and from our equity warrant assets, as well as gains from liquidity events and distributions. During the three and six months ended June 30, 2012, the Level 3 assets that are measured at fair value on a recurring basis experienced net realized and unrealized gains of \$16.9 million and \$29.2 million, (which is inclusive of noncontrolling interest), respectively.

Table of Contents

The valuation of non-marketable securities and equity warrant assets in shares of private company capital stock is subject to significant judgment. The inherent uncertainty in the process of valuing securities for which a ready market does not exist may cause our estimated values of these securities to differ significantly from the values that would have been derived had a ready market for the securities existed, and those differences could be material. The timing and amount of changes in fair value, if any, of these financial instruments depend upon factors beyond our control, including the performance of the underlying companies, fluctuations in the market prices of the preferred or common stock of the underlying companies, general volatility and interest rate market factors, and legal and contractual restrictions. The timing and amount of actual net proceeds, if any, from the disposition of these financial instruments depend upon factors beyond our control, including investor demand for IPOs, levels of M&A activity, legal and contractual restrictions on our ability to sell, and the perceived and actual performance of portfolio companies. All of these factors are difficult to predict and there can be no assurances that we will realize the full value of these securities, which could result in significant losses. (see “Risk Factors” set forth in our 2012 Form 10-K).

Capital Resources

Our management seeks to maintain adequate capital to support anticipated asset growth, operating needs and unexpected credit risks, and to ensure that SVB Financial and the Bank are in compliance with all regulatory capital guidelines. Our primary sources of new capital include retained earnings and proceeds from the sale and issuance of capital stock or other securities. Our management engages, in consultation with the Finance Committee of our Board of Directors, in a regular capital planning process in an effort to optimize the use of the capital available to us and to appropriately plan for our future capital needs. The capital plan considers capital needs for the foreseeable future and allocates capital to both existing and future business activities. Expected future use or activities for which capital may be set aside include balance sheet growth and associated relative increases in market or credit exposure, investment activity, potential product and business expansions, acquisitions and strategic or infrastructure investments.

SVBFG Stockholders’ Equity

SVBFG stockholders’ equity remained relatively flat at \$1.8 billion for both June 30, 2013 and December 31, 2012, with an increase of \$17 million, or 1.0 percent. This increase was primarily the result of net income of \$89.5 million for the six months ended June 30, 2013, and an increase in additional-paid-in-capital of \$46 million primarily from stock option exercises during the six months ended June 30, 2013. These increases were largely offset by a decrease in accumulated other comprehensive income of \$118 million primarily due to a decrease in the fair value of our available-for-sale securities portfolio as a result of significant increases in period-end market interest rates. Funds generated through retained earnings are a significant source of capital and liquidity and are expected to continue to be so in the future.

Capital Ratios

Both SVB Financial and the Bank are subject to various capital adequacy guidelines issued by the Federal Reserve Board and the California Department of Financial Institutions. To be classified as “adequately capitalized” under these capital guidelines, minimum ratios for total risk-based capital, Tier 1 risk-based capital and Tier 1 leverage ratio for bank holding companies and banks are 8.0%, 4.0% and 4.0%, respectively.

To be classified as “well capitalized” under these capital guidelines, minimum ratios for total risk-based capital and Tier 1 risk-based capital for bank holding companies and banks are 10.0% and 6.0%, respectively. Under the same capital adequacy guidelines, a well-capitalized state member bank must maintain a minimum Tier 1 leverage ratio of 5.0%. There is no Tier 1 leverage requirement for a holding company to be deemed well-capitalized.

The Federal Reserve has not issued any minimum guidelines for the tangible common equity to tangible assets ratio or the tangible common equity to risk-weighted assets ratio. However, we believe these ratios provide meaningful supplemental information regarding our capital levels and are therefore provided below.

Regulatory capital ratios for SVB Financial and the Bank exceeded minimum federal regulatory guidelines for a well-capitalized depository institution as of June 30, 2013 and December 31, 2012. Capital ratios for SVB Financial and the Bank, compared to the minimum regulatory ratios to be considered “well capitalized” and “adequately capitalized”, are set forth below:

Table of Contents

	June 30, 2013		December 31, 2012		Minimum ratio to be “Well Capitalized”		Minimum ratio to be “Adequately Capitalized”	
SVB Financial:								
Total risk-based capital ratio	14.03	%	14.05	%	10.0	%	8.0	%
Tier 1 risk-based capital ratio	12.84		12.79		6.0		4.0	
Tier 1 leverage ratio	8.78		8.06		N/A		4.0	
Tangible common equity to tangible assets ratio (1)(2)	8.34		8.04		N/A		N/A	
Tangible common equity to risk-weighted assets ratio (1)(2)	12.73		13.53		N/A		N/A	
Bank:								
Total risk-based capital ratio	12.42	%	12.53	%	10.0	%	8.0	%
Tier 1 risk-based capital ratio	11.20		11.24		6.0		4.0	
Tier 1 leverage ratio	7.66		7.06		5.0		4.0	
Tangible common equity to tangible assets ratio (1)(2)	7.60		7.41		N/A		N/A	
Tangible common equity to risk-weighted assets ratio (1)(2)	11.18		12.08		N/A		N/A	

(1) See below for a reconciliation of non-GAAP tangible common equity to tangible assets and tangible common equity to risk-weighted assets.

(2) The Federal Reserve Bank has not issued any minimum guidelines for the tangible common equity to tangible assets ratio or the tangible common equity to risk-weighted assets ratio. However, we believe these ratios provide meaningful supplemental information regarding our capital levels and are therefore provided above.

Our total and tier 1 risk-based capital ratios for both SVB Financial and the Bank remained relatively flat compared to December 31, 2012 reflective of increases in risk-weighted assets, which primarily reflects our growth in period-end loan balances. The growth in risk-weighted assets was largely offset by growth in retained earnings and additional-paid-in-capital. Our tier 1 leverage ratios for both SVB Financial and the Bank increased compared to December 31, 2012 due to growth in retained earnings and additional-paid-in-capital, while average assets remained relatively flat. All of our capital ratios are above the levels to be considered “well capitalized”.

The tangible common equity to tangible assets ratio and the tangible common equity to risk-weighted assets ratios are not required by GAAP or applicable bank regulatory requirements. However, we believe these ratios provide meaningful supplemental information regarding our capital levels. Our management uses, and believes that investors benefit from referring to, these ratios in evaluating the adequacy of the Company’s capital levels; however, this financial measure should be considered in addition to, not as a substitute for or preferable to, comparable financial measures prepared in accordance with GAAP. These ratios are calculated by dividing total SVBFG stockholder’s equity, by total period-end assets and risk-weighted assets, after reducing both amounts by acquired intangibles, if any. The manner in which this ratio is calculated varies among companies. Accordingly, our ratio is not necessarily comparable to similar measures of other companies. The following table provides a reconciliation of non-GAAP financial measures with financial measures defined by GAAP:

	SVB Financial		Bank	
	June 30, 2013	December 31, 2012	June 30, 2013	December 31, 2012
Non-GAAP tangible common equity and tangible assets (dollars in thousands, except ratios)				
GAAP SVBFG stockholders’ equity	\$1,847,956	\$1,830,555	\$1,585,117	\$1,591,643
Less:				
Intangible assets	—	—	—	—

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Tangible common equity	\$1,847,956	\$1,830,555	\$1,585,117	\$1,591,643
GAAP Total assets	\$22,153,901	\$22,766,123	\$20,867,463	\$21,471,111
Less:				
Intangible assets	—	—	—	—
Tangible assets	\$22,153,901	\$22,766,123	\$20,867,463	\$21,471,111
Risk-weighted assets	\$14,519,645	\$13,532,984	\$14,174,380	\$13,177,887
Tangible common equity to tangible assets	8.34	% 8.04	% 7.60	% 7.41
Tangible common equity to risk-weighted assets	12.73	13.53	11.18	12.08

84

Table of Contents

For both SVB Financial and the Bank, the tangible common equity to tangible assets ratios increased due to decreases in total assets resulting from a decrease in deposits, while total equity remained relatively flat. See "SVBFG Stockholders' Equity" above for further details on changes to the individual components of our equity balance.

For both SVB Financial and the Bank, the tangible common equity to risk-weighted assets ratios increased due to increases in risk-weighted assets, which primarily reflects our growth in period-end loan balances.

Off-Balance Sheet Arrangements

In the normal course of business, we use financial instruments with off-balance sheet risk to meet the financing needs of our customers. These financial instruments include commitments to extend credit, commercial and standby letters of credit and commitments to invest in venture capital and private equity fund investments. These instruments involve, to varying degrees, elements of credit risk. Credit risk is defined as the possibility of sustaining a loss because other parties to the financial instrument fail to perform in accordance with the terms of the contract. For details of our commitments to extend credit, and commercial and standby letters of credit, please refer to Note 11—"Off-Balance Sheet Arrangements, Guarantees, and Other Commitments" of the "Notes to Interim Consolidated Financial Statements (unaudited)" under Part I, Item 1 of this report.

Commitments to Invest in Venture Capital/Private Equity Funds

We make commitments to invest in venture capital and private equity funds, which in turn make investments generally in, or in some cases make loans to, privately-held companies. Commitments to invest in these funds are generally made for a 10-year period from the inception of the fund. Although the limited partnership agreements governing these investments typically do not restrict the general partners from calling 100% of committed capital in one year, it is customary for these funds to generally call most of the capital commitments over 5 to 7 years; however in certain cases, the funds may not call 100% of committed capital over the life of the fund. The actual timing of future cash requirements to fund these commitments is generally dependent upon the investment cycle, overall market conditions, and the nature and type of industry in which the privately held companies operate.

For further details on our commitments to invest in private equity funds, refer to Note 11—"Off-Balance Sheet Arrangements, Guarantees, and Other Commitments" of the "Notes to Interim Consolidated Financial Statements (unaudited)" under Part I, Item 1 of this report.

Liquidity

The objective of liquidity management is to ensure that funds are available in a timely manner to meet our financial obligations, including, as necessary, paying creditors, meeting depositors' needs, accommodating loan demand and growth, funding investments, repurchasing securities and other operating or capital needs, without incurring undue cost or risk, or causing a disruption to normal operating conditions.

We regularly assess the amount and likelihood of projected funding requirements through a review of factors such as historical deposit volatility and funding patterns, present and forecasted market and economic conditions, individual client funding needs, and existing and planned business activities. Our Asset/Liability Committee ("ALCO"), which is a management committee, provides oversight to the liquidity management process and recommends policy guidelines for the approval of the Finance Committee of our Board of Directors, and courses of action to address our actual and projected liquidity needs.

Our deposit base is, and historically has been, our primary source of liquidity. Our deposit levels and cost of deposits may fluctuate from time to time due to a variety of factors, including market conditions, prevailing interest rates, changes in client deposit behaviors, availability of insurance protection, and our offering of deposit products. At June 30, 2013, our period-end total deposit balances decreased by \$486 million to \$18.7 billion, compared to \$19.2 billion at December 31, 2012. This decrease was primarily reflective of our existing clients' increased utilization of our off-balance sheet sweep product, partially offset by strong levels of new client additions.

Our liquidity requirements can also be met through the use of our portfolio of liquid assets. Our definition of liquid assets includes cash and cash equivalents in excess of the minimum levels necessary to carry out normal business operations, short-term investment securities maturing within one year, available-for-sale securities eligible and available for financing or pledging purposes with a maturity in excess of one year and anticipated near-term cash flows from investments.

On a stand-alone basis, SVB Financial's primary liquidity channels include dividends from the Bank, its portfolio of liquid assets, and its ability to raise debt and capital. The ability of the Bank to pay dividends is subject to certain regulations described in "Business—Supervision and Regulation—Restriction on Dividends" under Part I, Item 1 of our 2012 Form 10-K.

Table of Contents

Consolidated Summary of Cash Flows

Below is a summary of our average cash position and statement of cash flows for the six months ended June 30, 2013 and 2012. For further details, see our "Interim Consolidated Statements of Cash Flows" under Part I, Item 1 of this report.

(Dollars in thousands)	Six months ended June 30,		
	2013	2012	
Average cash and cash equivalents	\$1,047,091	\$1,325,539	
Percentage of total average assets	4.7	% 6.4	%
Net cash provided by (used for) operating activities	\$32,986	\$(6,102))
Net cash provided by (used for) investing activities	441,320	(981,459))
Net cash (used for) provided by financing activities	(610,038)	) 1,284,338	
Net (decrease) increase in cash and cash equivalents	\$(135,732)	) \$296,777	

Average cash and cash equivalents decreased by \$278 million, or 21.0 percent, to \$1.0 billion for the six months ended June 30, 2013, compared to \$1.3 billion for the comparable 2012 period. The decrease was primarily due to the funding of loan growth.

Net cash provided by operating activities was \$33 million for the six months ended June 30, 2013, primarily reflective of net income of \$89.5 million, partially offset by \$40 million in net payouts of accrued compensation.

Net cash provided by investing activities of \$441 million for the six months ended June 30, 2013 included \$1.3 billion from sales, maturities and paydowns of available-for-sale securities, partially offset by a \$671 million net increase in loans and \$220 million for purchases of available-for-sale securities.

Net cash used for financing activities was \$610 million for the six months ended June 30, 2013, reflective of a net decrease of \$486 million in deposits and \$160 million in repayment of overnight borrowings, partially offset by proceeds of \$32 million from the issuance of common stock and ESPP.

Cash and cash equivalents at June 30, 2013 were \$873 million, compared to \$1.4 billion at June 30, 2012.

Table of Contents

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Risk Management

Market risk is defined as the risk of adverse fluctuations in the market value of financial instruments due to changes in market interest rates. Interest rate risk is our primary market risk and can result from timing and volume differences in the repricing of our rate-sensitive assets and liabilities, widening or tightening of credit spreads, changes in the general level of market interest rates and changes in the shape and level of the benchmark LIBOR/SWAP yield curve.

Additionally, changes in interest rates can influence the rate of principal prepayments on mortgage securities which affects the rate of amortization of purchase premiums and discounts. Other market risks include foreign currency exchange risk and equity price risk. These risks are not considered significant and no separate quantitative information concerning them is presented herein.

Interest rate risk is managed by our ALCO. ALCO reviews the market valuation and 12-month forward looking earnings sensitivity of assets and liabilities to changes in interest rates, structural changes in investment and funding portfolios, loan and deposit activity and current market conditions. Adherence to relevant policies, which are approved by the Finance Committee of our Board of Directors, is monitored on an ongoing basis.

Management of interest rate risk is carried out primarily through strategies involving our available-for-sale securities, available funding channels and capital market activities. In addition, our policies permit the use of off-balance sheet derivative instruments to assist in managing interest rate risk.

We utilize a simulation model to perform sensitivity analysis on the economic value of equity and net interest income under a variety of interest rate scenarios, balance sheet forecasts and proposed strategies. The simulation model provides a dynamic assessment of interest rate sensitivity embedded in our balance sheet which measures the potential variability in forecasted results relating to changes in market interest rates over time. We review our interest rate risk position on a quarterly basis at a minimum.

Model Simulation and Sensitivity Analysis

One application of the aforementioned simulation model involves measurement of the impact of market interest rate changes on our economic value of equity ("EVE"). EVE is defined as the market value of assets, less the market value of liabilities, adjusted for any off-balance sheet items. A second application of the simulation model measures the impact of market interest rate changes on our net interest income ("NII") assuming a static balance sheet as of the period-end reporting date. The market interest rate changes that affect us are principally short-term interest rates and include the following: (1) National Prime and SVB Prime rates; (2) 1-month and 3-month LIBOR; and (3) Fed Funds target rate. Changes in these short-term rates impact interest earned on our variable rate loans, variable rate available-for-sale securities and balances held as cash and cash equivalents. Additionally, deposit pricing generally follows overall changes in short-term interest rates.

The following table presents our EVE and NII sensitivity exposure at June 30, 2013 and December 31, 2012, related to an instantaneous and sustained parallel shift in market interest rates of 100 and 200 basis points.

Change in interest rates (basis points)	Estimated	Estimated Increase In		Estimated	Estimated Increase/		
	EVE	EVE	Percent	NII	(Decrease) In NII	Percent	
	(Dollars in thousands)						
June 30, 2013:							
+200	\$3,720,730	\$505,850	15.7	\$855,928	\$144,580	20.3	%
+100	3,432,198	217,318	6.8	773,442	62,094	8.7	
—	3,214,880	—	—	711,348	—	—	
-100	3,143,393	(71,487)	(2.2)	700,844	(10,504)	(1.5))
-200	3,299,802	84,922	2.6	695,214	(16,134)	(2.3))
December 31, 2012:							
+200	\$3,176,231	\$345,925	12.2	% \$834,208	\$137,021	19.7	%
+100	2,862,361	32,055	1.1	757,662	60,475	8.7	
—	2,830,306	—	—	697,187	—	—	
-100	2,981,216	150,910	5.3	671,976	(25,211)	(3.6))

Table of Contents

Economic Value of Equity

The estimated EVE in the preceding table is based on a combination of valuation methodologies including a discounted cash flow analysis and a multi-path lattice based valuation. Both methodologies use publicly available market interest rates. The model simulations and calculations are highly assumption-dependent and will change regularly as our asset/liability structure changes, as interest rate environments evolve, and as we change our assumptions in response to relevant market or business circumstances. These calculations do not reflect the changes that we anticipate or may make to reduce our EVE exposure in response to a change in market interest rates as a part of our overall interest rate risk management strategy.

As with any method of measuring interest rate risk, certain limitations are inherent in the method of analysis presented in the preceding table. We are exposed to yield curve risk, prepayment risk and basis risk, which cannot be fully modeled and expressed using the above methodology. Accordingly, the results in the preceding table should not be relied upon as a precise indicator of actual results in the event of changing market interest rates. Additionally, the resulting EVE and NII estimates are not intended to represent, and should not be construed to represent the underlying value. In addition, we assume different rates of deposit balance decrease for each interest rate scenario based on a long-term historical deposit study of our clients.

Our base case EVE at June 30, 2013 increased from December 31, 2012 by \$385 million, primarily due to the change in balance sheet mix and steeper market yield curves. The change in balance sheet mix was primarily reflective of an increase of \$675 million in our loan portfolio, partially offset by a decrease of \$1.3 billion in available-for-sale securities. EVE sensitivity slightly increased in the simulated upward interest rate movements due to a decrease in fixed rate available-for-sale securities. In the simulated downward interest rate movements, EVE sensitivity decreased due to steeper and higher market yield curves. The higher yield curve had a bigger reduction impact on non-interest bearing deposits, which more than offset the asset value increase from the down rate scenarios.

12-Month Net Interest Income Simulation

Our expected 12-month NII at June 30, 2013 increased from December 31, 2012 by \$14 million, primarily due to an increase of \$675 million in our loan portfolio, partially offset by a decrease of \$1.3 billion in available-for-sale securities. NII sensitivity increased slightly in the simulated upward interest rate movements due to an increase in variable rate interest-earning assets, partially offset by an increase in interest bearing deposits. In the simulated downward interest rate movements, the NII sensitivity decreased due to a lower short-end market yield curve, which reduced the negative impact of rate reset from the variable rate assets.

The simulation model used in the above analysis embeds floors in our interest rate scenarios, which prevent model benchmark rates from moving below 0.0%. In addition, we assume different deposit balance decay rates for each interest rate scenario based on a long-term historical deposit study of our clients. These assumptions may change in future periods based on management discretion. Actual changes in our deposit pricing strategies may differ from our current model assumptions and may have an impact on our overall sensitivity.

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Disclosure controls and procedures are the controls and other procedures that are designed to ensure that information required to be disclosed in the reports that we file or submit under the Securities Exchange Act of 1934, as amended (the "Exchange Act") is recorded, processed, summarized, and reported within the time periods specified in SEC rules and forms. Disclosure controls and procedures include, among other things, processes, controls and procedures designed to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

We carried out an evaluation, under the supervision and with the participation of management, including the Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of our most recently completed fiscal quarter, pursuant to Exchange Act Rule 13a-15(b). Based upon this evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures were effective.

Changes in Internal Control

There were no changes in our internal control over financial reporting identified in management's evaluation pursuant to Rules 13a-15(d) or 15d-15(d) of the Exchange Act during the period covered by this Quarterly Report on Form 10-Q that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II—OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Please refer to Note 14—“Legal Matters” of the “Notes to Interim Consolidated Financial Statements (unaudited)” under Part I, Item 1 of this report.

ITEM 1A. RISK FACTORS

There are no material changes from the risk factors set forth in our 2012 Form 10-K.

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

Recent Sales of Unregistered Securities

During the first quarter of 2013, we discovered that we sold shares of our common stock that were not registered with the SEC to certain participants, through their investment in our unitized common stock fund, under our SVB Financial Group 401(k) and Employee Stock Ownership Plan (“401(k) Plan”). The common stock fund is comprised primarily of shares of our common stock, and to a lesser extent, cash; and participants may invest 401(k) Plan contributions for an interest in the fund. With respect to the purchases that were not registered, the shares of our common stock held in the common stock fund are purchased by our 401(k) Plan trustee from the open market; hence, these purchases do not represent any additional equity dilution of our outstanding shares. We do not receive any proceeds from these transactions.

Under applicable federal securities laws, certain participants may have a right to rescind, and to require us to repurchase, their purchases of our common stock (through their investment in the common stock fund) for an amount equal to the price paid for the securities, plus interest. Generally, the federal statute of limitations applicable to such rescission rights is one year. Additionally, we may be subject to potential civil and other penalties by regulatory authorities as a result of this registration issue.

Based on our estimates, we do not believe the amount of potential liability associated with the securities subject to rescission rights is material to our financial condition or results of operations. As of June 30, 2013, we estimate that there were less than 40,000 shares of our common stock (over the one-year period preceding such date) that would be subject to rescission rights; substantially none of which, based on our closing stock price of \$87.12 as of August 6, 2013 would be economically advantageous for participants to exercise any such rescission rights. These securities continue to be reflected in stockholders' equity in our balance sheet.

We filed a new registration statement on Form S-8 on May 20, 2013 to register future sales of our common stock through our common stock fund under the 401(k) Plan.

Issuer Purchases of Equity Securities

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

See Index to Exhibits at end of report.

Table of Contents

SIGNATURES

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

SVB Financial Group

Date: August 8, 2013

/s/ MICHAEL DESCHENEUX
Michael Descheneaux
Chief Financial Officer
(Principal Financial Officer)

SVB Financial Group

Date: August 8, 2013

/s/ KAMRAN HUSAIN
Kamran Husain
Chief Accounting Officer
(Principal Accounting Officer)

90

Table of Contents

INDEX TO EXHIBITS

Exhibit Number	Exhibit Description	Incorporated by Reference			Filing Date	Filed Herewith
		Form	File No.	Exhibit		
3.1	Restated Certificate of Incorporation	8-K	000-15637	3.1	May 31, 2005	
3.2	Amended and Restated Bylaws	8-K	000-15637	3.2	July 27, 2010	
3.3	Certificate of Designation of Rights, Preferences and Privileges of Series A Participating Preferred Stock	8-K	000-15637	3.3	December 8, 2008	
3.4	Certificate of Designations of Fixed Rate Cumulative Perpetual Preferred Stock, Series B	8-K	000-15637	3.4	December 15, 2008	
4.1	Junior Subordinated Indenture, dated as of October 30, 2003 between SVB Financial and Wilmington Trust Company, as trustee	8-K	000-15637	4.12	November 19, 2003	
4.2	7.0% Junior Subordinated Deferrable Interest Debenture due October 15, 2033 of SVB Financial	8-K	000-15637	4.13	November 19, 2003	
4.3	Amended and Restated Trust Agreement, dated as of October 30, 2003, by and among SVB Financial as depositor, Wilmington Trust Company as property trustee, Wilmington Trust Company as Delaware trustee, and the Administrative Trustees named therein	8-K	000-15637	4.14	November 19, 2003	
4.4	Certificate Evidencing 7% Cumulative Trust Preferred Securities of SVB Capital II, dated October 30, 2003	8-K	000-15637	4.15	November 19, 2003	
4.5	Guarantee Agreement, dated October 30, 2003, between SVB Financial and Wilmington Trust Company, as trustee	8-K	000-15637	4.16	November 19, 2003	
4.6	Agreement as to Expenses and Liabilities, dated as of October 30, 2003, between SVB Financial and SVB Capital II	8-K	000-15637	4.17	November 19, 2003	
4.7	Certificate Evidencing 7% Common Securities of SVB Capital II, dated October 30, 2003	8-K	000-15637	4.18	November 19, 2003	
4.8	Officers' Certificate and Company Order, dated October 30, 2003, relating to the 7.0% Junior Subordinated Deferrable Interest Debentures due October 15, 2033	8-K	000-15637	4.19	November 19, 2003	
4.9	Amended and Restated Preferred Stock Rights Agreement, dated as of January 29, 2004, between SVB Financial and Wells Fargo Bank	8-A12G/A	000-15637	4.20	February 27, 2004	

	Minnesota, N.A.				
	Amendment No. 1 to Amended & Restated Preferred Stock Rights				
4.10	Agreement, dated as of August 2, 2004, by and between SVB Financial and Wells Fargo Bank, N.A.	8-A12G/A	000-15637	4.13	August 3, 2004
	Amendment No. 2 to Amended & Restated Preferred Stock Rights				
4.11	Agreement, dated as of January 29, 2008, by and between SVB Financial and Wells Fargo Bank, N.A.	8-A/A	000-15637	4.14	January 29, 2008
	Amendment No. 3 to Amended and Restated Preferred Stock Rights				
4.12	Agreement, dated as of April 30, 2008, by and between SVB Financial and Wells Fargo Bank, N.A.	8-A/A	000-15637	4.20	April 30, 2008

Table of Contents

Exhibit Number	Exhibit Description	Incorporated by Reference			Filing Date	Filed Herewith
		Form	File No.	Exhibit		
4.13	Amendment No. 4 to Amended and Restated Preferred Stock Rights Agreement, dated as of January 15, 2010, by and between SVB Financial, Wells Fargo Bank, N.A. and American Stock Transfer & Trust Company, LLC	8-A/A	000-15637	4.22	January 19, 2010	
4.14	Indenture, dated September 20, 2010, by and between SVB Financial Group and U.S. Bank National Association, as trustee	8-K	000-15637	4.1	September 20, 2010	
4.15	Form of 5.375% Senior Note due 2020	8-K	000-15637	4.2	September 20, 2010	
31.1	Rule 13a-14(a) / 15(d)-14(a) Certification of Principal Executive Officer					X
31.2	Rule 13a-14(a) / 15(d)-14(a) Certification of Principal Financial Officer					X
32.1	Section 1350 Certifications					**
101.INS	XBRL Instance Document					X
101.SCH	XBRL Taxonomy Extension Schema Document					X
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document					X
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document					X
101.LAB	XBRL Taxonomy Extension Label Linkbase Document					X
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document					X
**	Furnished herewith					