MERCURY SYSTEMS INC
Form 8-K
August 05, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 8-K

CURRENT REPORT
PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934
Date of report (Date of earliest event reported): August 5, 2014

Mercury Systems, Inc.
(Exact Name of Registrant as Specified in Charter)

Massachusetts (State or Other Jurisdiction of Incorporation)	000-23599 (Commission File Number)	04-2741391 (IRS Employer Identification No.)

201 Riverneck Road, Chelmsford, Massachusetts	01824
(Address of Principal Executive Offices)	(Zip Code)

Registrant’s telephone number, including area code: (978) 256-1300
Not Applicable
(Former Name or Former Address, if Changed Since Last Report)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions (see General Instruction A.2. below):

..
Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

..
Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)

..
Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))

..
Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

Item 2.02. Results of Operations and Financial Condition.

On August 5, 2014, Mercury Systems, Inc. (the "Company") issued a press release regarding its financial results for the quarter and fiscal year ended June 30, 2014. The Company's press release is attached as exhibit 99.1 to this Current Report on Form 8-K and incorporated by reference herein.

Information in Item 2.02 of this Current Report on Form 8-K and the exhibit 99.1 attached hereto shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the "Exchange Act") or otherwise subject to the liabilities of that section, nor shall it be deemed incorporated by reference in any filing under the Securities Act of 1933, as amended, or the Exchange Act, regardless of any general incorporation language in such filing.

USE OF NON-GAAP FINANCIAL MEASURES

In addition to reporting financial results in accordance with generally accepted accounting principles, or GAAP, the Company provides adjusted EBITDA and free cash flow, which are non-GAAP financial measures. Adjusted EBITDA excludes certain non-cash and other specified charges, while free cash flow adjusts cash flows from operations by the amount of capital expenditures. The Company believes these non-GAAP financial measures are useful to help investors more completely understand its past financial performance and prospects for the future. However, the presentation of adjusted EBITDA and free cash flow is not meant to be considered in isolation or as a substitute for financial information provided in accordance with GAAP. Management believes the adjusted EBITDA and free cash flow financial measures assist in providing a more complete understanding of the Company's underlying operational results and trends, and management uses these measures along with the corresponding GAAP financial measures to manage the Company's business, to evaluate its performance compared to prior periods and the marketplace, and to establish operational goals.

Item 9.01. Financial Statements and Exhibits.

(d) Exhibits.

Exhibit No.	Description
99.1	Press Release, dated August 5, 2014, of Mercury Systems, Inc.

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.

Dated: August 5, 2014

MERCURY SYSTEMS, INC.

By: /s/ Kevin M. Bisson
Kevin M. Bisson
Senior Vice President, Chief Financial Officer, and Treasurer

EXHIBIT INDEX

Exhibit No.	Description
99.1	Press Release, dated August 5, 2014, of Mercury Systems, Inc.

25,536

Other reallocation (2)

657 (893) (370)

(Recapture of) provision for loan losses

(16,750) 7,068 61,200 80,500

Allowance for loan losses at end of period

$75,235 $92,441 $93,964 $105,259 $108,924

Summary of reserve for unfunded loan commitments:

Reserve for unfunded loan commitments at beginning of period

$8,588 $9,588 $10,506 $7,906 $4,156

Provision for unfunded loan commitments

500   (1,000)   (918)   2,600   3,750

Reserve for unfunded loan commitments at end of period	$9,088	$8,588	$9,588	$10,506	$7,906

Reserve for unfunded loan commitments to total unfunded loan commitments	1.45%	1.55%	1.47%	1.64%	1.19%
Amount of total loans at end of period (1)	$3,385,916	$3,252,313	$3,219,727	$3,373,728	$3,608,379
Average total loans outstanding (1)	$3,223,713	$3,199,629	$3,222,450	$3,485,836	$3,735,339
Net charge-offs to average total loans	0.01%	0.07%	0.54%	1.85%	0.68%
Net charge-offs to total loans at end of period	0.01%	0.07%	0.54%	1.91%	0.71%
Allowance for loan losses to average total loans	2.33%	2.89%	2.92%	3.02%	2.92%
Allowance for loan losses to total loans at end of period	2.22%	2.84%	2.92%	3.12%	3.02%
Net charge-offs to allowance for loan losses	0.61%	2.36%	18.59%	61.27%	23.44%
Net charge-offs to provision for loan losses	-2.72%		247.17%	105.38%	31.72%

(1) Net of deferred loan origination fees.

(2) During 2012, there was $657,000 in net recoveries for covered loans, resulting in a $ 657,000 recapture of provision for loan losses on the covered SJB loans. An offsetting adjustment was recorded to the FDIC loss-sharing asset based on the appropriate asset based on the appropriate loss-sharing percentage.

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Specific allowance: For impaired loans, we incorporate specific allowances based on loans individually evaluated utilizing one of three valuation methods, as prescribed under ASC 310-10. If the measure of the impaired loan is less than the recorded investment in the loan, the deficiency will be charged off against the ALLL or, alternatively, a specific allocation will be established and included in the overall ALLL balance. The specific allocation represents $3.2 million (4.22%), $2.3 million (2.52%) and $2.0 million (2.18%) of the total allowance as of December 31, 2013, December 31, 2012 and December 31, 2011, respectively.

General allowance: The loan portfolio collectively evaluated for impairment under ASC 450-20 is divided into classes of loan receivables between classified loans (including substandard and special mention loans) and unclassified loans, and then further disaggregated into loan segments by loan type with similar risk characteristics. The non-classified loans are divided into 37 segments, including 25 specific segments within the commercial real estate and construction loan portfolios split between owner and non-owner properties and based on property type (i.e. industrial, office, retail, etc.). The allowance is provided for each segment based upon that segment s average historical loss experience over a rolling twenty-quarter period, adjusted for current conditions based on our analysis of specific environmental or qualitative loss factors, as prescribed in the 2006 Interagency Policy Statement on ALLL, affecting the collectability of our loan portfolio that may cause actual loss rates to differ from historical loss experience.

In addition, recognizing the inherent imprecision in the estimation of these loss factors, we also incorporate an *unallocated reserve* that reflects management s best estimate of probable losses not otherwise captured by our qualitative loss factors or otherwise accounted for in our ALLL methodology. Management believes that appropriate drawdowns from usage of the unallocated reserve may include, but are not limited to, (i) consideration of conditions or factors that may not be easily allocated to a specific loan segment, (ii) addressing elevated risks from unique or unusual conditions of volatility and uncertainty affecting the collectability of our loan portfolio, (iii) supporting allocations resulting from refinements to our factors, and (iv) prudent releases of general reserves, if warranted and appropriate when current conditions show demonstrable improvement in credit quality for a sustained period.

Moreover, as conditions change, we may modify or refine our methodology to better reflect risk characteristics that currently impact underlying credit components and the collectability of the loan portfolio. Examples of such modifications or refinements impacting our ALLL in recent quarters include (i) addition of a qualitative factor on changes in the value of underlying collateral for collateral-dependent loans , based on continuing weakness in the values of commercial real estate in our primary lending markets, (ii) increasing the number of segments within the classified and criticized pools primarily to disaggregate our real estate portfolio between owner-occupied and non-owner occupied commercial real estate loans, as well as between residential and non-residential construction loans, and (iii) creating a specific allocated pool for our dairy and livestock loan segment to address perceived weaknesses in this segment due to phenomena such as highly volatile milk and feed prices, reduced levels of cow milk production, shorter cyclical periods between industry highs and lows, unstable values for herd liquidations, lack of adequate farm land to raise forage crops in certain geographical locations, and depleted resources available to certain dairy operators due to periodic industry stress factors.

In the fourth quarter ended December 31, 2013, the Bank implemented a change in its methodology to calculate the ALLL. Previously, the Bank used an annual three-year look-back period of historical losses, segmented by loan type, with the loss factors updated annually to include the current year s loss experience in the fourth quarter of each year. External factors that were considered were the improving credit environment and the stabilizing economy. In determining the look-back period, management considered the period used to develop the

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historical loss rate should be long enough to capture sufficient loss data. We determined that a rolling twenty quarters look-back period was appropriate as of December 31, 2013 because the most recent three-year period provides insufficient data, with very low loss experience, and in some cases recoveries actually exceed losses within certain loan segments during the three year period. We believe the rolling twenty quarters look-back period is the best indicator of inherent losses within the loan portfolio as many of the economic factors in the early stages of the economic recovery still exist.

During the fourth quarter of 2013, we made no further adjustments to qualitative loss factors despite slight improvement in certain underlying credit conditions and factors that affect the Bank s loan portfolio. While the Bank observed that recent improving credit factors and lower net loan loss experience may be partly due to gradual economic improvement compared to the economic meltdown of 2008-2009, including increases in GNP, rising housing prices and falling unemployment within the Bank s market area, etc., these conditions mask significant uncertainty in the economy and weakness that represents continued risk, and inherent loss, to our loan portfolio. In reaching the decision to remain static as to our qualitative factors, we considered various offsetting conditions in the current environment including rising commercial real estate cap rates which could depress real estate values, a strengthening U.S. dollar which may drive exports down, an unstable international economy with major trading partners in the Pacific Rim experiencing a significant slowdown in growth, drought conditions in the State of California causing water resource issues that may impact agribusiness and other industries, and health care laws that are impacting the labor force, etc. We will continue to review the qualitative factors each quarter for possible adjustments, as appropriate. Although there was no impact from qualitative factors to our allowance requirements, the combined effect of lower historical loss rates, updated during this reporting period to include a change in methodology as described above, along with improving credit metrics and a continued decline in classified loans of $18.5 million from September 30, 2013, reduced our allocated allowance requirement by $5.4 million. This reduction of $5.4 million to our allocated allowance requirement and along with net recoveries of $1.3 million during the fourth quarter of 2013, resulted in a loan loss provision recapture of $6.8 million for the quarter ended December 31, 2013.

During the third quarter of 2013, in light of continued improvement in certain underlying credit conditions that affect key segments (e.g. commercial real estate, commercial and industrial and dairy & livestock) within the Bank s loan portfolio, we reduced loss factors related to several of the qualitative factors including (i) changes in economic and business conditions, (ii) changes in volume and severity of past due loans and volume of nonaccrual and classified loans, (iii) changes in the collateral value of collateral-dependent loans, and (iv) certain qualitative factors pertaining specifically to the dairy & livestock segment, which experienced improvement in both industry and borrower factors. The improvements noted included, but are not limited to, (i) better economic conditions and rising home values, improving consumer confidence and spending creating revenue growth generally for businesses we serve, (ii) improvement in cash flows of our business customers generally resulting in lower rates of loan delinquency and lower levels of classified loans for the Bank, (iii) improving rental rates, reduced vacancies, and better absorption rates for commercial real estate in real estate markets we serve resulting in rising collateral values for collateral-dependent loans, and (iv) improving conditions in the dairy & livestock segment, including higher milk prices and lower feed costs industry-wide that resulted in better operating results for our borrowers. The impact of these changes to our factors in addition to a significant decline in classified loans of $40.3 million from June 30, 2013 which, based on our methodologies, reduced our allowance requirement by $3.8 million resulting in a loan loss provision recapture of $3.8 million for the third quarter of 2013. This compares to a $6.2 million loan loss provision recapture for the second quarter of 2013. Future adjustments will then, as now, be based on an evaluation of all relevant facts and circumstances that we determine in our best judgment are necessary to reflect current conditions as they may impact overall loan loss rates and improve our ability to estimate losses inherent in the Bank s loan portfolio.

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

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Summary of Loan Loss Experience ***(Covered Loans)***

	For the Year Ended December 31, 2013	2012
	(Dollars in thousands)	
Allowance for loan losses at beginning of period	$	$
Loans charged-off		81
Recoveries		738
Provision charged to operating expense		(657)
Allowance for loan losses at end of period	$	$

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

The following table provides a summary of the allocation of the allowance for loan losses for specific loan categories at the dates indicated for non-covered loans. The allocations presented should not be interpreted as an indication that loans charged to the allowance for loan losses will occur in these amounts or proportions, or that the portion of the allowance allocated to each loan category, represents the total amount available for future losses that may occur within these categories.

Allocation of Allowance for Loan losses ***(Non-Covered Loans)***

	December 31, 2013		2012		2011		2010		2009	
	Allowance for Loan Losses	% of Loans to Total Loans in Each Category	Allowance for Loan Losses	% of Loans to Total Loans in Each Category	Allowance for Loan Losses	% of Loans to Total Loans in Each Category	Allowance for Loan Losses	% of Loans to Total Loans in Each Category	Allowance for Loan Losses	% of Loans to Total Loans in Each Category
	(Dollars in thousands)									
Commercial and industrial	$ 10,834	15.1%	$ 11,652	16.8%	$ 10,654	15.3%	$ 11,472	13.6%	$ 7,530	11.4%
Real estate:										
Commercial real estate	39,402	65.0%	47,457	61.1%	47,841	60.4%	40,234	58.6%	38,480	55.0%
Construction	1,305	1.4%	2,291	1.8%	4,947	2.4%	10,188	4.1%	21,222	7.3%
SFR mortgage	2,718	5.6%	3,448	4.9%	4,032	5.4%	3,295	6.4%	3,735	7.4%
Dairy & livestock and agribusiness	11,728	8.7%	18,696	10.3%	17,278	10.8%	36,061	11.2%	31,051	11.7%
Muni lease finance receivables	2,335	2.6%	1,588	3.2%	2,403	3.5%	2,172	3.8%	1,724	4.4%
Consumer and other loans	960	1.6%	1,170	1.9%	1,590	2.2%	1,034	2.3%	1,004	2.8%
Unallocated	5,953		6,139		5,219		803		4,178	
Total	$ 75,235	100.0%	$ 92,441	100.0%	$ 93,964	100.0%	$ 105,259	100.0%	$ 108,924	100.0%

Deposits

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

Total deposits were $4.89 billion at December 31, 2013. This represented an increase of $116.6 million, or 2.44%, over total deposits of $4.77 billion at December 31, 2012. This increase was due to organic growth

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primarily from our Centers. The average balance of deposits by category and the average effective interest rates paid on deposits is summarized for the years ended December 31, 2013, 2012 and 2011 in the table below.

	For the Year Ended December 31,					
	2013		2012		2011	
			Average			
	Balance	Rate	Balance	Rate	Balance	Rate
			(Dollars in thousands)			
Noninterest-bearing deposits						
Demand deposits	$ 2,452,689		$ 2,220,714		$ 1,905,605	
Interest-bearing deposits						
Investment Checking	308,935	0.05%	315,082	0.05%	343,150	0.10%
Money Market	1,080,080	0.28%	1,131,268	0.32%	1,135,742	0.40%
Savings	263,298	0.11%	268,801	0.14%	262,236	0.26%
Time deposits	698,905	0.19%	767,533	0.23%	910,965	0.34%
Total deposits	$ 4,803,907		$ 4,703,398		$ 4,557,698	

The amount of noninterest-bearing demand deposits in relation to total deposits is an integral element in achieving a low cost of funds. Average demand deposits totaled $2.45 billion for 2013, representing an increase of $232.0 million, or 10.45%, from average demand deposits of $2.22 billion for 2012. Average noninterest-bearing demand deposits represented 51.06% of total average deposits for 2013, compared to 47.22% of total average deposits for 2012.

Average savings deposits, which include savings, interest-bearing demand, and money market accounts, were $1.65 billion for 2013, representing a decrease of $62.8 million, or 3.66%, from average savings deposits of $1.72 billion for 2012.

Average time deposits totaled $698.9 million for 2013, representing a decrease of $68.6 million, or 8.94%, from total average time deposits of $767.5 million for 2012.

The following table provides the remaining maturities of large denomination ($100,000 or more) time deposits, including public funds, at December 31, 2013.

Maturity Distribution of Large Denomination Time Deposits

	December 31, 2013
	(Dollars in thousands)
3 months or less	$ 444,484
Over 3 months through 6 months	75,828
Over 6 months through 12 months	79,114
Over 12 months	12,444
Total	$ 611,870

FHLB Advances and other Borrowed Funds

In order to enhance the Bank s spread between its cost of funds and interest-earning assets, we first seek noninterest-bearing deposits (the lowest cost of funds to the Company). Next, we pursue growth in interest-bearing deposits, and finally, we supplement the growth in deposits with borrowed funds (borrowings and customer repurchase agreements). Average borrowed funds, as a percent of total funding (total deposits plus borrowed funds), was 13.59% for 2013, compared to 15.46% for 2012.

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The following table summarizes information about our term FHLB advances repurchase agreements and other borrowings outstanding as of the dates indicated:

	Repurchase Agreements	FHLB Advances (Dollars in thousands)	Other Borrowings
At December 31, 2013			
Amount outstanding	$ 643,251	$ 199,206	$ 69,000
Weighted-average interest rate	0.29%	4.52%	0.06%
For the year ended December 31, 2013			
Highest amount at month-end	$ 643,251	$ 199,206	$ 69,000
Daily-average amount outstanding	$ 543,656	$ 199,079	$ 12,554
Weighted-average interest rate	0.28%	4.52%	0.16%
At December 31, 2012			
Amount outstanding	$ 473,244	$ 198,934	$ 26,000
Weighted-average interest rate	0.28%	4.52%	0.12%
For the year ended December 31, 2012			
Highest amount at month-end	$ 537,109	$ 448,821	$ 26,000
Daily-average amount outstanding	$ 496,978	$ 362,741	$ 411
Weighted-average interest rate	0.31%	4.17%	0.15%
At December 31, 2011			
Amount outstanding	$ 509,370	$ 448,662	$
Weighted-average interest rate	0.35%	3.89%	
For the year ended December 31, 2011			
Highest amount at month-end	$ 581,579	$ 548,639	$
Daily-average amount outstanding	$ 530,924	$ 547,987	50,828
Weighted-average interest rate	0.38%	3.82%	0.06%

At December 31, 2013, our borrowings included $199.2 million in term FHLB advances, $643.3 million of repurchase agreements, and $69.0 million of other borrowings. At December 31, 2012, our borrowings included $198.9 million in term FHLB advances, $473.2 million in repurchase agreements and other borrowings of $26.0 million.

At December 31, 2013, borrowed funds totaled $911.5 million. This represented a decrease of $213.3 million, or 30.55%, from total borrowed funds of $698.2 million at December 31, 2012. During 2012, we redeemed $250.0 million of our FHLB advances, which carried an average coupon of 3.39% and a weighted average remaining life of 2.6 years. The repayment of these advances, which resulted in a $20.4 million pre-tax debt termination expense as reflected in other operating expense, was funded from Citizens Business Bank deposits. During 2011, we prepaid $100.0 million of our FHLB advances, which carried an interest rate of 2.89% and was scheduled to mature in April 2013. The repayment of this debt resulted in a $3.3 million prepayment charge. At December 31, 2013, we had $69.0 million of overnight borrowings with the FHLB at a cost of 6 basis points.

In November 2006, we began a repurchase agreement product with our customers. This product, known as Citizens Sweep Manager, sells our investment securities overnight to our customers under an agreement to repurchase them the next day at a price which reflects the market value of the use of funds by the Bank for the period concerned. These repurchase agreements are signed with customers who want to invest their excess deposits, above a pre-determined balance in a demand deposit account, in order to earn interest. As of December 31, 2013 and December 31, 2012, total customer repurchases were $643.3 million and $473.2 million, respectively, with weighted average interest rates of 0.29% and 0.28%, respectively.

We entered into borrowing agreements with the Federal Home Loan Bank. We had outstanding balances of $199.2 million under these agreements at December 31, 2013 and $198.9 million at December 31, 2012. The weighted average interest rate was 4.52% at December, 2013 and 2012. The FHLB holds certain investment securities and loans as collateral for these borrowings.

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At December 31, 2013, $2.31 billion of loans and $2.60 billion of investment securities, at carrying value, were pledged to secure public deposits, short and long-term borrowings, and for other purposes as required or permitted by law.

Aggregate Contractual Obligations

The following table summarizes the aggregate contractual obligations as of December 31, 2013:

		Maturity by Period			
	Total	Less Than One Year	One Year Through Three Years	Four Years Through Five Years	Over Five Years
			(Dollars in thousands)		
Deposits (1)	$ 4,890,631	$ 4,874,625	$ 12,108	$ 239	$ 3,659
Customer repurchase agreements (1)	643,251	643,251			
FHLB advances (1)	199,206		199,206		
Other borrowings	69,000	69,000			
Junior subordinated debentures (1)	25,774				25,774
Deferred compensation	9,449	871	1,430	640	6,508
Operating leases	20,081	4,936	8,287	4,776	2,082
Advertising agreements	4,750	1,750	1,600	1,400	
Total	$ 5,862,142	$ 5,594,433	$ 222,631	$ 7,055	$ 38,023

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

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

FHLB advances represent the amount that is due to the FHLB. We have one advance with a fixed maturity date of November 28, 2016.

At December 31, 2013, the Bank had $69.0 million of overnight borrowings with the FHLB at a cost of 6 basis points.

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

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

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

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

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Off-Balance Sheet Arrangements

The following table summarizes the off-balance sheet items at December 31, 2013:

		Maturity by Period			
	Total	Less Than One Year	One Year to Three Years	Four Years to Five Years	After Five Years
	(Dollars in thousands)				
Commitments to extend credit:					
Commercial and Industrial	$ 324,905	$ 250,651	$ 55,770	$ 14,496	$ 3,988
Real estate:					
Commercial real estate	68,058	24,212	18,659	12,530	12,657
Construction	15,280	13,805	1,475		
Dairy & livestock and agribusiness (1)	119,585	91,165	28,420		
Consumer and other loans	61,075	7,151	1,688	7,500	44,736
Total Commitment to extend credit	588,903	386,984	106,012	34,526	61,381
Obligations under letters of credit	37,029	34,204	2,825		
Total	$ 625,932	$ 421,188	$ 108,837	$ 34,526	$ 61,381

(1) Total commitment to extend credit to agribusiness was $4.5 million at December 31, 2013.

As of December 31, 2013, we had commitments to extend credit of approximately $588.9 million, and obligations under letters of credit of $37.0 million. Commitments to extend credit are agreements to lend to customers, provided there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Commitments are generally variable rate, and many of these commitments are expected to expire without being drawn upon. As such, the total commitment amounts do not necessarily represent future cash requirements. We use the same credit underwriting policies in granting or accepting such commitments or contingent obligations as we do for on-balance sheet instruments, which consist of evaluating customers creditworthiness individually. The Company recorded a provision for unfunded loan commitments of $500,000 for 2013, compared to a $1.0 million recapture of the provision for 2012. The Company had a reserve for unfunded loan commitments of $9.1 million as of December 31, 2013 and $8.6 million as of December 31, 2012 included in other liabilities.

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

Capital Resources

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

The Company s equity capital was $771.9 million at December 31, 2013. This represented an increase of $8.9 million, or 1.17%, from equity capital of $763.0 million at December 31, 2012. The increase in 2013 resulted primarily from $95.6 million in net earnings and $6.4 million for shares issued pursuant to our stock-based compensation plan, offset by a decrease of $52.6 million in other comprehensive income, net of tax, resulting from the net change in fair value of our investment securities portfolio and $40.5 million for common stock dividends declared.

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

For further information about our capital ratios, see Item 1 Business Capital Adequacy Requirements.

During 2013, the Board of Directors of the Company declared quarterly common stock cash dividends that totaled $0.385 per share. Dividends are payable at the discretion of the Board of Directors and there can be no assurance that the Board of Directors will continue to pay dividends at the same rate, or at all, in the future. CVB s ability to pay cash dividends to its shareholders is subject to restrictions under federal and California law, including restrictions imposed by the Federal Reserve, and covenants set forth in various agreements we are a party to including covenants set forth in our junior subordinated debentures.

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

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

			December 31, 2013		December 31, 2012	
Capital Ratios	**Adequately Capitalized Ratios**	**Well Capitalized Ratios**	**CVB Financial Corp. Consolidated**	**Citizens Business Bank**	**CVB Financial Corp. Consolidated**	**Citizens Business Bank**
Tier 1 leverage capital ratio	4.00%	5.00%	11.30%	11.20%	11.50%	11.21%
Tier 1 risk-based capital ratio	4.00%	6.00%	17.83%	17.67%	18.23%	17.77%
Total risk-based capital ratio	8.00%	10.00%	19.09%	18.93%	19.49%	19.03%

As a result of recently adopted federal regulatory changes to capital requirements (Basel III), which will become effective for us commencing in 2015, our board of directors, in consultation with management, will continue to assess the adequacy and components of our capital to ensure that we meet all required regulatory standards.

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RISK MANAGEMENT

All financial institutions must manage and control a variety of business risks that can significantly affect their financial performance. Our Board of Directors (Board) and executive management team have overall and ultimate responsibility for management of these risks, which they carry out through committees with specific and well-defined risk management functions. The Risk Management Plan that we have adopted seeks to implement the proper control and management of key risk factors inherent in the operation of the Company and the Bank. Some of the key risks that we must manage are credit risks, asset/liability, interest rate and market risks, counterparty risk, transaction risk, compliance risk, strategic risk, cybersecurity risk, price risk and foreign exchange risk. These specific risk factors are not mutually exclusive. It is recognized that any product or service offered by us may expose the Bank to one or more of these risks. Our Risk Management Committee and Risk Management Division monitor these risks to minimize exposure to the Company. The Board and its committees work closely with management in overseeing risk. Each Board committee receives reports and information regarding risk issues directly from management.

Credit Risk Management

Loans represent the largest component of assets on our balance sheet and their related credit risk is among the most significant risks we manage. We define credit risk as the risk of loss associated with a borrower or counterparty default (failure to meet obligations in accordance with agreed upon terms). Credit risk is found in all activities where success depends on a counter party, issuer, or borrower performance. Credit risk arises through the extension of loans and leases, certain securities, and letters of credit.

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

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

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

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

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

Implicit in lending activities is the risk that losses will occur and that the amount of such losses will vary over time. Consequently, we maintain an allowance for loan losses by charging a provision for loan losses to earnings. Loans, including impaired loans, determined to be losses are charged against the allowance for loan losses. Our allowance for loan losses is maintained at a level considered by us to be appropriate to provide for estimated probable losses inherent in the existing portfolio. In this regard, it is important to note that the Bank s practice with regard to impaired loans, including modified loans or troubled debt restructurings that are classified as impaired, is to generally charge off any impairment amount against the ALLL upon evaluating the loan using one of the three methods described in ASC 310-10-35 at the time a probable loss becomes recognized. As such, the Bank s specific allowance for impaired loans, including troubled debt restructurings, is relatively low as a percentage of impaired loans outstanding since any known impairment amount will generally have been charged off.

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

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

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

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

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

In the first phase, individual loans are reviewed to identify loans for impairment. A loan is generally considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the original contractual terms of the loan. A loan for which there is an insignificant delay in the amount of payments is not considered an impaired loan. Utilizing one of the three methods described in ASC 310-10-35-22, impairment is measured based on either the expected future cash flows discounted at each loan s effective interest rate, the fair value of the loan s collateral if the loan is collateral dependent, or an observable market price of the loan (if one exists). If the measure of the impaired loan is less than the recorded investment in the loan, the deficiency will be charged off against the ALLL or, alternatively, a specific allocation will be established and included in the overall ALLL balance.

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

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

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

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

then-existing economic and business conditions of areas outside the lending areas, such as other sections of the United States,

credit quality trends (including trends in past due loans, adversely graded loans, and nonperforming loans expected to result from existing conditions), collateral values, including changes in the value of underlying collateral for collateral-dependent loans,

the existence and effect of any concentrations of credit, and changes in the level of such concentrations,

changes in loan volumes,

specific industry conditions within portfolio segments,

recent loss experience in particular segments of the portfolio,

duration of the current business cycle,

the effect of external factors such as legal and regulatory requirements, including bank regulatory examination results and findings of the Company s external credit examiners.

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

Refer to additional discussion concerning loans, nonperforming assets, allowance for loan losses and related tables under the Analysis of Financial Condition contained herein.

ASSET/LIABILITY AND MARKET RISK MANAGEMENT

Liquidity and Cash Flow

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

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

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

Since the primary sources and uses of funds for the Company are loans and deposits, the relationship between gross loans and total deposits provides a useful measure of the Bank s liquidity. Typically, the closer the ratio of loans to deposits is to 100%, the more reliant we are on loan portfolio interest and principal payments to provide for short-term liquidity needs. Since repayment of loans tends to be less predictable than the maturity of investments and other liquid resources, the higher the loans to deposit ratio the less liquid are the Company s assets. For 2013, the loan to deposit ratio averaged 70.64%, compared to an average ratio of 72.95% for 2012 and 77.80 for 2011. The ratio of loans to deposits and customer repurchases averaged 63.46% for 2013, 65.98% for 2012 and 69.68% for 2011.

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

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

At December 31, 2013, approximately $52.6 million of the Bank s equity was unrestricted and available to be paid as dividends to CVB. Management of the Company believes that such restrictions will not have any current impact on the ability of CVB to meet its ongoing cash obligations. See Item 1 Business Regulation and Supervision Dividends. As of December 31, 2013, neither the Bank nor CVB had any material commitments for capital expenditures.

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

Net cash provided by operating activities totaled $111.8 million for 2013, compared to $154.8 million for 2012, and $130.0 million for 2011, respectively. The decrease in cash provided by operating activities in 2013 was due primarily to the decrease in interest and dividends received, an increase in income taxes paid, and a decrease in proceeds from FDIC shared-loss agreements, partially offset by a decrease in net cash paid to vendors and employees.

Cash used in investing activities totaled $378.5 million for 2013, compared to cash used in investing activities of $221.1 million and $86.7 million for 2012 and 2011, respectively. The cash used in investing activities in 2013 was primarily the result of an increase in loan and lease finance receivables, and a decrease in proceeds from repayment and sale of investment securities, partially offset by an increase in proceeds from sale of investment securities and a decrease in purchases of investment securities during 2013.

Net cash provided by financing activities totaled $262.9 million for 2013, compared to net cash used in financing activities of $180.6 million and $102.3 million for 2012 and 2011, respectively. The cash provided by financing activities during 2013 was primarily due to deposits, customer repurchase agreements, and borrowings, partially offset by $41.2 million for repayment of junior subordinated debentures in 2013.

At December 31, 2013, cash and cash equivalents totaled $94.7 million. This represented a decrease of $3.7 million, or 3.80%, over a total of $98.4 million at December 31, 2012.

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Market Risk

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

The table below provides the actual balances as of December 31, 2013 of interest-earning assets (net of deferred loan fees and allowance for loan losses) and interest-bearing liabilities, including the average rate earned or paid for 2013, the projected contractual maturities over the next five years, and the estimated fair value of each category determined using available market information and appropriate valuation methodologies.

			Maturing					
	December 31, 2013	**Average Rate**	**One Year**	**Two Years**	**Three Years**	**Four Years**	**Five Years and Beyond**	**Estimated Fair Value**
				(Dollars in thousands)				
Interest-earning assets:								
Investment securities available-for-sale (1)	$ 2,663,642	2.37%	$ 226,118	$ 425,792	$ 264,542	$ 915,912	$ 831,278	$ 2,663,642
Investment securities held-to-maturity	1,777	5.81%				1,777		2,296
Investment in FHLB stock	32,331	4.45%					32,331	32,331
Interest-earning deposits with other institutions	75,917	0.45%	75,917					75,917
Loans held-for-sale	3,667	3.57%	3,667					8,897
Loans and lease finance receivables (2)	3,559,020	4.89%	554,785	237,609	210,851	273,409	2,282,366	3,527,725
Total interest-earning assets	$ 6,336,354		$ 860,487	$ 663,401	$ 475,393	$ 1,191,098	$ 3,145,975	$ 6,310,808
Interest-bearing liabilities:								
Interest-bearing deposits	$ 2,327,651	0.21%	$ 2,311,645	$ 9,991	$ 2,117	$ 22	$ 3,876	$ 2,328,488
Borrowings	911,457	1.46%	712,251		199,206			932,408
Junior subordinated debentures	25,774	1.99%					25,774	25,819
Total interest-bearing liabilities	$ 3,264,882		$ 3,023,896	$ 9,991	$ 201,323	$ 22	$ 29,650	$ 3,286,715

(1) These include mortgage-backed securities which generally prepay before maturity.
(2) Average rate does not reflect discount accretion on covered loans.

Interest Rate Sensitivity Management

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

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

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The table below provides the Bank s maturity/re-pricing gap analysis at December 31, 2013, and 2012. We had a negative cumulative 180-day gap of $967.1 million and a negative cumulative 365-days gap of $525.4 million at December 31, 2013. This represented an increase of $491.5 million, over the 180-day cumulative negative gap of $475.7 million at December 31, 2012. In theory, this would indicate that at December 31, 2013, $967.1 million more in liabilities than assets would re-price if there were a change in interest rates over the next 180 days. If interest rates increase, the negative gap would tend to result in a lower net interest margin. If interest rates decrease, the negative gap would tend to result in an increase in the net interest margin. However, we do have the ability to anticipate the increase in deposit rates, and the ability to extend interest-bearing liabilities, offsetting, in part, the negative gap.

Asset and Liability Maturity/Repricing Gap

	December 31, 2013				
	90 days or less	Over 90 days to 180 days	Over 180 days to 365 days	Over 365 days	Total
	(Dollars in thousands)				
Earning Assets:					
Interest-earning deposits with other institutions	$ 5,917	$	$ 70,000	$	$ 75,917
Investment securities at carrying value	128,716	91,941	191,730	2,253,032	2,665,419
Loans held-for-sale	3,667				3,667
Gross loans, net of deferred fees	1,046,903	152,211	275,443	2,084,463	3,559,020
Total	$ 1,185,203	$ 244,152	$ 537,173	$ 4,337,495	$ 6,304,023
Interest Bearing Liabilities:					
Savings deposits	$ 1,088,875	$	$	$ 557,236	$ 1,646,111
Time deposits	475,383	94,192	95,478	16,487	681,540
FHLB advances and other borrowings	712,251			199,206	911,457
Junior subordinated debentures	25,774				25,774
Total	$ 2,302,283	$ 94,192	$ 95,478	$ 772,929	$ 3,264,882
Period gap	$ (1,117,080)	$ 149,960	$ 441,695	$ 3,564,566	$ 3,039,141
Cumulative gap	$ (1,117,080)	$ (967,120)	$ (525,425)	$ 3,039,141	

	December 31, 2012				
	90 days or less	Over 90 days to 180 days	Over 180 days to 365 days	Over 365 days	Total
	(Dollars in thousands)				
Earning Assets:					
Interest-earning deposits with other institutions	$ 11,157	$	$ 70,000	$	$ 81,157
Investment securities at carrying value	163,299	218,028	323,120	1,746,990	2,451,437
Loans held-for-sale					0
Gross loans, net of deferred fees	1,174,504	175,338	249,605	1,873,425	3,472,872
Total	$ 1,348,960	$ 393,366	$ 642,725	$ 3,620,415	$ 6,005,466
Interest Bearing Liabilities:					
Savings deposits	$ 1,048,925	$	$	$ 589,902	$ 1,638,827

Time deposits	510,704	92,091	95,083	16,289	714,167
FHLB advances and other borrowings	499,244			198,934	698,178
Junior subordinated debentures	67,012				67,012
Total	$ 2,125,885	$ 92,091	$ 95,083	$ 805,125	$ 3,118,184
Period gap	$ (776,925)	$ 301,275	$ 547,642	$ 2,815,290	$ 2,887,282
Cumulative gap	$ (776,925)	$ (475,650)	$ 71,992	$ 2,887,282	

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

Approximately $1.75 billion, or 66%, of the total investment portfolio at December 31, 2013 consisted of securities backed by mortgages. The final maturity of these securities can be affected by the speed at which the underlying mortgages repay. Mortgages tend to repay faster as interest rates fall, and slower as interest rates rise. As a result, we may be subject to a prepayment risk resulting from greater funds available for reinvestment at a time when available yields are lower. Conversely, we may be subject to extension risk resulting, as lesser amounts would be available for reinvestment at a time when available yields are higher. Prepayment risk includes the risk associated with the payment of an investment s principal faster than originally intended. Extension risk is the risk associated with the payment of an investment s principal over a longer time period than originally anticipated. In addition, there can be greater risk of price volatility for mortgage-backed securities as a result of anticipated prepayment or extension risk.

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

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

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

Simulated Rate Changes	Estimated Net Interest Income Sensitivity (1)
+ 200 basis points	(2.42%)
- 100 basis points	(0.36%)

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

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

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Counterparty Risk

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

- We do not have any investments in the preferred stock of any other company.

- We have one issuance of a trust preferred security totaling $4.9 million with a large financial institution.

- Most of our investment securities are either municipal securities, callable agencies or securities backed by mortgages, Fannie Mae, Freddie Mac, SBA or FHLB.

- All of our commercial line insurance policies are with companies with the highest AM Best ratings of A or above.

- We have no significant exposure to our Cash Surrender Value of Life Insurance since the Cash Surrender Value balance is with insurance companies that carry an AM Best rating of A- or greater and one company is not rated.

- We have no significant Counterparty exposure related to derivatives such as interest rate swaps with a major financial institution as our agreement requires the Counterparty to post cash collateral for mark-to-market balances due to us.

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

- We have $456.0 million in Fed Funds lines of credit with other banks. All of these banks are major U.S. banks, each with over $20.0 billion in assets. We rely on these funds for overnight borrowings. We currently have no outstanding Fed Funds balance.

- Our secured borrowing capacity with the FHLB was $2.29 billion, of which $2.06 billion was available as of December 31, 2013.

Transaction Risk

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

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

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

Compliance Risk

Compliance risk is the risk to earnings or capital arising from violations of, or non-conformance with, laws, rules, regulations, prescribed practices, or ethical standards. Compliance risk also arises in situations where the laws or rules governing certain products or activities of the Bank s customers may be ambiguous or untested. Compliance risk exposes us to fines, civil money penalties, payment of damages, and the voiding of contracts.

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Compliance risk can also lead to a diminished reputation, reduced business value, limited business opportunities, lessened expansion potential, and lack of contract enforceability.

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

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

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

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

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

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

Strategic Risk

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

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

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

1. Banks of comparable size
2. High performing banks
3. A list of specific banks

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

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

Cybersecurity Risk

Cybersecurity and fraud risk refers to the risk of failures, interruptions of services, or breaches of security with respect to the Company s or the Bank s communication, information, operations, financial control, customer internet banking, data processing systems or applications. These risks could be heightened as the Bank seeks to implement mobile banking services in response to customer and market adoption trends. The ability of the Company s customers to bank remotely, including online and through mobile devices, requires secure transmission of confidential information and increases the risk of data security breaches. In addition, the Company and the Bank rely primarily on third party providers to develop, manage, maintain and protect these systems and applications. Any such failures, interruptions or fraud or security breaches, depending on the scope, duration, affected system(s) or customers(s), could expose the Company and/or the Bank to financial loss, reputation damage, litigation, or regulatory action. While we have implemented various measures which seek to protect our Company and Bank from the risk of fraud, data security breaches or service interruptions, there can be no assurance that these measures will be effective in preventing breaches or losses for us or our customers.

Price and Foreign Exchange Risk

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

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

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

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

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

ITEM 7A. ***QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK***

Market risk is the risk of loss from adverse changes in the market prices and interest rates. Our market risk arises primarily from interest rate risk inherent in our lending and deposit taking activities. We currently do not enter into futures, forwards, or option contracts. For quantative and qualitative disclosures about market risks in our portfolio, see Asset/Liability and Market Risk Management of the Company , included in Item 7 Management s Discussion and Analysis of Financial Condition and the Results of Operations presented elsewhere in this report. Our analysis of market risk and market sensitive financial information contain forward-looking statements and is subject to the disclosure at the beginning of Part I regarding such forward-looking information.

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ITEM 8. ***FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA***

CVB Financial Corp.

Index to Consolidated Financial Statements

and Financial Statement Schedules

All schedules are omitted because they are not applicable, not material or because the information is included in the financial statements or the notes thereto.

For information about the location of management s annual reports on internal control, our financial reporting and the audit report of KPMG LLP thereon. See Item 9A. Controls and Procedures.

ITEM 9. ***CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE***

None

ITEM 9A. ***CONTROLS AND PROCEDURES***

1) Management s Report on Internal Control over Financial Reporting

Management of CVB Financial Corp., together with its consolidated subsidiaries (the Company), is responsible for establishing and maintaining adequate internal control over financial reporting. The Company s internal control over financial reporting is a process designed by, or under the supervision of, the Company s principal executive and principal financial officers to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company s financial statements for external reporting purposes in accordance with U.S. generally accepted accounting principles.

Our internal control over financial reporting includes policies and procedures that pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect transactions and dispositions of assets; provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and that receipts and expenditures are being made only in accordance with authorizations of management and the directors of the Company; and 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 our financial statements.

As of December 31, 2013, management conducted an assessment of the effectiveness of the Company s internal control over financial reporting based on the framework established in Internal Control Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, management has determined that the Company s internal control over financial reporting as of December 31, 2013 is effective. KPMG LLP, an independent registered public accounting firm, has issued their report on the effectiveness of internal control over financial reporting as of December 31, 2013.

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2) Auditor attestation

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders

CVB Financial Corp.:

We have audited CVB Financial Corp. and subsidiaries (the Company) internal control over financial reporting as of December 31, 2013, based on criteria established in *Internal Control Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). CVB Financial Corp. and subsidiaries management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management s Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit 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 audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

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 (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) 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 (3) 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.

In our opinion, CVB Financial Corp. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on criteria established in *Internal Control Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of CVB Financial Corp. and subsidiaries as of December 31, 2013 and 2012, and the related consolidated statements of earnings and comprehensive income, stockholders equity, and cash flows for each of the years in the three-year period ended December 31, 2013, and our report dated March 3, 2014 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

Los Angeles, California

March 3, 2014

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3) Changes in Internal Control over Financial Reporting

We maintain controls and procedures designed to ensure that information is recorded and reported in all filings of financial reports. Such information is reported to our management, including our Chief Executive Officer and Chief Financial Officer to allow timely and accurate disclosure based on the definition of disclosure controls and procedures in SEC Rule 13a-15(e) and 15d-15(e).

As of the end of the period covered by this report, we carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures under the supervision and with the participation of the Chief Executive Officer and the Chief Financial Officer. Based on the foregoing, our Chief Executive Officer and the Chief Financial Officer concluded that our disclosure controls and procedures are effective as of the end of the period covered by this report.

During the fiscal quarter ended December 31, 2013, there have been no changes in our internal control over financial reporting that has materially affected or is reasonably likely to materially affect our internal control over financial reporting.

ITEM 9B. ***OTHER INFORMATION***

None.

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PART III

ITEM 10. ***DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE***

Except as hereinafter noted, the information concerning directors and executive officers of the Company, corporate governance and our audit committee financial experts is incorporated by reference from the section entitled Discussion of Proposals recommended by the Board Proposal 1: Election of Directors and Beneficial Ownership Reporting Compliance, Corporate Governance Principles and Board Matters, and Audit Committee of our definitive Proxy Statement to be filed pursuant to Regulation 14A within 120 days after the end of the last fiscal year. For information concerning the executive officers of the Company, see Item 4A of Part I hereto.

The Company has adopted a Code of Ethics that applies to all of the Company s employees, including the Company s principal executive officer, the principal financial officer, accounting officers, and all employees who perform these functions. A copy of the Code of Ethics is available to any person without charge by submitting a request to the Company s Chief Financial Officer at 701 N. Haven Avenue, Suite 350, Ontario, CA 91764. If the Company shall amend its Code of Ethics as applies to the principal executive officer, principal financial officer, principal accounting officer or controller (or persons performing similar functions) or shall grant a waiver from any provision of the code of ethics to any such person, the Company shall disclose such amendment or waiver on its website at www.cbbank.com under the tab Investor Relations.

ITEM 11. ***EXECUTIVE COMPENSATION***

Information concerning management remuneration and transactions is incorporated by reference from the section entitled Election of Directors and Executive Compensation Certain Relationships and Related Transactions of our definitive Proxy Statement to be filed pursuant to Regulation 14A within 120 days after the end of the last fiscal year.

ITEM 12. ***SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS***

The following table summarizes information as of December 31, 2013 relating to our equity compensation plans pursuant to which grants of options, restricted stock, or other rights to acquire shares may be granted from time to time.

Equity Compensation Plan Information

Plan category	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants, and Rights (a)	Weighted-Average Exercise Price of Outstanding Options, Warrants, and Rights (b)	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a)) (c)
Equity compensation plans approved by security holders	2,105,843	$ 10.61	1,526,828
Equity compensation plans not approved by security holders		$	
Total	2,105,843	$ 10.61	1,526,828

Information concerning security ownership of certain beneficial owners and management is incorporated by reference from the sections entitled Stock Ownership of our definitive Proxy Statement to be filed pursuant to Regulation 14A within 120 days after the end of the last fiscal year.

ITEM 13. ***CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE***

Information concerning certain relationships and related transactions with management and others and information regarding director independence is incorporated by reference from the section entitled Executive Compensation Certain Relationships and Related Transactions and Director Independence of our definitive Proxy Statement to be filed pursuant to Regulation 14A within 120 days after the end of the last fiscal year.

ITEM 14. ***PRINCIPAL ACCOUNTANT FEES AND SERVICES***

Information concerning principal accounting fees and services is incorporated by reference from the section entitled Ratification of Appointment of Independent Public Accountants of our definitive Proxy Statement to be filed pursuant to Regulation 14A within 120 days after the end of the last fiscal year.

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PART IV

ITEM 15. ***EXHIBITS AND FINANCIAL STATEMENT SCHEDULES***
Financial Statements

(a) (1) All Financial Statements
Reference is made to the Index to Financial Statements on page 85 for a list of financial statements filed as part of this Annual Report on Form 10-K.

(2) Financial Statement Schedules
Reference is made to the Index to Financial Statements on page 85 for the listing of supplementary financial statement schedules required by this item.

(3) Exhibits
The listing of exhibits required by this item is set forth in the Index to Exhibits on page 153 of this Annual Report on Form 10-K.

(b) Exhibits
See Index to Exhibits on Page 153 of this Form 10-K.

(c) Financial Statement Schedules
There are no financial statement schedules required by Regulation S-X that have been excluded from the annual report to shareholders.

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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, on the 3rd day of March 2014.

CVB FINANCIAL CORP.

By: /s/ CHRISTOPHER D. MYERS

Christopher D. Myers
President and Chief Executive Officer

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 in the capacities and on the dates indicated.

Signature	Title	Date
/s/ RONALD O. KRUSE Ronald O. Kruse	Chairman of the Board	March 3, 2014
/s/ GEORGE. A. BORBA, JR. George A. Borba, Jr.	Director	March 3, 2014
/s/ STEPHEN A. DEL GUERCIO Stephen A. Del Guercio	Director	March 3, 2014
/s/ ROBERT M. JACOBY Robert M. Jacoby	Director	March 3, 2014
/s/ RAYMOND V. O BRIEN III Raymond V. O Brien	Director	March 3, 2014
/s/ HAL W. OSWALT Hal W. Oswalt	Director	March 3, 2014
/s/ SAN E. VACCARO San E. Vaccaro	Director	March 3, 2014
/s/ D. LINN WILEY D. Linn Wiley	Vice Chairman	March 3, 2014
/s/ CHRISTOPHER D. MYERS Christopher D. Myers	Director, President and Chief Executive Officer	March 3, 2014

	(Principal Executive Officer)	
/s/ RICHARD C. THOMAS	Chief Financial Officer	March 3, 2014
Richard C. Thomas	(Principal Financial and Accounting Officer)	

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CVB FINANCIAL CORP. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except share data)

	December 31, 2013	December 31, 2012
ASSETS		
Cash and due from banks	$ 88,776	$ 87,274
Interest-earning balances due from Federal Reserve	5,917	11,157
Total cash and cash equivalents	94,693	98,431
Interest-earning balances due from depository institutions	70,000	70,000
Investment securities available-for-sale, at fair value (with amortized cost of $2,679,727 at December 31, 2013, and $2,374,816 at December 31, 2012)	2,663,642	2,449,387
Investment securities held-to-maturity	1,777	2,050
Investment in stock of Federal Home Loan Bank (FHLB)	32,331	56,651
Non-covered loans held-for-sale	3,667	
Loans and lease finance receivables, excluding covered loans	3,385,916	3,252,313
Allowance for loan losses	(75,235)	(92,441)
Net loans and lease finance receivables	3,310,681	3,159,872
Covered loans and lease finance receivables, net	160,315	195,215
Premises and equipment, net	32,831	35,080
Bank owned life insurance	123,168	119,744
Accrued interest receivable	22,051	22,355
Intangibles	2,261	3,389
Goodwill	55,097	55,097
FDIC loss sharing asset	4,764	18,489
Non-covered other real estate owned	6,475	14,832
Covered other real estate owned	504	1,067
Income taxes	59,786	16,978
Other assets	20,924	44,727
TOTAL ASSETS	$ 6,664,967	$ 6,363,364
LIABILITIES AND STOCKHOLDERS EQUITY		
Liabilities:		
Deposits:		
Noninterest-bearing	$ 2,562,980	$ 2,420,993
Interest-bearing	2,327,651	2,352,994
Total deposits	4,890,631	4,773,987
Customer repurchase agreements	643,251	473,244
FHLB advances	199,206	198,934
Other borrowings	69,000	26,000
Accrued interest payable	1,111	1,493
Deferred compensation	9,449	8,781
Junior subordinated debentures	25,774	67,012
Other liabilities	54,658	50,943

TOTAL LIABILITIES	5,893,080	5,600,394
COMMITMENTS AND CONTINGENCIES		
Stockholders Equity:		
Common stock, authorized, 225,000,000 shares without par; issued and outstanding 105,370,170 at December 31, 2013, and 104,889,586 at December 31, 2012.	491,068	484,709
Retained earnings	290,149	235,010
Accumulated other comprehensive income, net of tax	(9,330)	43,251
Total stockholders equity	771,887	762,970
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 6,664,967	$ 6,363,364

See accompanying notes to the consolidated financial statements.

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CVB FINANCIAL CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF EARNINGS AND COMPREHENSIVE INCOME

(Dollars in thousands, except per share amounts)

	For the Year Ended December 31, 2013	2012	2011
Interest income:			
Loans and leases, including fees	$ 166,775	$ 183,146	$ 194,504
Accretion on acquired loans	12,856	22,607	12,586
Total loans and leases, including fees	179,631	205,753	207,090
Investment securities:			
Taxable	28,374	32,025	37,310
Tax-advantaged	22,025	22,718	23,640
Total investment income	50,399	54,743	60,950
Dividends from FHLB stock	2,033	671	242
Federal funds sold	221	616	995
Interest-earning deposits with other institutions	489	439	443
Total interest income	232,773	262,222	269,720
Interest expense:			
Deposits	4,887	5,911	8,708
Borrowings	10,999	16,662	23,002
Junior subordinated debentures	621	2,699	3,329
Total interest expense	16,507	25,272	35,039
Net interest income before provision for loan losses	216,266	236,950	234,681
Provision for loan losses	(16,750)		7,068
Net interest income after provision for loan losses	233,016	236,950	227,613
Noninterest income:			
Impairment loss on investment securities			(254)
Plus: Reclassification of credit-related impairment loss from other comprehensive income			(402)
Net impairment loss on investment securities recognized in earnings			(656)
Service charges on deposit accounts	15,923	16,106	15,768
Trust and investment services	8,071	8,169	8,683
Bankcard services	3,481	3,650	3,144
BOLI income	2,511	2,973	3,259
Gain on sale of securities, net	2,094		
(Decrease) increase in FDIC loss sharing asset, net	(12,860)	(21,916)	171
Other	6,067	6,921	3,847
Total noninterest income	25,287	15,903	34,216
Noninterest expense:			
Salaries and employee benefits	71,015	68,496	69,993
Occupancy and equipment	14,504	15,473	16,583
Professional services	5,709	7,170	15,031
Software licenses and maintenance	4,671	4,279	3,669
Promotion	4,681	4,869	4,977

Provision for unfunded loan commitments	500	(1,000)	(918)
Amortization of intangible assets	1,127	2,159	3,481
Debt termination expense		20,379	3,310
OREO expense	856	2,146	6,729
Insurance reimbursements	(4,155)	(921)	
Other	15,120	15,110	18,170
Total noninterest expense	114,028	138,160	141,025
Earnings before income taxes	144,275	114,693	120,804
Income taxes	48,667	37,413	39,071
Net earnings	$ 95,608	$ 77,280	$ 81,733
Other comprehensive (loss) income:			
Unrealized (loss) gain on securities arising during the period	$ (88,562)	$ 3,074	$ 61,490
Less: Reclassification adjustment for net gain on securities included in net income	(2,094)		(656)
Other comprehensive (loss) income, before tax	(90,656)	3,074	60,834
Less: income tax benefit (expense) related to items of other comprehensive income	38,075	(1,292)	(25,550)
Other comprehensive (loss) income, net of tax	(52,581)	1,782	35,284
Comprehensive income	$ 43,027	$ 79,062	$ 117,017
Basic earnings per common share	$ 0.91	$ 0.74	$ 0.77
Diluted earnings per common share	$ 0.91	$ 0.74	$ 0.77
Cash dividends declared per common share	$ 0.385	$ 0.34	$ 0.34

See accompanying notes to consolidated financial statements.

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CVB FINANCIAL CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

(Dollars and shares in thousands)

	Common Shares Outstanding	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income/(Loss)	Total
Balance January 1, 2011	106,076	$ 490,226	$ 147,444	$ 6,185	$ 643,855
Repurchase of common stock	(1,595)	(12,527)			(12,527)
Exercise of stock options	9	59			59
Tax benefit from exercise of stock options		1			1
Shares issued pursuant to stock-based compensation plan	(8)	2,214			2,214
Cash dividends declared on					
Common ($0.34 per share)			(35,805)		(35,805)
Net earnings			81,733		81,733
Other comprehensive income				35,284	35,284
Balance December 31, 2011	104,482	479,973	193,372	41,469	714,814
Repurchase of common stock	(5)	(54)			(54)
Exercise of stock options	292	2,557			2,557
Tax benefit from exercise of stock options		194			194
Shares issued pursuant to stock-based compensation plan	121	2,039			2,039
Cash dividends declared on					
Common ($0.34 per share)			(35,642)		(35,642)
Net earnings			77,280		77,280
Other comprehensive income				1,782	1,782
Balance December 31, 2012	104,890	484,709	235,010	43,251	762,970
Repurchase of common stock	(42)	(559)			(559)
Exercise of stock options	428	4,517			4,517
Tax benefit from exercise of stock options		475			475
Shares issued pursuant to stock-based compensation plan	94	1,926			1,926
Cash dividends declared on					
Common ($0.385 per share)			(40,469)		(40,469)
Net earnings			95,608		95,608
Other comprehensive income				(52,581)	(52,581)
Balance December 31, 2013	105,370	$ 491,068	$ 290,149	$ (9,330)	$ 771,887

See accompanying notes to consolidated financial statements.

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CVB FINANCIAL CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

	For the Year Ended December 31, 2013	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES			
Interest and dividends received	$ 244,205	$ 264,482	$ 270,885
Service charges and other fees received	30,494	36,399	33,855
Interest paid	(16,616)	(27,034)	(36,226)
Net cash paid to vendors and employees	(93,076)	(130,605)	(123,675)
Income taxes paid	(53,200)	(7,455)	(57,000)
Proceeds from FDIC loss share agreement	4	18,974	42,179
Net cash provided by operating activities	111,811	154,761	130,018
CASH FLOWS FROM INVESTING ACTIVITIES			
Proceeds from redemption of FHLB stock	24,320	16,038	14,055
Proceeds from sale of investment securities	99,155		
Proceeds from repayment of investment securities	414,881	559,187	373,740
Proceeds from maturity of investment securities	80,546	84,345	90,342
Purchases of investment securities	(920,657)	(942,710)	(816,386)
Net (increase) decrease in loan and lease finance receivables	(87,276)	48,001	232,164
Proceeds from sales of premises and equipment	25	27	191
Purchase of premises and equipment	(2,421)	(4,271)	(1,676)
Proceeds from sales of other real estate owned	12,971	18,295	20,907
Net cash used in investing activities	(378,456)	(221,088)	(86,663)
CASH FLOWS FROM FINANCING ACTIVITIES			
Net increase in transaction deposits	149,271	292,422	338,443
Net decrease in time deposits	(32,627)	(122,983)	(252,723)
Repayment of FHLB advances		(250,000)	(100,000)
Repayment of junior subordinated debentures	(41,238)	(48,043)	(5,000)
Net increase (decrease) in other borrowings	43,000	26,000	(1,917)
Net increase (decrease) in customer repurchase agreements	170,007	(36,126)	(32,818)
Cash dividends on common stock	(29,939)	(44,552)	(35,805)
Repurchase of common stock	(559)	(54)	(12,527)
Proceeds from exercise of stock options	4,517	2,557	59
Tax benefit related to exercise of stock options	475	194	1
Net cash provided by (used in) financing activities	262,907	(180,585)	(102,287)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(3,738)	(246,912)	(58,932)
CASH AND CASH EQUIVALENTS, beginning of period	98,431	345,343	404,275
CASH AND CASH EQUIVALENTS, end of period	$ 94,693	$ 98,431	$ 345,343

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CVB FINANCIAL CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)

(Dollars in thousands)

	For the Year Ended December 31, 2013	2012	2011
RECONCILIATION OF NET EARNINGS TO NET CASH PROVIDED BY OPERATING ACTIVITIES			
Net earnings	$ 95,608	$ 77,280	$ 81,733
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Gain on sale of investment securities	(2,094)		
(Gain) loss on sale of premises and equipment, net	(14)	70	(41)
Gain on sale of other real estate owned	(3,048)	(1,393)	(722)
Credit-related impairment loss on investment securities held-to-maturity			656
Amortization of capitalized prepayment penalty on borrowings	272	272	272
Increase in bank owned life insurance	(2,435)	(3,612)	(3,259)
Net amortization of premiums and discounts on investment securities	27,064	24,082	14,105
Accretion of SJB discount	(12,856)	(22,607)	(12,275)
Provision for loan losses	(16,750)		7,068
Provision for unfunded loan commitments	500	(1,000)	(918)
Valuation adjustment on other real estate owned	489	1,047	5,139
Change in FDIC loss share asset	12,860	21,916	(171)
Proceeds from FDIC loss share agreement	4	18,974	42,179
Stock-based compensation	1,926	2,039	2,214
Depreciation and amortization, net	2,449	7,532	9,648
Change in accrued interest receivable	304	1,157	135
Change in accrued interest payable	(382)	(2,033)	(1,459)
Change in other assets and liabilities	7,914	31,037	(14,286)
Total adjustments	16,203	77,481	48,285
NET CASH PROVIDED BY OPERATING ACTIVITIES	$ 111,811	$ 154,761	$ 130,018
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING ACTIVITIES			
Securities purchased and not settled	$ 3,533	$	$ 20,641
Transfer of loans to other real estate owned	$ 1,492	$ 10,246	$ 32,331

See accompanying notes to the consolidated financial statements.

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CVB FINANCIAL CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

THREE YEARS ENDED DECEMBER 31, 2013

1. BUSINESS

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

The Company s primary operations are related to traditional banking activities, including the acceptance of deposits and the lending and investing of money through the operations of the Bank. The Bank also provides automobile and equipment leasing to customers through its Citizens Financial Services Group and trust and investment-related services to customers through its CitizensTrust Division. The Bank s customers consist primarily of small to mid-sized businesses and individuals located in San Bernardino County, Riverside County, Los Angeles County, Orange County, Madera County, Fresno County, Tulare County, Kern County and San Joaquin County, California. The Bank operates 38 Business Financial Centers, six Commercial Banking Centers, and three trust office locations with its headquarters located in the city of Ontario, California.

2. BASIS OF PRESENTATION

The accompanying consolidated financial statements and notes thereto have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission (SEC) for Form 10-K and conform to practices within the banking industry and include all of the information and disclosures required by accounting principles generally accepted in the United States of America (GAAP) for financial reporting.

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Segments The Company s operating business units have been divided into two main segments: (i) Business Financial and Commercial Banking Centers (Centers) and (ii) Treasury. The Business Financial and Commercial Banking Centers lines of business generally consist of loans, deposits, and fee generating products and services that the Bank offers to its clients and prospects. The other segment is Treasury, which manages the investment portfolio of the Company. The Company s remaining centralized functions and eliminations of inter-segment amounts have been aggregated and included in Other.

The internal reporting of the Company considers all business units. Funds are allocated to each business unit based on its need to fund assets (use of funds) or its need to invest funds (source of funds). Net income is determined based on the actual net income of the business unit plus the allocated income or expense based on the sources and uses of funds for each business unit. Noninterest income and noninterest expense are those items directly attributable to a business unit.

Cash and cash equivalents Cash on hand, cash items in the process of collection, and amounts due from correspondent banks, the Federal Reserve Bank and interest-bearing balances due from depository institutions, with initial terms of ninety days or less, are included in Cash and cash equivalents.

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

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

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

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

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

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

Interest on non-covered loans and lease finance receivables is credited to income based on the principal amounts of such loans or receivables outstanding. Non-covered loans are considered delinquent when principal

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

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

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

The types of loans subject to modification vary greatly, but during the subject period are concentrated in commercial and industrial loans, dairy and agricultural loans, and term loans to commercial real estate investors. Some examples of key features include payment deferrals and delays, interest rate reductions, and extensions or

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renewals where the contract rate may or may not be below the market rate of interest for debt with similar characteristics as those of the modified debt. The typical length of the modified terms ranges from three (3) to twelve (12) months; however, all actual modified terms will depend on the facts, circumstances and attributes of the specific borrower requesting a modification. In general, after a careful evaluation of all relevant facts and circumstances taken together, including the nature of any concession, certain modification requests will result in troubled debt restructurings while certain other modifications will not, pursuant to the criteria and judgments as discussed throughout this report. In certain cases, modification requests for delays or deferrals of principal were evaluated and determined to be exempt from TDR reporting because they constituted insignificant delays under ASC 310-40-15.

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

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

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

   The frequency of payments due;

   The debt s original contractual maturity; or

   The debt s original expected duration.

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

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

The Company s policy is to record a specific valuation allowance, which is included in the allowance for loan losses, or to charge off that portion of an impaired loan that represents the impairment or shortfall amount as determined utilizing one of the three methods described in ASC 310-10-35-22. Impairment on non-collateral dependent restructured loans is measured by comparing the present value of expected future cash flows on the restructured loans discounted at the interest rate of the original loan agreement to the loan s carrying value. The impairment amount, if any, is generally charged off and recorded against the allowance for loan losses at the time impairment is measurable and a probable loss is determined. As a result, most of the TDRs have no specific allowance allocated because, consistent with the Company s stated practice, any impairment is typically charged off in the period in which it is identified. The Company measures impairment based on the present value of expected future cash flows discounted at the loan s effective interest rate, except that as a practical expedient, the Company may also measure impairment based on an observable market price for the loan, or the value of the collateral, for collateral dependent loans. Impairment on collateral dependent restructured loans is measured by determining the amount by which our recorded investment in the impaired loan exceeds the fair value of the

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collateral less estimated selling costs. The fair value is generally determined by one or more appraisals of the collateral, performed by a Company approved third-party independent appraiser. The majority of impaired loans that are collateral dependent are charged off down to their estimated fair value of the collateral (less selling costs) at each reporting date based on current appraised value.

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

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

Impaired single-family mortgage loans that have been modified in accordance with the various government modification programs are also measured based on the present value of the expected cash flows discounted at the loan s pre-modification interest rate. The Company recognizes the change in present value attributable to the passage of time as interest income on such performing single-family mortgage loans and the amount of interest income recognized to date has been insignificant.

Provision and Allowance for Loan Losses The allowance for loan losses is management s estimate of probable losses inherent in the loan and lease receivables portfolio. The allowance is increased by the provision for losses and decreased by charge-offs when management believes the uncollectability of a loan is confirmed. Subsequent recoveries, if any, are credited to the allowance. The determination of the balance in the allowance for loan losses is based on an analysis of the loan and lease finance receivables portfolio using a systematic methodology and reflects an amount that, in management s judgment, is appropriate to provide for probable loan losses inherent in the portfolio, after giving consideration to the character of the loan portfolio, current economic conditions, past loan loss experience, and such other factors that would deserve current recognition in estimating inherent loan losses.

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

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

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

In the first phase, individual loans are reviewed to identify loans for impairment. Impairment is measured based on the Company s policy for impaired loans for collateral dependent loans. If the Company determines that the fair value of the collateral is less than the recorded investment in the loan, the Company either recognizes an impairment reserve as a specific allowance, or charges off the impaired balance if it is determined that such amount represents a confirmed loss. Loans determined to be impaired are excluded from the formula allowance so as not to double count the loss exposure.

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

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

Periodically, we assess various attributes utilized in adjusting our historical loss factors to reflect current economic conditions. The methodology is consistently applied across all the portfolio segments taking into account the applicable historical loss rates and the qualitative factors applicable to each pool of loans.

In the fourth quarter ended December 31, 2013, the Bank implemented a change in its methodology to calculate the ALLL. Previously, the Bank used an annual three-year look-back period of historical losses, segmented by loan type, with the loss factors updated annually to include the current year s loss experience in the fourth quarter of each year. External factors that were considered were the improving credit environment and the stabilizing economy. In determining the look-back period, management considered the period used to develop the historical loss rate should be long enough to capture sufficient loss data. We determined that a rolling twenty quarters look-back period was appropriate as of December 31, 2013 because the most recent three-year period provides insufficient data, with very low loss experience, and in some cases recoveries actually exceed losses within certain loan segments during the three year period. We believe the rolling twenty quarters look-back period is the best indicator of inherent losses within the loan portfolio as many of the economic factors in the early stages of the economic recovery still exist.

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

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

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

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

Non-Covered Other Real Estate Owned Non-covered other real estate owned (OREO) represents real estate acquired through foreclosure in lieu of repayment of commercial and real estate loans and is stated at fair value, less estimated costs to sell (fair value at time of foreclosure). Non-covered loan balances in excess of fair value of the real estate acquired at the date of acquisition are charged against the allowance for loan losses. Any subsequent operating expenses or income, reduction in estimated values, and gains or losses on disposition of such properties are charged to current operations. Gain recognition upon disposition of a property is dependent on the sale having met certain criteria relating to the buyer s initial investment in the property sold.

Covered Other Real Estate Owned All other real estate owned acquired in the FDIC-assisted acquisition of SJB are included in a FDIC shared-loss agreement and are referred to as covered other real estate owned.

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Covered other real estate owned is reported exclusive of expected reimbursement cash flows from the FDIC. Fair value adjustments on covered other real estate owned result in a reduction of the covered other real estate carrying amount with the estimated net loss charged against earnings and a corresponding increase in the estimated FDIC loss sharing asset based on the appropriate loss-sharing percentage.

Premises and Equipment Premises and equipment are stated at cost, less accumulated depreciation, which is provided for in amounts sufficient to relate the cost of depreciable assets to operations over the estimated service lives of the respective asset and are computed on a straight-line basis. The ranges of useful lives of the principal classes of assets are as follows:

Bank premises	15 40 years
Leasehold improvements	Shorter of estimated economic lives of 15 years or term of the lease.
Computer equipment	3 5 years
Furniture, fixtures and equipment	5 7 years

Long-lived assets are reviewed periodically for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable. The existence of impairment is based on undiscounted cash flows. To the extent impairment exists, the impairment is calculated as the difference in fair value of assets and their carrying value. The impairment loss, if any, would be recorded in noninterest expense.

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

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

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

Fair Value of Financial Instruments We use fair value measurements to record fair value adjustments to certain financial instruments and to determine fair value disclosures. Investment securities available-for-sale and interest-rate swaps are financial instruments recorded at fair value on a recurring basis. Additionally, from time to time, we may be required to record at fair value other financial assets on a non-recurring basis, such as impaired loans and OREO. These nonrecurring fair value adjustments typically involve application of lower-of-cost-or-market accounting or write-downs of individual assets. Further, we include in Note 19 of the consolidated financial statements information about the extent to which fair value is used to measure assets and liabilities, the valuation methodologies used and its impact to earnings. Additionally, for financial instruments not recorded at fair value we disclose the estimate of their fair value.

Bank Owned Life Insurance The Company invests in Bank-Owned Life Insurance (BOLI). BOLI involves the purchasing of life insurance by the Company on a select group of employees. The Company is the owner and primary beneficiary of these policies. BOLI is recorded as an asset at the cash surrender value. Increases in the cash value of these policies, as well as insurance proceeds received, are recorded in other noninterest income and are not subject to income tax.

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Income Taxes Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Future realization of deferred tax assets ultimately depends on the existence of sufficient taxable income of the appropriate character (for example, ordinary income or capital gain) within the carryback or carryforward periods available under the tax law. Based on historical and future expected taxable earnings and available strategies, the Company considers the future realization of these deferred tax assets more likely than not.

The tax effects from an uncertain tax position are recognized in the financial statements only if, based on its merits, the position is more likely than not to be sustained on audit by the taxing authorities. Interest and penalties related to uncertain tax positions are recorded as part of other operating expense.

Earnings per Common Share The Company calculates earnings per common share (EPS) using the two-class method. The two-class method requires the Company to present EPS as if all of the earnings for the period are distributed to common shareholders and any participating securities. All outstanding unvested share-based payment awards that contain rights to non-forfeitable dividends are considered participating securities. The Company grants restricted shares under the 2008 Equity Incentive Plan that qualify as participating securities. Restricted shares issued under this plan are entitled to dividends at the same rate as common stock. A reconciliation of the numerator and the denominator used in the computation of basic and diluted earnings per common share is included in Note 16 of these consolidated financial statements.

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

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

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

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

Additional information is included in Note 17 Stock Option Plans and Restricted Stock Awards of the consolidated financial statements included herein.

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

Statement of Cash Flows Cash and cash equivalents as reported in the statements of cash flows include cash and due from banks, interest-bearing balances due from depository institutions and federal funds sold with original maturities of three months or less. Cash flows from loans and deposits are reported net.

CitizensTrust This division provides trust, investment and brokerage related services, as well as financial, estate and business succession planning services. CitizensTrust services its clients through three offices in Southern California: Pasadena, Ontario and Irvine. CitizensTrust has approximately $2.33 billion in assets under administration, including $1.74 billion in assets under management. The amount of these funds and the related liability have not been recorded in the accompanying consolidated balance sheets because they are not assets or liabilities of the Bank or Company, with the exception of any funds held on deposit with the Bank.

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

Other Contingencies In the ordinary course of business, the Company becomes involved in litigation. Based upon the Company s internal records and discussions with legal counsel, the Company records reserves as appropriate, for estimates of the probable outcome of all cases brought against the Company. Except as discussed in Note 14 at December 31, 2013, the Company does not have any litigation reserves and is not aware of any material pending legal action or complaints asserted against the Company.

Recent Accounting Pronouncements In July 2013, the FASB issued Accounting Standards Update (ASU) No. 2013-11, Income Taxes (Topic 740) *Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists* . This ASU requires an entity to present an unrecognized tax benefit as a reduction of a deferred tax asset for a net operating loss carryforward, or similar tax loss or tax credit carryforward, rather than a liability when (1) the uncertain tax position would reduce the net operating loss or other carryforward under the tax law of the applicable jurisdiction and (2) the entity intends to use the deferred tax asset for that purpose. The ASU does not require new recurring disclosures. ASU No. 2013-11 is effective prospectively for fiscal years, and interim periods within those years, beginning after December 15, 2013. The adoption of this new guidance is not expected to have a material impact on the Company s consolidated financial statements.

In January 2014, the FASB issued ASU No. 2014-01, Investments Equity Method and joint Ventures (Topic 323) *Accounting for Investments in Qualified Affordable Housing Projects*. This ASU allows reporting entities to make an accounting policy election concerning investments in Low Income Housing Tax Credit (LIHTC) programs, that meet specified conditions, to present the net tax benefits (net of the amortization of the cost of the investment) within income tax expense. The cost of LIHTC investments, that meet the specified conditions, may be amortized in proportion to the total expected tax benefits, including the tax credits and other tax benefits, as they are realized on the tax return. This ASU is effective beginning after December 15, 2014. This ASU is required to be applied retrospectively, if investors elect the proportional amortization method. However, if investors have existing LIHTC investments accounted for under the effective-yield method at adoption, they may continue to apply that method for those existing investments. The adoption of this new guidance is not expected to have a material impact on the Company s consolidated financial statements.

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4. INVESTMENT SECURITIES

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

	December 31, 2013				
	Amortized Cost	Gross Unrealized Holding Gain	Gross Unrealized Holding Loss	Fair Value	Total Percent
	(Dollars in thousands)				
Investment securities available-for-sale:					
Government agency	$ 350,378	$ 22	$ (23,875)	$ 326,525	12.26%
Residential mortgage-backed securities	1,391,631	13,100	(24,788)	1,379,943	51.81%
CMO s / REMIC s residential	361,573	6,576	(1,974)	366,175	13.75%
Municipal bonds	571,145	18,839	(3,893)	586,091	22.00%
Other securities	5,000		(92)	4,908	0.18%
Total investment securities	$ 2,679,727	$ 38,537	$ (54,622)	$ 2,663,642	100.00%

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

Approximately 78% of the available-for-sale portfolio at December 31, 2013 represents securities issued by the U.S government or U.S. government-sponsored enterprises, with the implied guarantee of payment of principal and interest. All non-agency available-for-sale CMO/REMIC issues held are rated investment grade or better by either Standard & Poor s or Moody s, as of December 31, 2013 and 2012. The Bank has $560,000 in CMO/REMIC s backed by whole loans issued by private-label companies (non-government sponsored).

During 2013, management identified 13 securities with a par value of $94.2 million that were experiencing accelerated prepayment speeds that were causing a deterioration in yield. These securities were sold and the Company recognized a net pre-tax gain on sale of $2.1 million. There were no realized gains or losses for the year ended December 31, 2012 and 2011.

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

	December 31, 2013					
	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Gross Unrealized Holding Losses	Fair Value	Gross Unrealized Holding Losses	Fair Value	Gross Unrealized Holding Losses
	(Dollars in thousands)					
Available-for-sale:						
Government agency	$ 267,936	$ 20,514	$ 38,563	$ 3,361	$ 306,499	$ 23,875
Residential mortgage-backed securities	851,621	23,313	22,999	1,475	874,620	24,788
CMO / REMICs residential	104,322	1,780	17,747	194	122,069	1,974
Municipal bonds	47,116	3,359	10,338	534	57,454	3,893
Other securities	4,908	92			4,908	92
Total	$ 1,275,903	$ 49,058	$ 89,647	$ 5,564	$ 1,365,550	$ 54,622

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

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

CMO Held-to-Maturity the Company has one investment security classified as held-to-maturity. This security was issued by Countrywide Financial and is collateralized by Alt-A mortgages. The mortgages are primarily fixed-rate, 30-year loans, originated in early 2006 with average FICO scores of 715 and an average LTV of 71% at origination. The security was a senior security in the securitization, was rated triple AAA at origination and was supported by subordinate securities. This security is classified as held-to-maturity as the

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Bank has both the intent and ability to hold this debt security to maturity. The Bank acquired this security in February 2008 at a price of 98.25%. The significant decline in the fair value of the security first appeared in August 2008 at the time the financial crisis in the markets occurred and the market for securities collateralized by Alt-A mortgages diminished.

As of December 31, 2013, the unrealized loss on this security was zero and the current fair value on the security was 76% of the current par value. This Alt-A bond, with a book value of $1.8 million as of December 31, 2013, has had $1.9 million in net impairment losses to date. These losses have been recorded as a reduction to noninterest income. The security is rated non-investment grade. We evaluated the security for an other-than-temporary decline in fair value as of December 31, 2013. The key assumptions include default rates, loss severities and prepayment rates. There were no changes in credit related other-than temporary impairment recognized in earnings for the years ended December 31, 2013, and 2012. The Company recorded credit related other-than-temporary impairment of $656,000 during the year ended December 31, 2011.

Government Agency & Government-Sponsored Enterprise The government agency bonds are backed by the full faith and credit of agencies of the U.S. Government. While the Government-Sponsored Enterprise bonds are not expressly guaranteed by the U.S. Government, they are currently being supported by the U.S. Government under a conservatorship arrangement. As of December 31, 2013, approximately $142.1 million in U.S. government agency bonds were callable. These securities are bullet securities, that is, they have a defined maturity date on which the principal is paid. The contractual term of these investments provides that the Company will receive the face value of the bond at maturity which will equal the amortized cost of the bond. Interest is received throughout the life of the security.

Mortgage-Backed Securities and CMO/REMICs Almost all of the available-for-sale mortgage-backed and CMO/REMICs securities are issued by government agencies or government-sponsored enterprises such as Ginnie Mae, Fannie Mae and Freddie Mac. These securities are collateralized or backed by the underlying residential mortgages. All mortgage-backed securities are considered to be rated investment grade with a weighted average life of approximately 4.4 years. Of the total MBS/CMO, 99.97% have the implied guarantee of U.S. government-sponsored agencies and enterprises. The remaining 0.03% are issued by banks. Accordingly, it is expected the securities would not be settled at a price less than the amortized cost of the bonds.

Municipal Bonds The majority of the Company s municipal bonds are insured by the largest bond insurance companies with maturities of approximately 8.7 years. The Company diversifies its holdings by owning selections of securities from different issuers and by holding securities from geographically diversified municipal issuers, thus reducing the Company s exposure to any single adverse event. Because we believe the decline in fair value is attributable to the changes in interest rates and not credit quality and because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized costs, which may be at maturity, management does not consider these investments to be other than temporarily impaired at December 31, 2013.

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

At December 31, 2013, and 2012, investment securities having a carrying value of approximately $2.60 billion and $2.24 billion, respectively, were pledged to secure public deposits, short and long-term borrowings, and for other purposes as required or permitted by law.

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The amortized cost and fair value of debt securities at December 31, 2013, by contractual maturity, are shown below. Although mortgage-backed securities and CMO/REMICs have contractual maturities through 2043, expected maturities will differ from contractual maturities because borrowers may have the right to prepay such obligations without penalty. Mortgage-backed securities and CMO/REMICs are included in maturity categories based upon estimated prepayment speeds.

	December 31, 2013		
	Amortized Cost	Fair Value	Weighted-Average Yield
	(Dollars in thousands)		
Available-for-sale:			
Due in one year or less	$ 130,839	$ 133,540	2.73%
Due after one year through five years	1,914,879	1,924,890	2.32%
Due after five years through ten years	572,574	546,387	2.23%
Due after ten years	61,435	58,825	3.44%
Total	$ 2,679,727	$ 2,663,642	2.35%

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

5. COVERED ASSETS AND FDIC LOSS SHARING ASSET

FDIC Assisted Acquisition

On October 16, 2009, the Bank acquired SJB and entered into a loss sharing agreements with the FDIC that is more fully discussed in the Significant Accounting Policies (Note 3) included herein. The acquisition has been accounted for under the purchase method of accounting. The assets and liabilities were recorded at their estimated fair values as of the October 16, 2009 acquisition date. The application of the purchase method of accounting resulted in an after-tax gain of $12.3 million which was included in 2009 earnings. The gain is the negative goodwill resulting from the acquired assets and liabilities recognized at fair value.

At December 31, 2013, the remaining discount associated with the SJB loans approximated $12.8 million. Based on the Company s regular forecast of expected cash flows from these loans, approximately $8.8 million of the related discount is expected to accrete into interest income over the remaining average lives of the respective pools and individual loans, which approximates 4.4 years and 1.3 years, respectively. Due to the decrease in estimated losses to be incurred in the remaining portfolio, the expected reimbursement from the FDIC under the loss sharing agreement decreased. The FDIC loss sharing asset of $4.8 million at December 31, 2013 will continue to be reduced by loss claims submitted to the FDIC with the remaining balance amortized on the same basis as the discount on the related loans, not to exceed its remaining contract life, which expires in October of 2014.

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The following table provides a summary of the components of covered loan and lease finance receivables as of December 31, 2013 and 2012:

	December 31, 2013	December 31, 2012
	(Dollars in thousands)	
Commercial and industrial	$ 20,461	$ 26,149
Real estate:		
Commercial real estate	141,141	179,428
Construction	644	1,579
SFR mortgage	313	1,415
Dairy & livestock and agribusiness	6,000	5,651
Municipal lease finance receivables		
Consumer and other loans	4,545	6,337
Gross covered loans	173,104	220,559
Less: Purchase accounting discount	(12,789)	(25,344)
Gross covered loans, net of discount	160,315	195,215
Less: Allowance for covered loan losses		
Net covered loans	$ 160,315	$ 195,215

Covered Loans Held-for-Sale

The following table provides a summary of the activity related to covered loans held-for-sale for the years ended December 31, 2013, and 2012:

	For the Year Ended December 31, 2013	2012
	(Dollars in thousands)	
Balance, beginning of period	$	$ 5,664
Sales of other loans		(3,745)
Write-down of loans held for sale		(1,219)
Payment on other loans		(700)
Balance, end of period	$	$

Credit Quality Indicators

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

Credit risk ratings are also used by Management in deriving expectations for future cash flows of covered loans, in addition to managing the underlying credit quality and collection efforts for these loans. Changes in credit risk ratings on covered loans assist the Company in establishing assumptions used in estimating expected future cash flows, and do not necessarily represent a need to establish or reverse an allowance for loan losses for these loans.

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The following table summarizes covered loans by internal risk ratings as of December 31, 2013 and 2012:

	December 31, 2013	December 31, 2012
	(Dollars in thousands)	
Pass	$ 38,961	$ 52,637
Watch list	74,369	72,803
Special mention	15,492	31,689
Substandard	44,241	63,354
Doubtful & loss	41	76
Total gross covered loans	$ 173,104	$ 220,559

Allowance for Loan Losses

The Company s Credit Management Division is responsible for regularly reviewing the ALLL methodology for covered loans. The ALLL for covered loans is determined separately from non-covered loans, and is based on expectations of future cash flows from the underlying pools of loans or individual loans in accordance with ASC 310-30, as more fully discussed in Note 3 Summary of Significant Accounting Policies. As of December 31, 2013, and 2012, the Company had zero allowance for loan losses recorded for covered loans.

Other Real Estate Owned

The following table summarizes the activity related to covered other real estate owned for the years ended December 31, 2013, and 2012:

	For the Year Ended December 31, 2013	2012
	(Dollars in thousands)	
Balance, beginning of period	$ 1,067	$ 9,782
Additions	1,492	1,738
Dispositions	(1,639)	(9,867)
Valuation adjustments	(416)	(586)
Balance, end of period	$ 504	$ 1,067

FDIC Loss Sharing Asset

The following table summarizes the activity related to the FDIC loss sharing asset for the years ended December 31, 2013, and 2012:

	For the Year Ended December 31, 2013	2012
	(Dollars in thousands)	
Balance, beginning of period	$ 18,489	$ 59,453
FDIC share of additional losses, net of recoveries	(81)	1,111
Cash received from FDIC, net of refund	(4)	(18,974)
Net amortization (1)	(12,779)	(23,027)
Other reductions, net	(861)	(74)
Balance, end of period	$ 4,764	$ 18,489

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(1) Net amortization included accelerated amortization as a result of loans being paid off in full, sold, or transferred to covered OREO. Through December 31, 2013, the Bank has submitted claims to the FDIC for net losses on covered loans totaling $122.8 million.

6. NON-COVERED LOANS AND LEASE FINANCE RECEIVABLES AND ALLOWANCE FOR LOAN LOSSES

The following table provides a summary of the components of non-covered loan and lease finance receivables:

	December 31, 2013	December 31, 2012
	(Dollars in thousands)	
Commercial and industrial	$ 512,792	$ 547,422
Real estate:		
Commercial real estate	2,207,515	1,990,107
Construction	47,109	59,721
SFR mortgage	189,233	159,288
Dairy & livestock and agribusiness	294,292	336,660
Municipal lease finance receivables	89,106	105,767
Consumer and other loans	55,103	60,273
Gross non-covered loans	3,395,150	3,259,238
Less: Deferred loan fees, net	(9,234)	(6,925)
Gross loans, net of deferred loan fees	3,385,916	3,252,313
Less: Allowance for non-covered loan losses	(75,235)	(92,441)
Net non-covered loans	$ 3,310,681	$ 3,159,872

As of December 31, 2013, 65.02% of the total non-covered loan portfolio consisted of commercial real estate loans and 1.39% of the total loan portfolio consisted of construction loans, respectively. Substantially all of the Company s real estate loans and construction loans are secured by real properties located in California. At December 31, 2013, the Company held approximately $1.64 billion of non-covered fixed rate loans.

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

Non-Covered Loans Held-for-Sale

The following table provides a summary of the activity related to non-covered loans held-for-sale for the years ended December 31, 2013, and 2012:

	For the Year Ended December 31, 2013	2012
	(Dollars in thousands)	
Balance, beginning of period	$	$ 348
Originations of mortgage loans	485	25,489
Sales of mortgage loans	(485)	(22,250)
Transfer of mortgage loans to held for investment		(3,587)
Sales of other loans		
Transfers of other loans to held for sale	3,667	
Write-down of loans held for sale		
Balance, end of period	$ 3,667	$

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Credit Quality Indicators

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

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

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

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

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

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

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

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

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The following table summarizes each class of non-covered loans according to internal risk ratings as of December 31, 2013 and 2012:

	December 31, 2013					
	Pass	Watch List	Special Mention	Substandard	Doubtful & Loss	Total
	(Dollars in thousands)					
Commercial and industrial	$ 312,927	$ 128,068	$ 53,417	$ 17,950	$ 430	$ 512,792
Real estate:						
Commercial real estate						
Owner occupied	449,853	147,165	74,999	57,934		729,951
Non-owner occupied	1,104,065	242,431	81,088	49,980		1,477,564
Construction						
Speculative	8,611	21	1,529	17,617		27,778
Non-speculative	6,940	3,190		9,201		19,331
SFR mortgage	152,500	20,485	3,302	12,946		189,233
Dairy & livestock and agribusiness	43,588	86,580	92,514	69,005	2,605	294,292
Municipal lease finance receivables	43,445	18,338	20,893	6,430		89,106
Consumer and other loans	43,225	6,938	3,449	1,491		55,103
Total non-covered gross loans	$ 2,165,154	$ 653,216	$ 331,191	$ 242,554	$ 3,035	$ 3,395,150

	December 31, 2012					
	Pass	Watch List	Special Mention	Substandard	Doubtful & Loss	Total
	(Dollars in thousands)					
Commercial and industrial	$ 347,275	$ 131,186	$ 44,466	$ 22,901	$ 1,594	$ 547,422
Real estate:						
Commercial real estate						
Owner occupied	382,111	159,653	78,087	84,116		703,967
Non-owner occupied	888,777	214,901	105,121	77,341		1,286,140
Construction						
Speculative	1,417		15,163	21,314		37,894
Non-speculative	9,841	2,767		9,219		21,827
SFR mortgage	129,730	10,215	3,107	16,236		159,288
Dairy & livestock and agribusiness	72,113	111,393	75,316	77,721	117	336,660
Municipal lease finance receivables	72,432	20,237	11,124	1,974		105,767
Consumer and other loans	49,321	6,763	2,714	1,421	54	60,273
Total non-covered gross loans	$ 1,953,017	$ 657,115	$ 335,098	$ 312,243	$ 1,765	$ 3,259,238

Allowance for Loan Losses

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

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Our methodology for assessing the appropriateness of the allowance is conducted on a regular basis and considers the Bank s overall loan portfolio. Refer to Note 3 Summary of Significant Accounting Policies for a more detailed discussion concerning the allowance for loan losses.

Management believes that the ALLL was appropriate at December 31, 2013 and 2012. No assurance can be given that economic conditions which adversely affect the Company s service areas or other circumstances will not be reflected in increased provisions for loan losses in the future.

The following tables present the balance and activity related to the allowance for loan losses for non-covered held-for-investment loans by portfolio segment as of December 31, 2013, 2012 and 2011:

	For the Year Ended December 31, 2013				
	Ending Balance December 31, 2012	Charge-offs	Recoveries	Provision for Loan Losses	Ending Balance December 31, 2013
			(Dollars in thousands)		
Commercial and industrial	$ 11,652	$ (2,491)	$ 759	$ 914	$ 10,834
Real estate:					
Commercial real estate	47,457		402	(8,457)	39,402
Construction	2,291		703	(1,689)	1,305
SFR mortgage	3,448	(252)	367	(845)	2,718
Dairy & livestock and agribusiness	18,696		109	(7,077)	11,728
Municipal lease finance receivables	1,588			747	2,335
Consumer and other loans	1,170	(108)	55	(157)	960
Unallocated	6,139			(186)	5,953
Total allowance for loan losses	$ 92,441	$ (2,851)	$ 2,395	$ (16,750)	$ 75,235

	For the Year Ended December 31, 2012				
	Ending Balance December 31, 2011	Charge-offs	Recoveries	Provision for Loan Losses	Ending Balance December 31, 2012
			(Dollars in thousands)		
Commercial and industrial	$ 10,654	$ (1,259)	$ 1,280	$ 977	$ 11,652
Real estate:					
Commercial real estate	47,841	(1,873)	514	975	47,457
Construction	4,947		1,139	(3,795)	2,291
SFR mortgage	4,032	(642)	(108)	166	3,448
Dairy & livestock and agribusiness	17,278	(1,150)	166	2,402	18,696
Municipal lease finance receivables	2,403			(815)	1,588
Consumer and other loans	1,590	(283)	36	(173)	1,170
Unallocated	5,219			920	6,139
Total allowance for loan losses	$ 93,964	$ (5,207)	$ 3,027	$ 657	$ 92,441

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	For the Year Ended December 31, 2011				
	Ending Balance December 31, 2010	Charge-offs	Recoveries	Provision for Loan Losses	Ending Balance December 31, 2011
			(Dollars in thousands)		
Commercial and industrial	$ 11,472	$ (1,980)	$ 302	$ 860	$ 10,654
Real estate:					
Commercial real estate	40,234	(4,766)	606	11,767	47,841
Construction	10,188	(7,976)	757	1,978	4,947
SFR mortgage	3,295	(1,104)	142	1,699	4,032
Dairy & livestock and agribusiness	36,061	(3,291)	151	(15,643)	17,278
Municipal lease finance receivables	2,172			231	2,403
Consumer and other loans	1,034	(511)	200	867	1,590
Unallocated	803			4,416	5,219
Total allowance for loan losses	$ 105,259	$ (19,628)	$ 2,158	$ 6,175	$ 93,964

The following tables present the recorded investment in non-covered loans held-for-investment, and the related allowance for loan losses by portfolio segment, based on the Company s methodology for determining the allowance for loan losses as December 31, 2013 and 2012:

	December 31, 2013			
	Recorded Investment in Loans		Allowance for Loan Losses	
	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Individually Evaluated for Impairment	Collectively Evaluated for Impairment
		(Dollars in thousands)		
Commercial and industrial	$ 5,033	$ 507,759	$ 365	$ 10,469
Real estate:				
Commercial real estate	33,440	2,174,075		39,402
Construction	26,818	20,291		1,305
SFR mortgage	11,405	177,828	103	2,615
Dairy & livestock and agribusiness	29,812	264,480	2,702	9,026
Municipal lease finance receivables		89,106		2,335
Consumer and other loans	401	54,702	4	956
Unallocated				5,953
Total	$ 106,909	$ 3,288,241	$ 3,174	$ 72,061

	December 31, 2012			
	Recorded Investment in Loans		Allowance for Loan Losses	
	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Individually Evaluated for Impairment	Collectively Evaluated for Impairment
		(Dollars in thousands)		
Commercial and industrial	$ 3,689	$ 543,733	$ 289	$ 11,363
Real estate:				
Commercial real estate	42,136	1,947,971	2	47,455
Construction	30,533	29,188		2,291
SFR mortgage	14,845	144,443	434	3,014
Dairy & livestock and agribusiness	16,709	319,951	1,596	17,100
Municipal lease finance receivables	263	105,504		1,588
Consumer and other loans	215	60,058	11	1,159
Unallocated				6,139

Total	$ 108,390	$ 3,150,848	$ 2,332	$ 90,109

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Past Due and Nonperforming Loans

We seek to manage asset quality and control credit risk through diversification of the non-covered loan portfolio and the application of policies designed to promote sound underwriting and loan monitoring practices. The Bank s Credit Management Division is in charge of monitoring asset quality, establishing credit policies and procedures and enforcing the consistent application of these policies and procedures across the Bank. Reviews of nonperforming, past due non-covered loans and larger credits, designed to identify potential charges to the allowance for loan losses, and to determine the adequacy of the allowance, are conducted on an ongoing basis. These reviews consider such factors as the financial strength of borrowers and any guarantors, the value of the applicable collateral, loan loss experience, estimated loan losses, growth in the loan portfolio, prevailing economic conditions and other factors. Refer to Note 3 Summary of Significant Accounting Policies for additional discussion concerning the Bank s policy for past due and nonperforming loans.

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

Generally, when loans are identified as impaired they are moved to our Special Assets Department. When we identify a loan as impaired, we measure the loan for potential impairment using discounted cash flows, unless the loan is determined to be collateral dependent. In these cases, we use the current fair value of collateral, less selling costs. Generally, the determination of fair value is established through obtaining external appraisals of the collateral.

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

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

	December 31, 2013						
	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due and Accruing	Total Past Due and Accruing	Nonaccrual (1)	Current	Total Loans and Financing Receivables
	(Dollars in thousands)						
Commercial and industrial	$ 900	$ 93	$	$ 993	$ 3,861	$ 507,938	$ 512,792
Real estate:							
Commercial real estate							
Owner occupied	220			220	4,105	725,626	729,951
Non-owner occupied	303			303	8,305	1,468,956	1,477,564
Construction							
Speculative					9,966	17,812	27,778
Non-speculative						19,331	19,331
SFR mortgage	773	935		1,708	7,577	179,948	189,233
Dairy & livestock and agribusiness					5,739	288,553	294,292
Municipal lease finance receivables						89,106	89,106
Consumer and other loans	75			75	401	54,627	55,103
Total non-covered gross loans	$ 2,271	$ 1,028	$	$ 3,299	$ 39,954	$ 3,351,897	$ 3,395,150

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(1) As of December 31, 2013, $23.9 million of nonaccruing loans were current, $473,000 were 30-59 days past due, $854,000 were 60-89 days past due, and $14.7 million were 90+ days past due.

	December 31, 2012						
	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due and Accruing	Total Past Due and Accruing	Nonaccrual (1)	Current	Total Loans and Financing Receivables
	(Dollars in thousands)						
Commercial and industrial	$ 233	$ 457	$	$ 690	$ 3,136	$ 543,596	$ 547,422
Real estate:							
Commercial real estate							
Owner occupied					5,415	698,552	703,967
Non-owner occupied					15,624	1,270,516	1,286,140
Construction							
Speculative					10,663	27,231	37,894
Non-speculative						21,827	21,827
SFR mortgage	107			107	13,102	146,079	159,288
Dairy & livestock and agribusiness					9,842	326,818	336,660
Municipal lease finance receivables						105,767	105,767
Consumer and other loans	82	8		90	215	59,968	60,273
Total non-covered gross loans	$ 422	$ 465	$	$ 887	$ 57,997	$ 3,200,354	$ 3,259,238

(1) As of December 31, 2012, $40.1 million of nonaccruing loans were current, $2.6 million were 30-59 days past due, and $15.3 million were 90+ days past due.

Non-Covered Impaired Loans

At December 31, 2013, the Company had non-covered impaired loans of $106.9 million. Of this amount, there was $10.0 million in nonaccrual commercial construction loans, $7.6 million of nonaccrual SFR mortgage loans, $12.4 million of nonaccrual commercial real estate loans, $3.9 million of nonaccrual commercial and industrial loans, $5.7 million of nonaccrual dairy & livestock and agribusiness loans and $401,000 of consumer and other loans. These non-covered impaired loans included $92.1 million of loans whose terms were modified in a troubled debt restructuring, of which $25.1 million are classified as nonaccrual. The remaining balance of $67.0 million consists of 46 loans performing according to the restructured terms. The impaired loans had a specific allowance of $3.2 million at December 31, 2013. At December 31, 2012, the Company had classified as impaired, non-covered loans with a balance of $108.4 million with a related allowance of $2.3 million.

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The following tables present held-for-investment loans individually evaluated for impairment by class of loans, as of December 31, 2013, 2012 and 2011:

	December 31, 2013				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
			(Dollars in thousands)		
With no related allowance recorded:					
Commercial and industrial	$ 4,668	$ 5,927	$	$ 4,965	$ 66
Real estate:					
Commercial real estate					
Owner occupied	13,041	14,133		13,463	548
Non-owner occupied	20,399	26,155		21,313	817
Construction					
Speculative	17,617	18,408		18,043	310
Non-speculative	9,201	9,201		9,217	572
SFR mortgage	10,919	12,516		10,408	103
Dairy & livestock and agribusiness	17,702	17,702		19,205	434
Municipal lease finance receivables					
Consumer and other loans	385	445		389	
Total	93,932	104,487		97,003	2,850
With a related allowance recorded:					
Commercial and industrial	365	379	365	386	
Real estate:					
Commercial real estate					
Owner occupied					
Non-owner occupied					
Construction					
Speculative					
Non-speculative					
SFR mortgage	486	489	103	479	
Dairy & livestock and agribusiness	12,110	12,783	2,702	13,377	209
Municipal lease finance receivables					
Consumer and other loans	16	19	4	18	
Total	12,977	13,670	3,174	14,260	209
Total non-covered impaired loans	$ 106,909	$ 118,157	$ 3,174	$ 111,263	$ 3,059

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

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	December 31, 2011				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
			(Dollars in thousands)		
With no related allowance recorded:					
Commercial and industrial	$ 3,566	$ 4,630	$	$ 4,649	$ 93
Real estate:					
Commercial real estate					
Owner occupied	13,567	14,013		11,941	449
Non-owner occupied	16,435	23,656		21,096	67
Construction					
Speculative	13,317	15,718		15,434	
Non-speculative	20,085	20,085		16,437	1,123
SFR mortgage	14,069	17,411		15,120	47
Dairy & livestock and agribusiness	8,879	10,358		10,535	446
Municipal lease finance receivables					
Consumer and other loans	104	150		127	
Total	90,022	106,021		95,339	2,225
With a related allowance recorded:					
Commercial and industrial	1,388	1,410	165	1,554	
Real estate:					
Commercial real estate					
Owner occupied	3,900	3,900	928	3,900	
Non-owner occupied	83	85	5	86	
Construction					
Speculative					
Non-speculative					
SFR mortgage	4,087	4,369	406	3,967	
Dairy & livestock and agribusiness	1,372	3,324	1,372	2,402	
Municipal lease finance receivables					
Consumer and other loans	374	388	92	417	
Total	11,204	13,476	2,968	12,326	
Total non-covered impaired loans	$ 101,226	$ 119,497	$ 2,968	$ 107,665	$ 2,225

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

Impaired construction speculative loans increased in the third quarter of 2012 due to a participating interest in the Company s only Shared National Credit loan that was transferred to nonaccrual status. The outstanding balance was $10.0 million as December 31, 2013.

Reserve for Unfunded Loan Commitments

The allowance for off-balance sheet credit exposure relates to commitments to extend credit, letters of credit and undisbursed funds on lines of credit. The Company evaluates credit risk associated with the off-balance sheet loan commitments at the same time it evaluates credit risk associated with the loan and lease portfolio. The Company recorded a provision for unfunded loan commitments of $500,000 for the year ended December 31,

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2013, compared to a $1.0 million recapture of the provision for the year ended December 31, 2012. As of December 31, 2013 and December 31, 2012, the balance in this reserve was $9.1 and $8.6 million, respectively, and was included in other liabilities.

Troubled Debt Restructurings (TDR)

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

As of December 31 2013, there were $92.1 million of loans classified as a TDR of which $25.1 million were nonperforming and $67.0 million are performing. TDRs on accrual status are comprised of loans that were accruing interest at the time of restructuring or have demonstrated repayment performance in compliance with the restructured terms for a sustained period and for which the Company anticipates full repayment of both principal and interest. At December 31, 2013, performing TDRs were comprised of 15 commercial real estate loans of $21.0 million, two construction loans of $16.9 million, 11 dairy & livestock loans of $24.1 million, 11 SFR mortgage loans of $3.8 million, and seven commercial and industrial loans of $1.2 million. There were no loans removed from TDR classification for the year ended December 31, 2013 and 2012.

The majority of TDRs have no specific allowance allocated as any impairment amount is normally charged off at the time a probable loss is determined. We have allocated $2.7 million and $1.7 million of specific allowance to TDRs as of December 31, 2013 and December 31, 2012, respectively.

The following table provides a summary of the activity related to TDRs for the years ended December 31, 2013 and 2012:

	For the Year Ended December 31, 2013	2012
	(Dollars in thousands)	
Performing TDRs:		
Beginning balance	$ 50,392	$ 38,554
New modifications	30,796	24,339
Payoffs and payments, net	(15,492)	(8,536)
TDRs returned to accrual status	1,259	1,215
TDRs placed on nonaccrual status		(5,180)
Ending balance	$ 66,955	$ 50,392

	For the Year Ended December 31, 2013	2012
	(Dollars in thousands)	
Nonperforming TDRs:		
Beginning balance	$ 31,309	$ 23,844
New modifications	4,187	18,094
Charge-offs	(92)	(19)
Transfer to OREO		(4,897)
Payoffs and payments, net	(9,026)	(9,678)
TDRs returned to accrual status	(1,259)	(1,215)
TDRs placed on nonaccrual status		5,180
Ending balance	$ 25,119	$ 31,309

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The following are the loans modified as troubled debt restructurings for the years ended December 31, 2013, 2012 and 2011:

Modifications (1)

	For the Year Ended December 31, 2013				
	Number of Loans	**Pre-Modification Outstanding Recorded Investment**	**Post-Modification Outstanding Recorded Investment**	**Outstanding Recorded Investment at December 31, 2013**	**Financial Effect Resulting From Modifications (2)**
	(Dollars in thousands)				
Commercial and industrial:					
Interest rate reduction		$	$	$	$
Change in amortization period or maturity	4	621	621	570	95
Real estate:					
Commercial real estate:					
Owner occupied					
Interest rate reduction					
Change in amortization period or maturity	1	168	168	138	
SFR mortgage:					
Interest rate reduction	3	1,365	1,365	1,349	
Change in amortization period or maturity					
Dairy & livestock and agribusiness:					
Interest rate reduction					
Change in amortization period or maturity	10	26,915	26,915	22,662	149
Total non-covered loans	18	$ 29,069	$ 29,069	$ 24,719	$ 244

(1) The tables exclude modified loans that were paid off prior to the end of the period.

(2) Financial effects resulting from modifications represent charge-offs and specific allowance recorded at modification date.

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	For the Year Ended December 31, 2012				
	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Outstanding Recorded Investment at December 31, 2012	Financial Effect Resulting From Modifications (2)
	(Dollars in thousands)				
Commercial and industrial:					
Interest rate reduction	1	$ 80	$ 80	$ 66	$
Change in amortization period or maturity	8	2,301	2,301	1,817	3
Real estate:					
Commercial real estate:					
Owner occupied					
Interest rate reduction					
Change in amortization period or maturity	6	4,225	4,225	3,903	
Non-owner occupied					
Interest rate reduction	1	3,378	3,378	3,359	
Change in amortization period or maturity	4	5,906	5,906	5,303	
Construction:					
Speculative					
Interest rate reduction					
Change in amortization period or maturity	1	10,966	10,966	10,663	
SFR mortgage:					
Interest rate reduction	1	399	399	398	
Change in amortization period or maturity					
Dairy & livestock and agribusiness:					
Interest rate reduction					
Change in amortization period or maturity	7	9,447	9,447	9,184	
Municipal lease finance receivables					
Interest rate reduction					
Change in amortization period or maturity	2	519	519	263	
Total non-covered loans	31	$ 37,221	$ 37,221	$ 34,956	$ 3

(1) The tables exclude modified loans that were paid off prior to the end of the period.
(2) Financial effects resulting from modifications represent charge-offs and specific allowance recorded at modification date.

	For the Year Ended December 31, 2011			
	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Outstanding Recorded Investment at December 31, 2011
	(Dollars in thousands)			
Commercial and industrial:	5	$ 1,673	$ 1,372	$ 1,224
Real estate:				
Commercial real estate:				
Owner occupied	3	3,195	3,195	3,067
Non-owner occupied	3	11,707	11,707	10,236
Construction:				
Speculative	2	16,886	16,886	15,394
Non-speculative	1	9,219	9,219	9,219
SFR mortgage:	6	2,162	2,161	2,049
Dairy & livestock and agribusiness:	5	11,750	11,750	8,662
Total non-covered loans	25	56,592	56,290	49,851

(1) The tables exclude modified loans that were paid off prior to the end of the period.

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As of December 31 2013, there was no loan that was previously modified as a troubled debt restructuring within the previous 12 months that subsequently defaulted during the year ended December 31, 2013.

As of December 31, 2012, there was one construction loan with an outstanding balance of $10.7 million and one commercial real estate loan with an outstanding balance of $2.4 million that were previously modified as a troubled debt restructuring within the previous 12 months that subsequently defaulted during the year ended December 31, 2012.

As of December 31, 2011, there were two dairy & livestock loans with a total outstanding balance of $886,000 and two commercial real estate loans with a total outstanding balance of $3.4 million modified as troubled debt restructurings within the previous 12 months that subsequently defaulted during the 12 months ended December 31, 2011.

7. NON-COVERED OTHER REAL ESTATE OWNED

The following table summarizes the activity related to Other Real Estate Owned for the years ended December 31, 2013 and 2012:

	For the Year Ended December 31, 2013	2012
	(Dollars in thousands)	
Balance, beginning of period	$ 14,832	$ 13,820
Additions		8,508
Dispositions	(8,284)	(7,035)
Valuation adjustments	(73)	(461)
Balance, end of period	$ 6,475	$ 14,832

8. INTANGIBLE ASSETS

The following summarizes activity of amortizable core deposit intangible assets for the years ended December 2013 and 2012:

	As of And For the Year Ended December 31, 2013		2012	
	Gross Carrying Amount	**Accumulated Amortization**	**Gross Carrying Amount**	**Accumulated Amortization**
	(Dollars in thousands)			
Amortizing intangible assets	$ 31,999	$ (29,738)	$ 31,999	$ (28,610)
Aggregate amortization expense:				
For year ended December 31,	$ 1,127		$ 2,159	
Estimated Amortization Expense:				
For the year ended December 31, 2014	$ 475			
For the year ended December 31, 2015	437			
For the year ended December 31, 2016	395			
For the year ended December 31, 2017	366			
For the year ended December 31, 2018	338			
Thereafter				