CITY NATIONAL CORP
Form 10-Q
August 08, 2014
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2014

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

For the transition period from to

Commission file number 1-10521

CITY NATIONAL CORPORATION

(Exact name of registrant as specified in its charter)

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

City National Plaza

555 South Flower Street, Los Angeles, California, 90071

(Address of principal executive offices)(Zip Code)

(213) 673-7700

(Registrant s telephone number, including area code)

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

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

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

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

Large accelerated filer x	Accelerated filer o	Non-accelerated filer o	Smaller reporting company o
		(Do not check if a smaller reporting company)	

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

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

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CITY NATIONAL CORPORATION

CONSOLIDATED BALANCE SHEETS

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

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

See accompanying Notes to the Unaudited Consolidated Financial Statements.

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CITY NATIONAL CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

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

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

See accompanying Notes to the Unaudited Consolidated Financial Statements.

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CITY NATIONAL CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited)

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

See accompanying Notes to the Unaudited Consolidated Financial Statements.

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CITY NATIONAL CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

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

Non-cash investing activities:				
Transfer of loans to other real estate owned	$	4,131	$	14,629

See accompanying Notes to the Unaudited Consolidated Financial Statements.

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CITY NATIONAL CORPORATION

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY

(Unaudited)

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

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

See accompanying Notes to the Unaudited Consolidated Financial Statements.

CITY NATIONAL CORPORATION

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. Summary of Significant Accounting Policies

Organization

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

Consolidation

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

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

Use of Estimates

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

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

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Note 1. Summary of Significant Accounting Policies (Continued)

Basis of Presentation

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

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

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

Accounting Pronouncements

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

- In February 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2013-04, *Liabilities (Topic 405): Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation is Fixed at the Reporting Date* (ASU 2013-04). ASU 2013-04 provides guidance for the recognition, measurement and disclosure of obligations resulting from joint and several liability arrangements. Examples of obligations within the scope of the ASU include debt arrangements, other contractual obligations and settled litigation. ASU 2013-04 requires entities to measure obligations resulting from joint and several liability arrangements for which the total amount of the obligation within the scope of the guidance is fixed at the reporting date, as the sum of (1) the amount the reporting entity agreed to pay on the basis of its arrangement among its co-obligors, and (2) any additional amount the reporting entity expects to pay on behalf of its co-obligors. Required disclosures include a description of the joint-and-several arrangement and the total outstanding amount of the obligation for all joint parties. Adoption of the new guidance on January 1, 2014 did not have a significant impact on the Company s consolidated financial statements.

- In July 2013, the FASB issued ASU 2013-11, *Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*. The new guidance requires an entity to present liabilities for unrecognized tax benefits in the statement of financial position as a reduction to a deferred tax asset for a net operating loss carryforward or a tax credit carryforward, except as follows: (1) to the extent a net operating loss carryforward or tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position, or (2) the tax law of the applicable jurisdiction does not require the entity to use and the entity does not intend to use the deferred tax asset for such purpose. In these situations, the unrecognized tax benefit should be presented in the balance sheet as a liability and should not be combined with deferred tax assets. Adoption of the new guidance on January 1, 2014 did not have a significant impact on the Company s consolidated financial statements.

The following is a summary of recently issued accounting pronouncements:

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

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Note 1. Summary of Significant Accounting Policies (Continued)

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

- In January 2014, the FASB issued ASU 2014-04, *Receivables-Troubled Debt Restructurings by Creditors (Subtopic 310-40), Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure* (ASU 2014-04). ASU 2014-04 requires entities to reclassify consumer mortgage loans collateralized by residential real estate to OREO when either (1) the creditor obtains legal title to the residential real estate property or (2) the borrower conveys all interest in the property to the creditor to satisfy the loan by completing a deed in lieu of foreclosure or similar agreement. The ASU becomes effective for the Company for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. Entities will have the option of adopting the guidance using either a modified retrospective transition method or a prospective transition method. Early adoption is permitted. Adoption of the new guidance is not expected to have a significant impact on the Company s consolidated financial statements.

- In April 2014, the FASB issued ASU 2014-08, *Presentation of Financial Statements (Topic 205) and Property, Plant and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity* (ASU 2014-08). ASU 2014-08 raises the threshold for a disposal to qualify as a discontinued operation and requires new disclosures of both discontinued operations and certain other disposals that do not meet the definition of a discontinued operation. Under the revised standard, a discontinued operation is (1) a component of an entity or group of components that has been disposed of by sale, disposed of other than by sale or is classified as held for sale that represents a strategic shift that has or will have a major effect on an entity s operations and financial results or (2) an acquired business or nonprofit activity that is classified as held for sale on the date of the acquisition. ASU 2014-08 is effective for annual periods beginning on or after December 15, 2014, and interim periods therein. The new guidance will be applied prospectively. Early adoption is permitted. Adoption of the new guidance is not expected to have a significant impact on the Company s consolidated financial statements.

- In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers: Topic 606* (ASU 2014-09). The standard outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The ASU outlines a five-step process for applying the new revenue model and expands required disclosures on revenue recognition. The ASU is effective for annual reporting periods, and interim reporting periods within those periods, beginning after December 15, 2016. Entities have the option of using either a full or modified retrospective approach for adoption. Early application is not permitted. The Company is assessing the impact of the new guidance on its consolidated financial statements.

- In June 2014, the FASB issued ASU 2014-11, *Transfers and Servicing (Topic 860), Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures* (ASU 2014-11). ASU 2014-11 aligns the accounting for repurchase-to-maturity transactions and repurchase agreements executed as a repurchase financing with the accounting for other repurchase agreements. Going forward, these transactions will all be accounted for as secured borrowings. Under the new guidance, parties to a repurchase financing transaction will be required to separately account for the initial transfer of the financial asset and the related repurchase agreement. The initial transfer of the financial asset would be accounted for as a sale by the transferor only if all criteria for derecognition have been met. ASU 2014-11 requires new or expanded disclosures for repurchase agreements and similar transactions accounted for as secured borrowings. The ASU becomes effective for the Company for the first interim or annual period beginning after December 15, 2014. Adoption of the new guidance is not expected to have a significant impact on the Company s consolidated financial statements.

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Note 2. Fair Value Measurements

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

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

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

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

(3) Includes covered OREO.

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Note 2. Fair Value Measurements (Continued)

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

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

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

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

(4) Includes covered OREO.

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

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Note 2. Fair Value Measurements (Continued)

Recurring Fair Value Measurements

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

Level 3 Assets and Liabilities Measured on a Recurring Basis

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

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

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

Redeemable noncontrolling interest is classified as Level 3 in the fair value hierarchy and measured on a recurring basis. Redeemable noncontrolling interest is valued based on a combination of factors, including but not limited to, observable valuation of firms similar to the affiliates, multiples of revenue or profit, unique investment products or performance track records, strength in the marketplace, projected discounted cash flow scenarios, strategic value of affiliates to other entities, as well as unique sources of value specific to an individual firm. The methodology used to fair value these interests is consistent with the industry practice of valuing similar types of instruments. Refer to Note 17, *Noncontrolling Interest*, for a rollforward of activity for the six months ended June 30, 2014 and 2013.

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Note 2. Fair Value Measurements (Continued)

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

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

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

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

Nonrecurring Fair Value Measurements

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

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Note 2. Fair Value Measurements (Continued)

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

Information About Nonrecurring Level 3 Fair Value Measurements

(in thousands)	Fair Value at June 30, 2014		Valuation Method	Unobservable Inputs
Other real estate owned	$	7,849	Third-party appraisal	- Fair values are primarily based on unadjusted appraised values. - A limited number of properties were valued using comparable sales values or broker opinions, or a combination of these approaches, resulting in discounts to appraised values ranging from 14% to 31%.

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

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

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

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

Fair Value of Financial Instruments

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

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

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Note 2. Fair Value Measurements (Continued)

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

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

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

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

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

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

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Note 2. Fair Value Measurements (Continued)

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

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

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

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

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

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

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

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

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

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

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Note 3. Securities

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

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

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