CVB FINANCIAL CORP
Form 10-Q
August 10, 2015
Table of Contents

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, 2015

or

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

For the transition period from __________ to __________

Commission File Number: 0-10140

CVB FINANCIAL CORP.

(Exact name of registrant as specified in its charter)

California	**95-3629339**
(State or other jurisdiction of	**(I.R.S. Employer**
Incorporation or organization)	**Identification No.)**

701 North Haven Ave., Suite 350	
Ontario, California	**91764**
(Address of principal executive offices)	**(Zip Code)**

(909) 980-4030

(Registrant s telephone number, including area code)

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

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

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

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

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

Number of shares of common stock of the registrant: 106,340,143 outstanding as of July 30, 2015.

TABLE OF CONTENTS

Table of Contents

PART I FINANCIAL INFORMATION (UNAUDITED)

GENERAL

Forward Looking Statements

Certain statements in this Report on Form 10-Q, including, but not limited to, statements under the heading Management Discussion and Analysis of Financial Condition and Results of Operations constitute forward-looking statements under the Private Securities Litigation Reform Act of 1995, including but not limited to, statements about anticipated future operating and financial performance and results, financial position and liquidity, business prospects, strategic alternatives, business strategies, technology initiatives and cyber security, regulatory and compliance policies, competitive outlook, capital and financing needs and availability, acquisition and divestiture opportunities, investment and expenditure plans, plans and objectives of management for legacy and future operations, legal proceedings or investigations, board and management hiring and retention and other similar forecasts and statements of expectations or assumptions underlying any of the foregoing. Words such as will likely result, aims , anticipates , believes , could , estimates , expects , hopes , intends , may , plans , projects , seeks , should , will words and similar expressions are intended to identify these forward looking statements, which involve risks and uncertainties. Our actual results may differ significantly from the results discussed in such forward-looking statements. Factors that might cause such a difference include, but are not limited to, local, regional, national and international economic and market conditions and events and the impact they may have on the Company, our customers and/or our assets and liabilities; our ability to attract and maintain deposits, borrowings and other sources of funding or liquidity, and the pricing and rates applicable thereto; supply and demand for real estate and renewed fluctuations or periodic deterioration in the market values of real estate in California or other jurisdictions where we lend, whether involving residential or commercial property; a prolonged slowdown or decline in real estate sales or construction activity; changes in the financial performance and/or condition of our loan and deposit customers or key vendors or counterparties; changes in the levels of performing and nonperforming bank assets and charge-offs; the cost or effect of acquisitions or divestitures we may make; the effect of changes in laws and regulations (including laws, regulations and judicial decisions concerning financial reform, taxes, bank or holding company capital levels, securities, employment, executive compensation, insurance, compliance, vendor management and information security) with which we and our subsidiaries must comply (or believe we must comply); changes in the applicability or costs of deposit insurance or other regulatory fees; changes in estimates of future reserve requirements and minimum capital requirements based upon the periodic review thereof under relevant legal, regulatory and accounting requirements; inflation, interest rate, securities market and monetary fluctuations; internal and external fraud and cyber-security threats, including theft or loss of Company or customer funds, loss of system functionality or access, or theft or loss of Company or customer information; political instability; acts of war or terrorism, or natural disasters, such as earthquakes, droughts or pandemic diseases; the timely development and acceptance of new banking products and services (including technology-based services and products) and the perceived value of these products and services by customers and potential customers; the Company s relationships with and reliance upon vendors with respect to the operation of key internal or external systems and applications; changes in consumer spending, borrowing and savings preferences or habits; the effects of technological changes, the expanding use of technology in banking (including the adoption of mobile banking applications) and product innovation or contraction; the ability to retain or increase market share, retain or grow customers and control expenses; changes in the risk or competitive environment among financial and bank holding companies, banks and other financial service providers; volatility in the credit and equity markets and its effects on the general economy or local or regional business conditions; market fluctuations in the prices of the Company s common stock or other securities; the effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as by the Public Company Accounting Oversight Board, the Financial Accounting Standards Board and other national or international accounting standard setters; changes in our organization, management, compensation and benefit plans, and our ability to retain or expand our management team and our board of directors; the costs and effects of legal, regulatory and compliance changes or developments; the initiation and the favorable or unfavorable resolution of legal proceedings or regulatory or other governmental inquiries involving the Company, including, but not limited to, any consumer or employment class action litigation, and the current investigation by the Securities and Exchange Commission and the related federal class-action and state law derivative action lawsuits filed against us; the results of regulatory examinations or reviews or other government actions; and our ongoing relationships with our various federal and state regulators, including the SEC, FDIC and California DBO.

The Company cautions that the foregoing factors are not exclusive. For additional information concerning these factors and other factors which may cause actual results to differ from the results discussed in our forward-looking statements, see the periodic filings the Company makes with the Securities and Exchange Commission, and, in particular, the information set forth in Item 1A herein and in Item 1A. Risk Factors contained in the Company s Annual Report on Form 10-K for the year ended December 31, 2014. The Company does not undertake, and specifically disclaims, any obligation to update any forward-looking statements to reflect occurrences or unanticipated events or circumstances after the date of such statements except as required by law.

Table of Contents

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

CVB FINANCIAL CORP. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except share data)

(Unaudited)

	June 30, 2015	December 31, 2014
Assets		
Cash and due from banks	$ 125,431	$ 95,030
Interest-earning balances due from Federal Reserve	321,015	10,738
Total cash and cash equivalents	446,446	105,768
Interest-earning balances due from depository institutions	24,378	27,118
Investment securities available-for-sale, at fair value (with amortized cost of $3,113,339 at June 30, 2015, and $3,083,582 at December 31, 2014)	3,154,217	3,137,158
Investment securities held-to-maturity	1,400	1,528
Investment in stock of Federal Home Loan Bank (FHLB)	17,588	25,338
Loans and lease finance receivables	3,784,219	3,817,067
Allowance for loan losses	(59,554)	(59,825)
Net loans and lease finance receivables	3,724,665	3,757,242
Premises and equipment, net	31,894	33,591
Bank owned life insurance	129,597	126,927
Accrued interest receivable	22,173	23,194
Intangibles	2,707	3,214
Goodwill	74,244	74,244
Other real estate owned	7,835	5,637
Income taxes	40,756	31,461
Other assets	19,458	25,500
Total assets	$ 7,697,358	$ 7,377,920
Liabilities and Stockholders Equity		
Deposits:		
Noninterest-bearing	$ 3,250,574	$ 2,866,365
Interest-bearing	2,743,306	2,738,293
Total deposits	5,993,880	5,604,658
Customer repurchase agreements	662,326	563,627
FHLB advances		199,479

Other borrowings		46,000
Accrued interest payable	321	1,161
Deferred compensation	11,093	10,291
Junior subordinated debentures	25,774	25,774
Payable for securities purchased	59,693	
Other liabilities	50,280	48,821
Total liabilities	6,803,367	6,499,811
Commitments and Contingencies		
Stockholders Equity		
Common stock, authorized, 225,000,000 shares without par; issued and outstanding 106,337,106 at June 30, 2015, and 105,893,216 at December 31, 2014	501,322	495,220
Retained earnings	368,960	351,814
Accumulated other comprehensive income, net of tax	23,709	31,075
Total stockholders equity	893,991	878,109
Total liabilities and stockholders equity	$ 7,697,358	$ 7,377,920

See accompanying notes to the unaudited condensed consolidated financial statements.

4

Table of Contents

CVB FINANCIAL CORP. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS AND COMPREHENSIVE INCOME

(Dollars in thousands, except per share amounts)

(Unaudited)

	For the Three Months Ended June 30, 2015	For the Three Months Ended June 30, 2014	For the Six Months Ended June 30, 2015	For the Six Months Ended June 30, 2014
Interest income:				
Loans and leases, including fees	$ 45,322	$ 43,558	$ 90,864	$ 88,214
Investment securities:				
Taxable	12,820	11,686	25,781	21,965
Tax-advantaged	4,719	5,186	9,730	10,464
Total investment income	17,539	16,872	35,511	32,429
Dividends from FHLB stock	1,414	526	1,883	1,130
Federal funds sold	187	127	329	251
Interest-earning deposits with other institutions	53	133	108	254
Total interest income	64,515	61,216	128,695	122,278
Interest expense:				
Deposits	1,307	1,222	2,600	2,408
Borrowings	342	2,729	2,115	5,559
Junior subordinated debentures	108	106	213	210
Total interest expense	1,757	4,057	4,928	8,177
Net interest income before recapture of provision for loan losses	62,758	57,159	123,767	114,101
Recapture of provision for loan losses	(2,000)	(7,600)	(2,000)	(15,100)
Net interest income after recapture of provision for loan losses	64,758	64,759	125,767	129,201
Noninterest income:				
Service charges on deposit accounts	3,952	3,905	7,913	7,733
Trust and investment services	2,181	2,133	4,332	4,058
Bankcard services	842	923	1,575	1,701
BOLI income	808	601	1,457	1,239
Gain on sale of loans held-for-sale				5,330
Decrease in FDIC loss sharing asset, net	(413)	(1,467)	(803)	(3,174)
Gain on OREO, net	132	130	256	135

Other	843	825	1,626	1,526
Total noninterest income	8,345	7,050	16,356	18,548
Noninterest expense:				
Salaries and employee benefits	19,648	18,387	38,943	37,804
Occupancy and equipment	3,713	3,676	7,365	7,401
Professional services	1,527	1,646	2,680	3,010
Software licenses and maintenance	993	1,010	2,023	2,075
Promotion	1,201	1,341	2,528	2,607
Recapture of provision for unfunded loan commitments			(500)	
Amortization of intangible assets	239	193	507	315
Debt termination expense			13,870	
OREO expense	251	113	335	138
Acquisition related expenses		865		1,292
Other	3,961	4,093	8,254	7,839
Total noninterest expense	31,533	31,324	76,005	62,481
Earnings before income taxes	41,570	40,485	66,118	85,268
Income taxes	14,757	15,001	23,472	31,123
Net earnings	$ 26,813	$ 25,484	$ 42,646	$ 54,145
Other comprehensive income:				
Unrealized gain on securities arising during the period	$ (32,968)	$ 32,782	$ (12,698)	$ 57,563
Less: Reclassification adjustment for net gain on securities included in net income				
Other comprehensive income, before tax	(32,968)	32,782	(12,698)	57,563
Less: Income tax expense related to items of other comprehensive income	13,846	(13,769)	5,332	(24,176)
Other comprehensive income, net of tax	(19,122)	19,013	(7,366)	33,387
Comprehensive income	$ 7,691	$ 44,497	$ 35,280	$ 87,532
Basic earnings per common share	$ 0.25	$ 0.24	$ 0.40	$ 0.51
Diluted earnings per common share	$ 0.25	$ 0.24	$ 0.40	$ 0.51
Cash dividends declared per common share	$ 0.12	$ 0.10	$ 0.24	$ 0.20

See accompanying notes to the unaudited condensed consolidated financial statements.

Table of Contents

CVB FINANCIAL CORP. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

Six months ended June 30, 2015 and 2014

(Dollars and shares in thousands)

(Unaudited)

	Common Shares Outstanding	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income	Total
Balance January 1, 2014	105,370	$ 491,068	$ 290,149	$ (9,330)	$ 771,887
Repurchase of common stock	(346)	(4,908)			(4,908)
Exercise of stock options	469	5,109			5,109
Tax benefit from exercise of stock options		796			796
Shares issued pursuant to stock-based compensation plan	306	1,531			1,531
Cash dividends declared on common stock ($0.20 per share)			(21,188)		(21,188)
Net earnings			54,145		54,145
Other comprehensive income				33,387	33,387
Balance June 30, 2014	105,799	$ 493,596	$ 323,106	$ 24,057	$ 840,759
Balance January 1, 2015	105,893	$ 495,220	$ 351,814	$ 31,075	$ 878,109
Repurchase of common stock	(33)	(511)			(511)
Exercise of stock options	397	4,500			4,500
Tax benefit from exercise of stock options		742			742
Shares issued pursuant to stock-based compensation plan	80	1,371			1,371
Cash dividends declared on common stock ($0.24 per share)			(25,500)		(25,500)
Net earnings			42,646		42,646
Other comprehensive income				(7,366)	(7,366)
Balance June 30, 2015	106,337	$ 501,322	$ 368,960	$ 23,709	$ 893,991

See accompanying notes to the unaudited condensed consolidated financial statements.

Table of Contents

CVB FINANCIAL CORP. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

(Unaudited)

	For the Six Months Ended June 30,	
	2015	**2014**
Cash Flows from Operating Activities		
Interest and dividends received	$ 137,747	$ 125,583
Service charges and other fees received	13,840	15,036
Interest paid	(5,768)	(7,984)
Net cash paid to vendors, employees and others	(68,710)	(63,504)
Income taxes paid	(27,000)	(35,500)
Payments to FDIC, loss share agreement	(460)	(1,372)
Net cash provided by operating activities	49,649	32,259
Cash Flows from Investing Activities		
Proceeds from redemption of FHLB stock	7,750	8,899
Proceeds from maturity of interest-earning balances from depository institutions	2,740	1,494
Proceeds from sale of investment securities		14,271
Proceeds from repayment of investment securities	202,162	143,151
Proceeds from maturity of investment securities	54,601	47,199
Purchases of investment securities	(236,451)	(413,458)
Net decrease in loan and lease finance receivables	35,862	184,031
Proceeds from sales of premises and equipment		663
Purchase of premises and equipment	(485)	(964)
Proceeds from sales of other real estate owned	1,538	2,254
Cash acquired on purchase of American Security Bank, net of cash paid		50,038
Net cash provided by investing activities	67,717	37,578
Cash Flows from Financing Activities		
Net increase in transaction deposits	430,912	392,737
Net decrease in time deposits	(41,690)	(32,172)
Repayment of FHLB advances	(200,000)	
Net decrease in other borrowings	(46,000)	(69,000)
Net increase (decrease) in customer repurchase agreements	98,699	(31,792)
Cash dividends on common stock	(23,340)	(21,117)
Repurchase of common stock	(511)	(4,908)
Proceeds from exercise of stock options	4,500	5,109

Tax benefit related to exercise of stock options	742	796
Net cash provided by financing activities	223,312	239,653
Net increase in cash and cash equivalents	340,678	309,490
Cash and cash equivalents, beginning of period	105,768	94,693
Cash and cash equivalents, end of period	$ 446,446	$ 404,183

See accompanying notes to the unaudited condensed consolidated financial statements.

Table of Contents

CVB FINANCIAL CORP. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)

(Dollars in thousands)

(Unaudited)

	For the Six Months Ended June 30, 2015	2014
Reconciliation of Net Earnings to Net Cash Provided by Operating Activities		
Net earnings	$ 42,646	$ 54,145
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Gain on sale of loans held-for-sale		(5,330)
Loss on sale of premises and equipment, net	52	71
Gain on sale of other real estate owned	(232)	(117)
Amortization of capitalized prepayment penalty on borrowings	521	136
Increase in bank owned life insurance	(2,670)	(1,161)
Net amortization of premiums and discounts on investment securities	9,749	10,044
Accretion of SJB discount	(2,012)	(3,174)
Recapture of provision for loan losses	(2,000)	(15,100)
Recapture of provision for unfunded loan commitments	(500)	
Valuation adjustment on other real estate owned	162	
Change in FDIC loss share asset	299	3,174
Payments to FDIC, loss share agreement	(460)	(1,372)
Stock-based compensation	1,371	1,531
Depreciation and amortization, net	(229)	858
Change in accrued interest receivable	1,021	331
Change in accrued interest payable	(840)	12
Change in other assets and liabilities	2,771	(11,789)
Total adjustments	7,003	(21,886)
Net cash provided by operating activities	$ 49,649	$ 32,259
Supplemental Disclosure of Non-cash Investing Activities		
Securities purchased and not settled	$ 59,693	$ 56,430
Transfer of loans to other real estate owned	$ 3,666	$ 478

See accompanying notes to the unaudited condensed consolidated financial statements.

Table of Contents

CVB FINANCIAL CORP. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. BUSINESS

The condensed consolidated financial statements include the accounts of CVB Financial Corp. (referred to herein on an unconsolidated basis as CVB and on a consolidated basis as we, our or the Company) and its wholly owned subsidiaries: Citizens Business Bank (the Bank or CBB) after elimination of all intercompany transactions and balances. The Company has one inactive subsidiary, Chino Valley 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, this trust does not meet the criteria for consolidation.

The Company s primary operations are related to traditional banking activities. This includes 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 Equipment Financing 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, Ventura County, San Diego County, Madera County, Fresno County, Tulare County, and Kern County, California. The Bank operates 40 Business Financial Centers, seven Commercial Banking Centers, and three trust offices. The Company is headquartered in the city of Ontario, California.

2. BASIS OF PRESENTATION

The accompanying unaudited condensed 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-Q and conform to practices within the banking industry and include all of the information and disclosures required by accounting principles generally accepted in the United States of America (GAAP) for interim financial reporting. The accompanying unaudited condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments), which are necessary for a fair presentation of financial results for the interim periods presented. The results of operations for the three and six months ended June 30, 2015 are not necessarily indicative of the results for the full year. Certain information and note disclosures normally included in annual financial statements prepared in accordance with GAAP have been condensed or omitted. These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements, accounting policies and financial notes thereto included in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2014, filed with the SEC. A summary of the significant accounting policies consistently applied in the preparation of the accompanying unaudited condensed consolidated financial statements follows.

Reclassification Certain amounts in the prior periods condensed consolidated 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

Except as discussed below, our accounting policies are described in Note 3 *Summary of Significant Accounting Policies,* of our audited consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2014 as filed with the SEC (Form 10-K).

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, as well as valuation of deferred tax assets, other intangibles and OREO.

Recent Accounting Pronouncements In February 2015, the FASB issued ASU No. 2015-02, Consolidation (Topic 810): Amendments to the Consolidation Analysis . The new guidance reduces the number of consolidation models from four to two as well as simplifies the FASB Accounting Standards Codification and improves GAAP by placing more of an emphasis on risk of loss when determining a controlling financial interest, reducing the frequency of the application of related party guidance when determining a controlling financial interest in a variable interest entity (VIE) and changing the consolidation conclusions for public and private companies in several industries that typically make use of VIEs. ASU 2015-02 will be effective for the first interim period within annual reporting periods beginning after December 15, 2016. Early adoption is permitted. The adoption of this guidance is not expected to have a material impact on the Company s consolidated financial statements.

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.

	June 30, 2015				
	Amortized Cost	Gross Unrealized Holding Gain	Gross Unrealized Holding Loss	Fair Value	Total Percent
	(Dollars in thousands)				
Investment securities available-for-sale:					
Government agency/GSEs	$ 358,052	$ 16	$ (6,785)	$ 351,283	11.14%
Residential mortgage-backed securities	1,830,381	30,770	(4,661)	1,856,490	58.86%
CMOs/REMICs - residential	403,108	7,265	(626)	409,747	12.99%
Municipal bonds	516,798	16,488	(1,671)	531,615	16.85%
Other securities	5,000	82		5,082	0.16%
Total	$ 3,113,339	$ 54,621	$ (13,743)	$ 3,154,217	100.00%

	December 31, 2014				
	Amortized Cost	Gross Unrealized Holding Gain	Gross Unrealized Holding Loss	Fair Value	Total Percent
	(Dollars in thousands)				
Investment securities available-for-sale:					
Government agency/GSEs	$ 339,071	$	$ (8,228)	$ 330,843	10.55%
Residential mortgage-backed securities	1,884,370	36,154	(3,028)	1,917,496	61.12%
CMOs/REMICs - residential	297,318	7,050	(277)	304,091	9.69%
Municipal bonds	557,823	22,463	(645)	579,641	18.48%
Other securities	5,000	87		5,087	0.16%
Total	$ 3,083,582	$ 65,754	$ (12,178)	$ 3,137,158	100.00%

Approximately 83% of the available-for-sale portfolio at June 30, 2015 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 collateralized mortgage obligations (CMO)/Real Estate Mortgage Investment Conduit (REMIC) issues held are rated investment grade or better by either Standard & Poor s or Moody s, as of June 30, 2015 and December 31, 2014. The Bank had $234,000 in CMOs/REMICs backed by whole loans issued by private-label companies (nongovernment sponsored).

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 June 30, 2015 and December 31, 2014. Management has reviewed individual securities to determine whether a decline in fair value below the amortized cost basis is other-than-temporary.

Table of Contents

	June 30, 2015					
	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/GSEs	$ 45,332	$ 119	$ 284,011	$ 6,666	$ 329,343	$ 6,785
Residential mortgage-backed securities	212,143	1,128	122,027	3,533	334,170	4,661
CMOs/REMICs - residential	114,943	458	6,315	168	121,258	626
Municipal bonds	52,881	813	24,599	858	77,480	1,671
Other securities						
Total	$ 425,299	$ 2,518	$ 436,952	$ 11,225	$ 862,251	$ 13,743

	December 31, 2014					
	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/GSEs	$ 22,224	$ 28	$ 307,873	$ 8,200	$ 330,097	$ 8,228
Residential mortgage-backed securities	19,636	4	145,681	3,024	165,317	3,028
CMOs/REMICs - residential			31,143	277	31,143	277
Municipal bonds	1,953	23	24,812	622	26,765	645
Other securities						
Total	$ 43,813	$ 55	$ 509,509	$ 12,123	$ 553,322	$ 12,178

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

CMO Held-to-Maturity The Company has one investment security classified as held-to-maturity. This security was issued by Countrywide Financial and is collateralized by Alt-A (limited documentation) 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 subordinated securities. This security is classified as held-to-maturity as the 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 became apparent in August 2008 at the time the crisis in the financial markets occurred and the market for securities collateralized by Alt-A mortgages declined.

This Alt-A bond, with a book value of $1.4 million as of June 30, 2015 and has $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 June 30, 2015. The key assumptions include default rates, loss severities and prepayment rates. There were no changes in credit related other-than-temporary impairment (OTTI) recognized in earnings for the three and six months ended June 30, 2015 and 2014.

Government Agency & Government-Sponsored Enterprise (GSE) 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 with the

Table of Contents

Government-Sponsored Enterprises. As of June 30, 2015, approximately $240.1 million in U.S. government agency bonds are callable. These securities are bullet securities, that is, they have a defined maturity date on which the principal is due to be paid. The contractual terms of these investments provide 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. Accordingly, it is expected that the securities would not be settled at a price less than the amortized cost of the bonds.

Mortgage-Backed Securities and CMOs/REMICs Almost all of the Company s available-for-sale mortgage-backed and CMOs/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 4.3 years. Of the total MBS/CMO, 99.99% have the implied guarantee of U.S. Government-Sponsored Agencies and Enterprises. The remaining 0.01% are issued by banks. Accordingly, it is expected that 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, with a weighted-average life of approximately 8.5 years, are insured by the largest bond insurance companies. 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. The decline in fair value is attributable to the changes in interest rates and not credit quality. Since 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, these investments are not considered other than temporarily impaired at June 30, 2015.

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 OTTI for any given security.

At June 30, 2015 and December 31, 2014, investment securities having a carrying value of approximately $2.92 billion and $3.11 billion, respectively, were pledged to secure public deposits, short and long-term borrowings, and for other purposes as required or permitted by law.

The amortized cost and fair value of debt securities at June 30, 2015, by contractual maturity, are shown in the table below. Although mortgage-backed securities and CMOs/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 CMOs/REMICs are included in maturity categories based upon estimated prepayment speeds.

	June 30, 2015	
	Amortized Cost	**Fair Value**
	(Dollars in thousands)	
Available-for-sale:		

Due in one year or less	$ 177,307	$ 180,332
Due after one year through five years	2,063,160	2,104,524
Due after five years through ten years	659,129	652,414
Due after ten years	213,743	216,947
Total	$ 3,113,339	$ 3,154,217

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 June 30, 2015.

Table of Contents

5. ACQUIRED SJB ASSETS AND FDIC LOSS SHARING ASSET

FDIC Assisted Acquisition

On October 16, 2009, the Bank acquired San Joaquin Bank (SJB) and entered into loss sharing agreements with the Federal Deposit Insurance Corporation (FDIC) that is more fully discussed in Note 3 *Summary of Significant Accounting Policies*, included in our Annual Report on Form 10-K for the year ended December 31, 2014. 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 acquired loans were accounted for as Purchase Credit Impaired (PCI) loans. 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 June 30, 2015, the remaining discount associated with the PCI loans approximated $5.7 million. Based on the Company s regular forecast of expected cash flows from these loans, approximately $3.5 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 3.4 years and 1.3 years, respectively. The loss sharing agreement for commercial loans expired October 16, 2014. The following table provides a summary of PCI loans and lease finance receivables by type and their credit quality indicators for the periods indicated.

	June 30, 2015	**December 31, 2014**
	(Dollars in thousands)	
Commercial and industrial	$ 13,310	$ 14,605
SBA	440	1,110
Real estate:		
Commercial real estate	93,700	109,350
Construction		
SFR mortgage	203	205
Dairy & livestock and agribusiness	276	4,890
Municipal lease finance receivables		
Consumer and other loans	2,817	3,336
Gross PCI loans	110,746	133,496
Less: Purchase accounting discount	(5,680)	(7,129)
Gross PCI loans, net of discount	105,066	126,367
Less: Allowance for PCI loans losses		
Net PCI loans	$ 105,066	$ 126,367

Credit Quality Indicators

The following table summarizes PCI loans by internal risk ratings for the periods indicated.

	June 30, 2015	**December 31, 2014**

	(Dollars in thousands)	
Pass	$ 21,863	$ 26,706
Watch list	65,435	77,371
Special mention	6,909	8,203
Substandard	16,539	21,216
Doubtful & loss		
Total PCI gross loans	$ 110,746	$ 133,496

Allowance for Loan Losses

The Company s Credit Management Division is responsible for regularly reviewing the ALLL methodology for PCI loans. The ALLL for PCI loans is determined separately from total 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 described in Note 3 *Summary of Significant*

Table of Contents

Accounting Policies, included in our Annual Report on Form 10-K for the year ended December 31, 2014. As of June 30, 2015 and December 31, 2014, there were no allowances for loan losses recorded for PCI loans.

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

The following table provides a summary of total loans and lease finance receivables, excluding PCI loans, by type.

	June 30, 2015	December 31, 2014
	(Dollars in thousands)	
Commercial and industrial	$ 406,423	$ 390,011
SBA	120,566	134,265
Real estate:		
Commercial real estate	2,569,411	2,487,803
Construction	46,927	55,173
SFR mortgage	214,503	205,124
Dairy & livestock and agribusiness	183,984	279,173
Municipal lease finance receivables	74,691	77,834
Consumer and other loans	71,176	69,884
Gross loans, excluding PCI loans	3,687,681	3,699,267
Less: Deferred loan fees, net	(8,528)	(8,567)
Gross loans, excluding PCI loans, net of deferred loan fees	3,679,153	3,690,700
Less: Allowance for loan losses	(59,554)	(59,825)
Net loans, excluding PCI loans	3,619,599	3,630,875
PCI Loans	110,746	133,496
Discount on PCI loans	(5,680)	(7,129)
PCI loans, net	105,066	126,367
Total loans and lease finance receivables	$ 3,724,665	$ 3,757,242

As of June 30, 2015, 69.68% of the total gross loan portfolio (excluding PCI loans) consisted of commercial real estate loans and 1.27% of the total loan portfolio consisted of construction loans. Substantially all of the Company s real estate loans and construction loans are secured by real properties located in California. As of June 30, 2015, $157.2 million, or 6.12%, of the total commercial real estate loans included loans secured by farmland, compared to $165.6 million, or 6.66%, at December 31, 2014. The loans secured by farmland included $130.0 million for loans secured by dairy & livestock land and $27.2 million for loans secured by agricultural land at June 30, 2015, compared to $144.1 million for loans secured by dairy & livestock land and $21.5 million for loans secured by agricultural land at December 31, 2014. As of June 30, 2015, $184.0 million, or 4.99%, of the total gross loan portfolio (excluding PCI loans) consisted of dairy & livestock and agribusiness commercial loans, compared to $279.2 million, or 7.55%, at December 31, 2014. This was comprised of $171.8 million for dairy & livestock loans and $12.2 million for agribusiness loans at June 30, 2015, compared to $268.1 million for dairy & livestock loans and $11.1 million for agribusiness loans at December 31, 2014. At June 30, 2015, the Company held approximately $1.84 billion of total fixed rate loans.

At June 30, 2015 and December 31, 2014, loans totaling $2.80 billion and $2.78 billion, respectively, were pledged to secure borrowings and available lines of credit from the FHLB and the Federal Reserve Bank.

Table of Contents

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 that it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be achieved in the future.

Table of Contents

The following tables summarize each class of loans, excluding PCI loans, according to our internal risk ratings for the periods presented.

	June 30, 2015					
	Pass	**Watch List**	**Special Mention**	**Substandard**	**Doubtful & Loss**	**Total**
Commercial and industrial	$ 259,171	$ 97,969	$ 37,649	$ 11,578	$ 56	$ 406,423
SBA	74,716	22,448	14,202	7,698	1,502	120,566
Real estate:						
Commercial real estate						
Owner occupied	581,824	146,611	49,507	13,456		791,398
Non-owner occupied	1,445,175	250,818	28,789	53,231		1,778,013
Construction						
Speculative	26,741	2,172		7,651		36,564
Non-speculative	9,710	653				10,363
SFR mortgage	185,302	21,230	4,261	3,710		214,503
Dairy & livestock and agribusiness	105,341	75,217	3,426			183,984
Municipal lease finance receivables	41,726	27,766	5,199			74,691
Consumer and other loans	55,776	10,497	2,032	2,774	97	71,176
Total gross loans, excluding PCI loans	$ 2,785,482	$ 655,381	$ 145,065	$ 100,098	$ 1,655	$ 3,687,681

	December 31, 2014					
	Pass	**Watch List**	**Special Mention**	**Substandard**	**Doubtful & Loss**	**Total**
Commercial and industrial	$ 234,029	$ 105,904	$ 33,795	$ 16,031	$ 252	$ 390,011
SBA	84,769	24,124	15,858	7,920	1,594	134,265
Real estate:						
Commercial real estate						
Owner occupied	552,072	159,908	46,248	32,139		790,367
Non-owner occupied	1,347,006	241,809	56,353	52,268		1,697,436
Construction						
Speculative	28,310	613		7,651		36,574
Non-speculative	18,071	528				18,599
SFR mortgage	174,311	20,218	2,442	8,153		205,124
Dairy & livestock and agribusiness	174,783	85,660	8,612	10,015	103	279,173
Municipal lease finance receivables	35,463	22,349	20,022			77,834
Consumer and other loans	62,904	2,233	1,789	2,763	195	69,884
	$ 2,711,718	$ 663,346	$ 185,119	$ 136,940	$ 2,144	$ 3,699,267

Total gross loans, excluding
PCI loans

Allowance for Loan Losses

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

Our methodology for assessing the appropriateness of the allowance is conducted on a regular basis and considers the Bank s overall loan portfolio. Refer to Note 3 Summary of Significant Accounting Policies of the 2014 Annual Report on Form 10-K for a more detailed discussion concerning the allowance for loan losses.

Management believes that the ALLL was appropriate at June 30, 2015 and December 31, 2014. 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 held-for-investment loans, by portfolio segment for the periods presented.

Table of Contents

	For the Three Months Ended June 30, 2015				
	Ending Balance March 31, 2015	Charge-offs	Recoveries	(Recapture of) Provision for Loan Losses	Ending Balance June 30, 2015
	(Dollars in thousands)				
Commercial and industrial	$ 7,502	$	$ 197	$ (514)	$ 7,185
SBA	2,196		3	(114)	2,085
Real estate:					
Commercial real estate	34,848	(107)	783	(110)	35,414
Construction	1,043		41	(338)	746
SFR mortgage	2,425	(215)		354	2,564
Dairy & livestock and agribusiness	3,746		111	117	3,974
Municipal lease finance receivables	1,030			(16)	1,014
Consumer and other loans	825	(20)	52	(23)	834
Unallocated	7,094			(1,356)	5,738
Total allowance for loan losses	$ 60,709	$ (342)	$ 1,187	$ (2,000)	$ 59,554

	For the Three Months Ended June 30, 2014				
	Ending Balance March 31, 2014	Charge-offs	Recoveries	(Recapture of) Provision for Loan Losses	Ending Balance June 30, 2014
	(Dollars in thousands)				
Commercial and industrial	$ 6,368	$ (100)	$ 43	$ (274)	$ 6,037
SBA	2,468		63	(166)	2,365
Real estate:					
Commercial real estate	39,400	(352)	70	(3,200)	35,918
Construction	458		19	128	605
SFR mortgage	2,282			(68)	2,214
Dairy & livestock and agribusiness	9,267		98	(3,937)	5,428
Municipal lease finance receivables	1,519			(55)	1,464
Consumer and other loans	950	(6)	14	(28)	930
Unallocated	6,013				6,013
Total allowance for loan losses	$ 68,725	$ (458)	$ 307	$ (7,600)	$ 60,974

	For the Six Months Ended June 30, 2015				
	Ending Balance December 31, 2014	Charge-offs	Recoveries	(Recapture of) Provision for Loan Losses	Ending Balance June 30, 2015
	(Dollars in thousands)				
Commercial and industrial	$ 7,074	$ (134)	$ 232	$ 13	$ 7,185

SBA	2,557	(33)	37	(476)	2,085
Real estate:					