

PACWEST BANCORP  
Form 10-K  
March 03, 2014

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[ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA](#)

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549

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**FORM 10-K**

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

For the fiscal year ended December 31, 2013

OR

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

**Commission file number 00-30747**

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**PACWEST BANCORP**

(Exact Name of Registrant as Specified in Its Charter)

**Delaware**  
(State or Other Jurisdiction of  
Incorporation or Organization)

**33-0885320**  
(I.R.S. Employer  
Identification No.)

**10250 Constellation Blvd., Suite 1640**  
**Los Angeles, California**  
(Address of Principal Executive Offices)

**90067**  
(Zip Code)

Registrant's telephone number, including area code: **(310) 286-1144**

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

**Title of Each Class**

**Name of Each Exchange on Which Registered**

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Common stock, \$.01 par value per share

The Nasdaq Stock Market, LLC

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

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

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

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

Indicate by check mark 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  No

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

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

Large Accelerated filer <input type="checkbox"/>	Accelerated filer <input type="checkbox"/>	Non-Accelerated filer <input type="checkbox"/>	Smaller reporting company <input type="checkbox"/>
		(Do not check if a smaller reporting company)	

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

As of June 30, 2013, the aggregate market value of the voting common stock held by non-affiliates of the registrant, computed by reference to the average high and low sales prices on The Nasdaq Global Select Market as of the close of business on June 28, 2013, was approximately \$1.2 billion. Registrant does not have any nonvoting common equities.

As of February 24, 2014, there were 44,690,144 shares of registrant's common stock outstanding, excluding treasury shares and 1,087,436 shares of unvested restricted stock.

## DOCUMENTS INCORPORATED BY REFERENCE

The information required by Items 10, 11, 12, 13 and 14 of Part III of this Annual Report on Form 10-K will be found in the Company's definitive proxy statement for its 2014 Annual Meeting of Stockholders, to be filed pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended, and such information is incorporated herein by this reference.

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**PACWEST BANCORP**

**2013 ANNUAL REPORT ON FORM 10-K**

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**PART I**

**ITEM 1. BUSINESS**

**General**

PacWest Bancorp is a bank holding company registered under the Bank Holding Company Act of 1956, as amended. Our principal business is to serve as the holding company for our Los Angeles-based wholly-owned banking subsidiary, Pacific Western Bank, which we refer to as Pacific Western or the Bank. When we say "we," "our" or the "Company," we mean the Company on a consolidated basis with the Bank. When we refer to "PacWest" or to the holding company, we are referring to the parent company on a stand-alone basis.

PacWest Bancorp was formerly known as First Community Bancorp, which was organized on October 22, 1999 as a California corporation. At a special meeting of the Company's stockholders held on April 23, 2008, the stockholders approved the reincorporation of the Company in Delaware from California and the change of the Company's name to PacWest Bancorp from First Community Bancorp. The reincorporation became effective on May 14, 2008. In connection with the reincorporation and name change, the Company also changed its ticker symbol on the NASDAQ Global Select Market to "PACW."

**Recent Transactions**

***CapitalSource Merger Announcement***

On July 22, 2013, PacWest announced the signing of a definitive agreement and plan of merger (the "Agreement") whereby PacWest and CapitalSource, Inc. ("CapitalSource") will merge in a transaction valued at approximately \$2.8 billion based on the closing price of PacWest common stock on February 13, 2014 of \$40.11. The combined company will be called PacWest Bancorp. As part of the merger, CapitalSource Bank, a wholly-owned subsidiary of CapitalSource, will merge with and into Pacific Western, and the combined subsidiary bank will be called Pacific Western Bank. The CapitalSource national lending operation will continue to do business under the name CapitalSource as a division of Pacific Western Bank.

Under the terms of the Agreement, CapitalSource shareholders will receive \$2.47 in cash and 0.2837 shares of PacWest common stock for each share of CapitalSource common stock. The total value of the CapitalSource per share merger consideration was \$13.85 based on the closing price of PacWest common stock on February 13, 2014 of \$40.11.

As of December 31, 2013, on a pro forma consolidated basis, the combined company would have had approximately \$15.4 billion in assets with 94 branches throughout California. The combined institution would be the 6<sup>th</sup> largest publicly-owned bank headquartered in California, and the 8<sup>th</sup> largest commercial bank headquartered in California (out of more than 214 financial institutions in the state).

We currently expect to receive final regulatory approval in the first quarter of 2014 and to close the merger on April 1, 2014.

***First California Financial Group Acquisition***

On May 31, 2013, we completed the acquisition of First California Financial Group, Inc., or FCAL, following receipt of shareholder approval from both institutions and all required regulatory approvals. As part of the acquisition, First California Bank, or FCB, a wholly-owned subsidiary of FCAL, merged with and into Pacific Western.

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In the FCAL acquisition, each share of FCAL common stock was converted into the right to receive 0.2966 of a share of PacWest common stock. The exchange ratio was calculated based on the volume-weighted average share price of PacWest common stock for the 20 consecutive trading days ending on the second full trading day prior to the receipt of the last of the regulatory approvals required under the merger agreement. PacWest issued an aggregate of approximately 8.4 million shares of PacWest common stock to FCAL stockholders. In addition, 1,094,000 shares of FCAL common stock previously owned by PacWest at a cost of \$4.1 million were cancelled in the transaction. These shares were carried in our securities available-for-sale portfolio at their estimated market value with their unrealized gain of \$5.2 million included in stockholders' equity at May 31, 2013. Under acquisition accounting, this unrealized gain was recognized in earnings. Based on the closing price of PacWest's common stock on May 31, 2013 of \$28.83 per share, the aggregate consideration paid to FCAL common stockholders, including the 1,094,000 shares of FCAL common stock owned by us and cancelled in the merger, was \$251.6 million. The application of the acquisition method of accounting resulted in goodwill of \$129.1 million. All of the recognized goodwill is expected to be non-deductible for tax purposes.

FCB was a full-service commercial bank headquartered in Westlake Village, California. FCB provided a full range of banking services, including revolving lines of credit, term loans, commercial real estate loans, construction loans, consumer loans and home equity loans to individuals, professionals, and small to mid-sized businesses. FCB operated 15 branches throughout Southern California in the Los Angeles, Orange, Riverside, San Bernardino, San Diego, Ventura, and San Luis Obispo Counties. We made this acquisition to expand our presence in Southern California. We completed the conversion and integration of the FCB branches to PWB's operating platform in June 2013 and as a result, we added seven locations to our branch network.

***2012 Transactions***

*Sale of Branches*

On September 21, 2012, Pacific Western completed the sale of 10 branches. The branches were located in Los Angeles, San Bernardino, Riverside, and San Diego Counties. The branch sale resulted in the transfer of \$125.2 million of deposits; no loans were sold in this transaction. The buyer paid a blended deposit premium of 2.5% and we recognized a net gain of \$297,000 on this transaction.

*American Perspective Bank Acquisition*

On August 1, 2012, Pacific Western completed the acquisition of American Perspective Bank, or APB, previously headquartered in San Luis Obispo, California. Pacific Western acquired all of the outstanding common stock of APB for \$58.1 million in cash and APB was merged with and into Pacific Western; we refer to this transaction as the APB acquisition. APB operated two branches located in San Luis Obispo and Santa Maria, California, and a loan production office located in Paso Robles, California, which has since been converted to a full-service branch. The APB acquisition strengthened our presence in the Central Coast region.

*Celtic Capital Corporation Acquisition*

On April 3, 2012, Pacific Western completed the acquisition of Celtic Capital Corporation, or Celtic, an asset-based lending company based in Santa Monica, California. Pacific Western acquired all of the capital stock of Celtic for \$18 million in cash and Celtic became a wholly-owned subsidiary of Pacific Western; we refer to this transaction as the Celtic acquisition. Celtic focuses on providing asset-based loans to borrowers across the United States for amounts generally up to \$5 million. The Celtic acquisition diversified our loan portfolio, expanded our product lines, and deployed excess liquidity into higher yielding assets.

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*Pacific Western Equipment Finance Acquisition*

On January 3, 2012, Pacific Western completed the acquisition of Pacific Western Equipment Finance (formerly known as Marquette Equipment Finance, and which we refer to as EQF), an equipment leasing company based in Midvale, Utah. Pacific Western acquired all of the capital stock of EQF for \$35 million in cash and EQF became a division of Pacific Western; we refer to this transaction as the EQF acquisition. EQF focuses on providing equipment and specialty leasing to customers across the United States for amounts up to \$50 million. The EQF acquisition diversified our lending portfolio, expanded our product lines, and deployed excess liquidity into higher yielding assets.

See " Strategic Evolution and Acquisition Strategy," "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations Overview," and Note 4 *Acquisitions*, and Note 5, *Goodwill and Other Intangible Assets*, of the Notes to Consolidated Financial Statements contained in "Item 8. Financial Statements and Supplementary Data" for further information regarding recent transactions.

**Banking Business**

Pacific Western is a full-service commercial bank offering a broad range of banking products and services including: accepting demand, money market, and time deposits; originating loans, including commercial, real estate construction, SBA guaranteed and consumer loans; originating equipment finance leases; and providing other business-oriented products. Our operations are primarily located in Southern California extending from San Diego County to California's Central Coast; we also operate three banking offices in the San Francisco Bay area, a leasing operation based in Utah, and asset-based lending operations based in Arizona as well as San Jose and Santa Monica, California. The Bank focuses on conducting business with small to medium-sized businesses in our marketplace and the owners and employees of those businesses. The majority of our loans are secured by the real estate collateral of such businesses. Our asset-based lending function operates in Arizona, California, Texas, Colorado, Minnesota, and the Pacific Northwest. Our equipment leasing function has lease receivables in 45 states.

Special services, including international banking services, multi-state deposit services and investment services, and requests for services beyond our current service area or product offerings are arranged through correspondent banks. The Bank also offers remote deposit capture services and issues ATM and debit cards. The Bank has a network of branded ATMs and offers access to ATM networks through other major service providers. We provide access to customer accounts via a 24-hour seven day a week toll-free automated telephone customer service and secure online banking services.

We are committed to providing premier, relationship-based community banking in the California markets we serve, meeting the credit needs of established businesses in our marketplace, as well as extending credit to growing businesses that may not yet meet the credit standards of the Bank through tightly controlled asset-based lending and factoring of accounts receivable. We compete actively for deposits, and emphasize solicitation of noninterest-bearing deposits. In managing the top line of our business, we focus on making quality loans and gathering low-cost deposits to maximize our net interest margin. The strategy for serving our target markets is the delivery of a finely-focused set of value-added products and services that satisfy the primary needs of our customers, emphasizing superior service and relationships over transaction volume or low pricing.

We generate our revenue primarily from interest received on loans and leases and, to a lesser extent, from interest received on investment securities, and fees received in connection with deposit services, extending credit, and other services offered, including foreign exchange services. Our major operating expenses are the interest paid by the Bank on deposits and borrowings, compensation and general operating expenses. The Bank relies on a foundation of locally generated and relationship-

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based deposits. The Bank has a relatively low cost of funds due to a high percentage of noninterest-bearing and low cost deposits.

Our operations, similar to other financial institutions with operations predominantly focused in Southern California, are significantly influenced by economic conditions in Southern California, including the strength of the real estate market, the fiscal and regulatory policies of the federal and state governments and the regulatory authorities that govern financial institutions. See " Supervision and Regulation." Through our offices located in Northern California, our asset-based lending operations with production and marketing offices located in Arizona, Northern California, Texas, Colorado, Minnesota and the Pacific Northwest, and our equipment leasing operations based in Utah, we are also subject to the economic conditions affecting these markets.

***Lending Activities***

Through the Bank, the Company concentrates its lending activities in five principal areas:

(1) ***Real Estate Loans.*** Real estate loans are comprised of construction loans, miniperm loans collateralized by first or junior deeds of trust on specific commercial properties and equity lines of credit. The properties collateralizing real estate loans are principally located in our primary market areas of Los Angeles, Orange, San Bernardino, Riverside, San Diego, Ventura, Santa Barbara and San Luis Obispo counties in California and the neighboring communities. Construction loans are comprised of loans on commercial, residential and income producing properties that generally have terms of less than two years and typically bear an interest rate that floats with the Bank's base rate or another established index. Miniperm loans finance the purchase and/or ownership of commercial properties, including owner-occupied and income producing properties. Miniperm loans are generally made with an amortization schedule ranging from 15 to 25 years with a lump sum balloon payment due in one to ten years. Equity lines of credit are revolving lines of credit collateralized by junior deeds of trust on residential real estate properties. They generally bear a rate of interest that floats with the Bank's base rate or the prime rate and have maturities of ten years. From time to time, we purchase participation interests in loans originated by other financial institutions. These loans are subject generally to the same underwriting criteria and approval process as loans originated directly by us.

The Bank's real estate portfolio is subject to certain risks, including, but not limited to: (i) the effects of economic downturns in the Southern California economy and in general; (ii) interest rate increases; (iii) reduction in real estate values in Southern California and in general; (iv) increased competition in pricing and loan structure; (v) the borrower's ability to refinance or payoff the balloon or line of credit at maturity; and (vi) environmental risks, including natural disasters. In addition to the foregoing, construction loans are also subject to project specific risks including, but not limited to: (a) construction costs being more than anticipated; (b) construction taking longer than anticipated; (c) failure by developers and contractors to meet project specifications; (d) disagreement between contractors, subcontractors and developers; (e) demand for completed projects being less than anticipated; (f) buyers being unable to secure financing; and (g) loss through foreclosure.

When underwriting loans, we strive to reduce the exposure to such risks by (i) reviewing each loan request and renewal individually, (ii) using a dual signature approval system for the approval of each loan request for loans over a certain dollar amount, (iii) adhering to written loan policies, including, among other factors, minimum collateral requirements, maximum loan-to-value ratio requirements, cash flow requirements and personal guarantees, (iv) obtaining independent third party appraisals which are reviewed by the Bank's appraisal department, (v) obtaining external independent credit reviews, (vi) evaluating concentrations as a percentage of capital and loans, and (vii) conducting environmental reviews, where appropriate. With respect to construction loans, in addition to the foregoing, we attempt to mitigate project specific risks by: (a) implementing a controlled disbursement process for loan proceeds in accordance with an agreed upon schedule; (b) conducting project site visits; and



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(c) adhering to release-price schedules to ensure the prices for which newly-built units to be sold are sufficient to repay the Bank. The risks related to buyer inability to secure financing and loss through foreclosure are not controllable. We review each loan request on the basis of our ability to recover both principal and interest in view of the inherent risks.

(2) **Commercial Loans.** Commercial loans, both domestic and foreign, are made to finance operations, to provide working capital, or for specific purposes such as to finance the purchase of assets, equipment or inventory. Since a borrower's cash flow from operations is generally the primary source of repayment, our policies provide specific guidelines regarding required debt coverage and other important financial ratios. Commercial loans include lines of credit and commercial term loans. Lines of credit are extended to businesses or individuals based on the financial strength and integrity of the borrower and guarantor(s) and generally (with some exceptions) are collateralized by short-term assets such as accounts receivable, inventory, equipment or real estate and have a maturity of one year or less. Such lines of credit generally bear an interest rate that floats with the Bank's base rate. Commercial term loans are typically made to finance the acquisition of fixed assets, refinance short-term debt originally used to purchase fixed assets or, in rare cases, to finance the purchase of businesses. Commercial term loans generally have terms of one to five years. They may be collateralized by the asset being acquired or other available assets and bear interest rates which either float with the Bank's base rate, LIBOR or another established index or remain fixed for the term of the loan.

The Bank's portfolio of commercial loans is subject to certain risks, including, but not limited to: (i) the effects of economic downturns in the Southern California economy; (ii) interest rate increases; (iii) deterioration of the value of the underlying collateral; (iv) increased competition in pricing and loan structure; (v) the deterioration of a borrower's or guarantor's financial capabilities; and (vi) environmental risks, including natural disasters, which can negatively affect a borrower's business. We strive to reduce the exposure to such risks through: (a) reviewing each loan request and renewal individually; (b) using a dual signature approval system; (c) adhering to written loan policies; and (d) obtaining external independent credit reviews. In addition, loans based on short-term asset values and factoring arrangements are monitored on a daily, weekly, monthly or quarterly basis and may include lockbox or control account arrangements. In general, the Bank receives and reviews financial statements and other documents of borrowing customers on an ongoing basis during the term of the relationship and responds to any deterioration noted.

(3) **SBA Loans.** SBA loans are made through programs designed by the federal government to assist the small business community in obtaining financing from financial institutions that are given government guarantees as an incentive to make the loans. Our SBA loans fall into two categories, loans originated under the SBA's 7(a) Program ("7(a) Loans") and loans originated under the SBA's 504 Program ("504 Loans"). SBA 7(a) Loans are commercial business loans generally made for the purpose of purchasing real estate to be occupied by the business owner, providing working capital, and/or purchasing equipment, accounts receivable or inventory. SBA 504 Loans are collateralized by commercial real estate and are generally made to business owners for the purpose of purchasing or improving real estate or equipment for use in their business.

SBA lending is subject to federal legislation that can affect the availability and funding of the program. From time to time, this dependence on legislative funding causes limitations and uncertainties with regard to the continued funding of such programs, which could potentially have an adverse financial impact on our business.

The Bank's portfolio of SBA loans is subject to certain risks, including, but not limited to: (i) the effects of economic downturns on the Southern California economy; (ii) interest rate increases; (iii) deterioration of the value of the underlying collateral; and (iv) deterioration of a borrower's or guarantor's financial capabilities. We strive to reduce the exposure of such risks through: (a) reviewing

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each loan request and renewal individually; (b) using a dual signature approval system; (c) adhering to written loan policies; (d) adhering to SBA written policies and regulations; (e) obtaining independent third party appraisals which are reviewed by the Bank's appraisal department; and (f) obtaining external independent credit reviews. In addition, SBA loans normally require monthly installment payments of principal and interest and therefore are continually monitored for past due conditions. In general, the Bank receives and reviews financial statements and other documents of borrowing customers on an ongoing basis during the term of the relationship and responds to any deterioration noted.

(4) **Consumer Loans.** Consumer loans include personal loans, auto loans, boat loans, home improvement loans, revolving lines of credit, other loans typically made by banks to individual borrowers, and purchased 95% participation interests in student loans originated and serviced by a third-party lender. The Bank does not currently originate first trust deed home mortgage loans. The student loans that we purchase are not guaranteed by any program of the U.S. Government, and are made to refinance the outstanding student loan debt of borrowers who meet certain underwriting criteria, and having terms that fully amortize the debt over five, ten or fifteen years. The Bank's consumer loan portfolio is subject to certain risks, including: (i) amount of credit offered to consumers in the market; (ii) interest rate increases; and (iii) (with the exception of the purchased student loan portfolio), consumer bankruptcy laws which allow consumers to discharge certain debts. The Bank's student loan participation interests are also subject to further risks, including (i) the ability of the originator and sub-servicer to originate and service the loans in accordance with the terms of the loan purchase agreement; and (ii) compliance with consumer lending regulations and oversight by the Consumer Financial Protection Bureau. We strive to reduce the exposure to such risks through the direct approval of all internally originated consumer loans by: (a) reviewing each loan request and renewal individually; (b) using a dual signature approval system; (c) adhering to written credit policies; and (d) obtaining external independent credit reviews, and for all purchased consumer loan participation interests through the monitoring of the performance of the originator and sub-servicer and the enforcement of our rights under the loan purchase agreement.

(5) **Leases.** Leases include leases and lease financing transactions. Leases are originated by our in-house sales force and purchased through a network of brokers. The types of equipment leased include: (i) technology; (ii) manufacturing; (iii) software; (iv) transportation; and (v) mining. The main industries served with our lease portfolio are: (i) finance and insurance; (ii) health care; (iii) manufacturing; and (iv) transportation. Leases are fixed-rate contracts with a one to six year term and any back-end exposure being secured with documented options controlled by the Bank. No residual risk is taken on the future value of the leased equipment. Lease transactions are done with lessees that meet our credit criteria based on their cash flow and ability to make their lease payments.

The Bank's lease portfolio is subject to certain risks, including but not limited to: (i) the effects of economic downturns in the national economy; (ii) interest rate increases; and, (iii) the deterioration of lessees' financial capabilities. When underwriting leases, we strive to reduce the exposure to such risks by: (i) reviewing each lease request individually; (ii) using a dual signature approval system; (iii) following the guidelines of our credit policies, with special attention to cash flow and profitability; and (iv) diversifying our exposure between industries, equipment types, and geographic locations in the United States.

***Business Concentrations***

One of the ways that we present our loans and leases is by "covered" and "non-covered" loan categories. Covered loans represent loans covered by loss sharing agreements with the Federal Deposit Insurance Corporation ("FDIC") for which we will be reimbursed for a substantial portion of any future losses under the terms of the agreements. Non-covered loans and leases represent loans and leases not covered by FDIC loss sharing agreements.

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The following tables present the composition of our loan portfolio by segment and class, showing the non-covered and covered components, as of the dates indicated:

	December 31, 2013					
	Non-Covered Loans and Leases		Covered Loans		Total Loans and Leases	
	Amount	% of Total	Amount	% of Total	Amount	% of Total
(Dollars in thousands)						
<b>Real estate mortgage:</b>						
Hospitality	\$ 179,340	5%	\$ 2,395	1%	\$ 181,735	4%
SBA 504	45,166	1%			45,166	1%
Other	2,153,519	56%	415,578	92%	2,569,097	60%
<b>Total real estate mortgage</b>	<b>2,378,025</b>	<b>62%</b>	<b>417,973</b>	<b>93%</b>	<b>2,795,998</b>	<b>65%</b>
<b>Real estate construction:</b>						
Residential	58,881	1%	17		58,898	1%
Commercial	142,842	4%	17,777	4%	160,619	4%
<b>Total real estate construction</b>	<b>201,723</b>	<b>5%</b>	<b>17,794</b>	<b>4%</b>	<b>219,517</b>	<b>5%</b>