CITY NATIONAL CORP
Form 10-Q
November 08, 2012


# 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 September 30, 2012**

**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 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<br>(Do not check if a smaller reporting company) | Smaller reporting company o |

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 October 31, 2012, there were 53,795,583 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) | | September 30, 2012 (Unaudited) | | December 31, 2011 |
|---|---|---|---|---|
| **Assets** | | | | |
| Cash and due from banks | $ | 235,038 | $ | 168,376 |
| Due from banks - interest-bearing | | 335,300 | | 76,438 |
| Federal funds sold | | 19,500 | | |
| Securities available-for-sale - cost $7,710,762 and $7,445,999 at September 30, 2012 and December 31, 2011, respectively: | | | | |
| Securities pledged as collateral | | 50,820 | | 37,861 |
| Held in portfolio | | 7,821,244 | | 7,534,040 |
| Securities held-to-maturity - fair value $1,222,721 and $473,903 at September 30, 2012 and December 31, 2011, respectively | | 1,174,161 | | 467,680 |
| Trading securities | | 64,749 | | 61,975 |
| Loans and leases, excluding covered loans | | 13,724,651 | | 12,309,385 |
| Less: Allowance for loan and lease losses | | 268,440 | | 262,557 |
| Loans and leases, excluding covered loans, net | | 13,456,211 | | 12,046,828 |
| Covered loans, net of allowance for loan losses | | 1,099,359 | | 1,417,289 |
| Net loans and leases | | 14,555,570 | | 13,464,117 |
| Premises and equipment, net | | 147,621 | | 143,641 |
| Deferred tax asset | | 139,829 | | 155,529 |
| Goodwill | | 641,694 | | 486,383 |
| Customer-relationship intangibles, net | | 50,071 | | 36,370 |
| Affordable housing investments | | 156,982 | | 121,039 |
| Customers acceptance liability | | 2,573 | | 1,702 |
| Other real estate owned ($83,618 and $98,550 covered by FDIC loss share at September 30, 2012 and December 31, 2011, respectively) | | 110,673 | | 129,340 |
| FDIC indemnification asset | | 160,991 | | 204,259 |
| Other assets | | 584,712 | | 577,541 |
| Total assets | $ | 26,251,528 | $ | 23,666,291 |
| **Liabilities** | | | | |
| Demand deposits | $ | 13,432,413 | $ | 11,146,627 |
| Interest checking deposits | | 1,979,580 | | 2,034,815 |
| Money market deposits | | 5,826,708 | | 5,954,886 |
| Savings deposits | | 374,197 | | 339,858 |
| Time deposits-under $100,000 | | 214,620 | | 251,782 |
| Time deposits-$100,000 and over | | 684,798 | | 659,614 |
| Total deposits | | 22,512,316 | | 20,387,582 |
| Short-term borrowings | | 211,739 | | 50,000 |
| Long-term debt | | 706,035 | | 697,778 |
| Reserve for off-balance sheet credit commitments | | 25,260 | | 23,097 |
| Acceptances outstanding | | 2,573 | | 1,702 |
| Other liabilities | | 421,895 | | 316,640 |

| | | | | |
|---|---|---|---|---|
| Total liabilities | | 23,879,818 | | 21,476,799 |
| **Redeemable noncontrolling interest** | | 41,386 | | 44,643 |
| **Commitments and contingencies** | | | | |
| **Shareholders Equity** | | | | |
| Common stock, par value $1.00 per share; 75,000,000 shares authorized; 53,885,886 shares issued at September 30, 2012 and December 31, 2011 | | 53,886 | | 53,886 |
| Additional paid-in capital | | 485,975 | | 489,200 |
| Accumulated other comprehensive income | | 93,924 | | 72,372 |
| Retained earnings | | 1,732,417 | | 1,611,969 |
| Treasury shares, at cost - 695,872 and 1,386,705 shares at September 30, 2012 and December 31, 2011, respectively | | (35,878) | | (82,578) |
| Total shareholders equity | | 2,330,324 | | 2,144,849 |
| Total liabilities and shareholders equity | $ | 26,251,528 | $ | 23,666,291 |

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 September 30, 2012 | For the three months ended September 30, 2011 | For the nine months ended September 30, 2012 | For the nine months ended September 30, 2011 |
|---|---|---|---|---|
| **Interest income** | | | | |
| Loans and leases | $ 180,349 | $ 175,435 | $ 534,521 | $ 508,366 |
| Securities | 44,182 | 40,893 | 133,118 | 117,951 |
| Due from banks - interest-bearing | 163 | 474 | 429 | 1,179 |
| Federal funds sold and securities purchased under resale agreements | 74 | 90 | 181 | 342 |
| Total interest income | 224,768 | 216,892 | 668,249 | 627,838 |
| **Interest expense** | | | | |
| Deposits | 3,316 | 8,535 | 10,914 | 28,742 |
| Federal funds purchased and securities sold under repurchase agreements | 9 | | 42 | 2 |
| Subordinated debt | 6,125 | 4,419 | 14,494 | 13,701 |
| Other long-term debt | 5,396 | 4,622 | 15,685 | 13,960 |
| Total interest expense | 14,846 | 17,576 | 41,135 | 56,405 |
| **Net interest income** | 209,922 | 199,316 | 627,114 | 571,433 |
| Provision for credit losses on loans and leases, excluding covered loans | 2,000 | 7,500 | 3,000 | 7,500 |
| Provision for losses on covered loans | 18,089 | 5,147 | 38,848 | 25,979 |
| Net interest income after provision | 189,833 | 186,669 | 585,266 | 537,954 |
| **Noninterest income** | | | | |
| Trust and investment fees | 43,477 | 35,412 | 111,198 | 107,737 |
| Brokerage and mutual fund fees | 9,059 | 5,079 | 19,380 | 15,604 |
| Cash management and deposit transaction charges | 11,526 | 10,986 | 34,169 | 33,616 |
| International services | 9,819 | 10,352 | 28,621 | 27,683 |
| FDIC loss sharing income (expense), net | 1,667 | (14,191) | (3,493) | (16,270) |
| Gain on disposal of assets | 3,199 | 5,191 | 8,401 | 16,037 |
| Gain on sale of securities | 856 | 3,520 | 1,026 | 5,339 |
| Gain on acquisition | | | | 8,164 |
| Other | 27,693 | 13,479 | 58,640 | 58,206 |
| Impairment loss on securities: | | | | |
| Total other-than-temporary impairment loss on securities | (1,510) | (4,549) | (1,688) | (5,007) |
| Less: Portion of loss recognized in other comprehensive income | 1,471 | 4,356 | 1,471 | 4,356 |
| Net impairment loss recognized in earnings | (39) | (193) | (217) | (651) |
| Total noninterest income | 107,257 | 69,635 | 257,725 | 255,465 |
| **Noninterest expense** | | | | |
| Salaries and employee benefits | 120,210 | 112,729 | 355,490 | 335,880 |
| Net occupancy of premises | 16,238 | 13,713 | 43,980 | 40,724 |
| Legal and professional fees | 11,757 | 14,242 | 34,996 | 39,109 |
| Information services | 8,660 | 7,906 | 25,348 | 23,738 |
| Depreciation and amortization | 8,324 | 6,930 | 23,765 | 20,582 |
| Amortization of intangibles | 1,932 | 2,105 | 5,336 | 6,377 |
| Marketing and advertising | 7,141 | 6,675 | 21,554 | 20,819 |
| Office services and equipment | 4,673 | 4,456 | 13,113 | 13,734 |

| | | | | |
|---|---|---|---|---|
| Other real estate owned | 8,749 | 13,160 | 28,384 | 49,811 |
| FDIC assessments | 4,616 | 6,670 | 13,618 | 25,000 |
| Other operating | 15,586 | 9,051 | 37,538 | 31,092 |
| Total noninterest expense | 207,886 | 197,637 | 603,122 | 606,866 |
| Income before income taxes | 89,204 | 58,667 | 239,869 | 186,553 |
| Income taxes | 29,052 | 16,267 | 78,042 | 54,803 |
| **Net income** | $ 60,152 | $ 42,400 | $ 161,827 | $ 131,750 |
| Less: Net income attributable to noncontrolling interest | 372 | 1,002 | 1,024 | 3,189 |
| **Net income attributable to City National Corporation** | $ 59,780 | $ 41,398 | $ 160,803 | $ 128,561 |
| Net income per share, basic | $ 1.10 | $ 0.78 | $ 2.98 | $ 2.41 |
| Net income per share, diluted | $ 1.10 | $ 0.77 | $ 2.97 | $ 2.39 |
| Shares used to compute net income per share, basic | 53,425 | 52,481 | 53,092 | 52,422 |
| Shares used to compute net income per share, diluted | 53,711 | 52,720 | 53,376 | 52,882 |
| Dividends per share | $ 0.25 | $ 0.20 | $ 0.75 | $ 0.60 |

See accompanying Notes to the Unaudited Consolidated Financial Statements.

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**CITY NATIONAL CORPORATION**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

**(Unaudited)**

| (in thousands) | For the three months ended September 30, 2012 | 2011 | For the nine months ended September 30, 2012 | 2011 |
|---|---|---|---|---|
| Net income | $ 60,152 | $ 42,400 | $ 161,827 | $ 131,750 |
| Other comprehensive income, net of tax: | | | | |
| Securities available for sale: | | | | |
| Net unrealized gains arising during the period | 12,042 | 30,523 | 21,715 | 51,834 |
| Reclassification adjustment for net gains included in net income | (28) | (1,780) | (267) | (2,882) |
| Non-credit related impairment loss | (856) | (2,533) | (856) | (2,533) |
| Net change on cash flow hedges (1) | (42) | 32 | (125) | (903) |
| Pension liability adjustment | | (68) | 1,085 | 98 |
| Total other comprehensive income | 11,116 | 26,174 | 21,552 | 45,614 |
| Comprehensive income | $ 71,268 | $ 68,574 | $ 183,379 | $ 177,364 |
| Less: Comprehensive income attributable to noncontrolling interest | 372 | 1,002 | 1,024 | 3,189 |
| Comprehensive income attributable to City National Corporation | $ 70,896 | $ 67,572 | $ 182,355 | $ 174,175 |

(1) See Note 12 for additional information on other comprehensive income related to cash flow hedges.

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 nine months ended September 30, 2012 | 2011 |
|---|---|---|
| **Cash Flows From Operating Activities** | | |
| Net income | $ 161,827 | $ 131,750 |
| Adjustments to net income: | | |
| Provision for credit losses on loans and leases, excluding covered loans | 3,000 | 7,500 |
| Provision for losses on covered loans | 38,848 | 25,979 |
| Amortization of intangibles | 5,336 | 6,377 |
| Depreciation and amortization | 23,765 | 20,582 |
| Share-based employee compensation expense | 13,694 | 14,171 |
| Deferred income tax benefit | 926 | 2,578 |
| Gain on disposal of assets | (8,401) | (16,037) |
| Gain on sale of securities | (1,026) | (5,339) |
| Gain on acquisition | | (8,164) |
| Impairment loss on securities | 217 | 651 |
| Other, net | (29,115) | (8,708) |
| Net change in: | | |
| Trading securities | (2,187) | 161,591 |
| Other assets and other liabilities, net | 75,109 | 105,224 |
| Net cash provided by operating activities | 281,993 | 438,155 |
| **Cash Flows From Investing Activities** | | |
| Purchase of securities available-for-sale | (2,997,503) | (3,990,753) |
| Sales of securities available-for-sale | 6,216 | 101,548 |
| Maturities and paydowns of securities available-for-sale | 2,699,482 | 2,496,283 |
| Purchase of securities held-to-maturity | (728,064) | |
| Maturities and paydowns of securities held-to-maturity | 20,124 | |
| Loan originations, net of principal collections | (779,081) | (508,913) |
| Net payments for premises and equipment | (23,039) | (32,927) |
| Net cash (paid) acquired in acquisitions | (123,746) | 28,066 |
| Other investing activities, net | 23,976 | 96,819 |
| Net cash used in investing activities | (1,901,635) | (1,809,877) |
| **Cash Flows From Financing Activities** | | |
| Net increase in deposits | 2,124,734 | 1,605,424 |
| Net (decrease) increase in federal funds purchased and securities sold under repurchase agreements | (50,000) | 30,000 |
| Net decrease in short-term borrowings, net of transfers from long-term debt | (94,141) | (150,895) |
| Net increase (decrease) in long-term debt | 1,906 | (757) |
| Proceeds from exercise of stock options | 21,653 | 4,792 |
| Tax benefit from exercise of stock options | 2,959 | 1,024 |
| Cash dividends paid | (40,029) | (31,851) |
| Other financing activities, net | (2,416) | (26,454) |
| Net cash provided by financing activities | 1,964,666 | 1,431,283 |
| Net increase in cash and cash equivalents | 345,024 | 59,561 |
| Cash and cash equivalents at beginning of year | 244,814 | 434,689 |
| Cash and cash equivalents at end of period | $ 589,838 | $ 494,250 |
| **Supplemental Disclosures of Cash Flow Information:** | | |
| Cash paid during the period for: | | |

| | | |
|---|---|---|
| Interest | $ 47,903 | $ 70,612 |
| Income taxes | 53,783 | 79,739 |
| Non-cash investing activities: | | |
| Transfer of loans to other real estate owned | $ 58,202 | $ 81,109 |
| Transfer of SERP liability to equity | 8,348 | |
| Assets acquired (liabilities assumed) in acquisitions: | | |
| Securities available-for-sale | $ | $ 10,441 |
| Loans and leases | 318,301 | |
| Covered loans | | 55,313 |
| Covered other real estate owned | | 7,463 |
| Deposits | | (126,795) |
| Other borrowings | (320,856) | (3,165) |

See accompanying Notes to the Unaudited Consolidated Financial Statements.

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**CITY NATIONAL CORPORATION**

**CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY**

**(Unaudited)**

| | City National Corporation Shareholders Equity | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **(in thousands, except share amounts)** | **Common shares issued** | **Common stock** | **Additional paid-in capital** | **Accumulated other comprehensive income** | **Retained earnings** | **Treasury shares** | **Non-controlling interest** | **Total equity** |
| Balance, January 1, 2011 | 53,885,886 | $ 53,886 | $ 487,868 | $ 36,853 | $ 1,482,037 | $ (101,065) | $ 25,139 | $ 1,984,718 |
| Net income (1) | | | | | 128,561 | | 1,678 | 130,239 |
| Other comprehensive income, net of tax | | | | 45,614 | | | | 45,614 |
| Dividends and distributions to noncontrolling interest | | | | | | | (1,678) | (1,678) |
| Issuance of shares under share-based compensation plans | | | (14,589) | | | 17,393 | | 2,804 |
| Share-based employee compensation expense | | | 14,039 | | | | | 14,039 |
| Tax benefit from share-based compensation plans | | | 1,247 | | | | | 1,247 |
| Common stock dividends | | | | | (31,851) | | | (31,851) |
| Net change in deferred compensation plans | | | 641 | | | | | 641 |
| Change in redeemable noncontrolling interest | | | (245) | | | | | (245) |
| Other (2) | | | 76 | | | | (25,139) | (25,063) |
| Balance, September 30, 2011 | 53,885,886 | $ 53,886 | $ 489,037 | $ 82,467 | $ 1,578,747 | $ (83,672) | $ | $ 2,120,465 |
| | | | | | | | | |
| Balance, January 1, 2012 | 53,885,886 | $ 53,886 | $ 489,200 | $ 72,372 | $ 1,611,969 | $ (82,578) | $ | $ 2,144,849 |
| Net income (1) | | | | | 160,803 | | | 160,803 |
| Other comprehensive income, net of tax | | | | 21,552 | | | | 21,552 |
| Issuance of shares under share-based compensation plans | | | (27,171) | | | 46,698 | | 19,527 |
| Share-based employee compensation expense | | | 12,825 | | | | | 12,825 |
| Tax benefit from share-based compensation plans | | | 953 | | | | | 953 |
| Common stock dividends | | | | | (40,355) | | | (40,355) |
| Net change in deferred compensation plans | | | 787 | | | 2 | | 789 |
| Change in redeemable noncontrolling interest | | | 1,033 | | | | | 1,033 |
| Other (3) | | | 8,348 | | | | | 8,348 |
| Balance, September 30, 2012 | 53,885,886 | $ 53,886 | $ 485,975 | $ 93,924 | $ 1,732,417 | $ (35,878) | $ | $ 2,330,324 |

(1) Net income excludes net income attributable to redeemable noncontrolling interest of $1,024 and $1,511 for the nine month periods ended September 30, 2012 and 2011, 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.

(2) See Note 17 for additional information on the change in noncontrolling interest.

(3) Conversion of pension liability to equity due to SERP amendment. See Note 14 for additional information.

See accompanying Notes to the Unaudited Consolidated Financial Statements.

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**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 78 offices in Southern California, the San Francisco Bay area, Nevada, New York City, Nashville, Tennessee and Atlanta, Georgia. As of September 30, 2012, the Corporation had five 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. Preferred stock of consolidated bank affiliates that is owned by third parties is reflected as Noncontrolling interest in the equity section of the consolidated balance sheets. This preferred stock was liquidated or redeemed in full by the Bank in the third quarter of 2011. Redeemable noncontrolling interest includes noncontrolling ownership interests that are redeemable at the option of the holder or outside the control of the issuer. The redeemable equity ownership interests of third parties in the Corporation s investment advisory affiliates are not considered to be permanent equity and are reflected as Redeemable noncontrolling interest 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 stock options and restricted stock, income taxes, goodwill and intangible asset impairment, securities impairment, private equity and alternative investment impairment, valuation of assets and liabilities acquired in business combinations, subsequent valuations of acquired impaired loans, Federal Deposit Insurance Corporation ( FDIC ) indemnification assets, valuation of noncontrolling interest and the valuation of financial assets and liabilities reported at fair value.

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**Note 1. Summary of Significant Accounting Policies (Continued)**

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.

*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, 2011.

The results for the 2012 interim period 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 2011 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, 2012. Refer to *Accounting Pronouncements* for discussion of accounting pronouncements adopted in 2012.

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

*Accounting Pronouncements*

During the nine months ended September 30, 2012, the following accounting pronouncements applicable to the Company were issued or became effective:

- In April 2011, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) 2011-03, *Transfers and Servicing (Topic 860): Reconsideration of Effective Control for Repurchase Agreements* ( ASU 2011-03 ). Accounting Standards Codification ( ASC ) Topic 860, *Transfers and Servicing*, provides the criteria for determining whether a transfer of financial assets under a repurchase agreement is accounted for as a secured borrowing or as a sale. In a typical repurchase transaction, an entity transfers financial assets to a counterparty in exchange for cash with an agreement for the counterparty to return the same or equivalent financial assets for a fixed price in the future. Under the guidance, an entity that maintains effective control over transferred assets must account for the transfer as a secured borrowing. ASU 2011-03 eliminates the requirement for entities to consider whether a transferor has the ability to repurchase the financial assets in a repurchase agreement for purposes of determining whether the transferor has maintained effective control. The ASU does not change the other criteria applicable to the assessment of effective control. Adoption of ASU 2011-03 on January 1, 2012 did not have a material effect on the Company s consolidated financial statements.

• In May 2011, the FASB issued ASU 2011-04, *Fair Value Measurements (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs* ( ASU 2011-04 ). ASU 2011-04 represents the converged guidance of the FASB and International Accounting Standards Board on fair value. The new guidance establishes a common framework for measuring fair value and for disclosing information about fair value measurements. While ASU 2011-04 is largely consistent with existing fair value measurement principles, it does expand disclosure requirements and amends certain guidance. Under the revised guidance, the highest and best use and valuation premise concepts only apply to measuring the fair value of nonfinancial assets. The highest and best use of a nonfinancial asset is one that is physically possible, legally permissible and financially feasible. The valuation premise guidance provides that the highest and best use of a nonfinancial asset is either on a stand-alone basis or in combination with other assets as a group. The ASU provides a framework for considering whether a premium or discount can be applied in a fair value measurement and provides a model for measuring the fair value of an instrument classified in shareholders equity. ASU 2011-04 requires entities to make an accounting policy election regarding fair value measurements of financial assets and liabilities, such as derivatives, for which the exposure to market or counterparty credit risks is managed on a net or portfolio basis. The Company elected to

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**Note 1. Summary of Significant Accounting Policies (Continued)**

continue measuring derivative instruments that are subject to master netting agreements on the net risk exposure at the measurement date.

The expanded disclosure requirements include more detailed disclosures about the valuation processes used in fair value measurements within Level 3 of the fair value hierarchy, and categorization by level of the fair value hierarchy for items that are not measured at fair value in the statement of financial position but for which fair value is required to be disclosed in accordance with ASC Topic 825, *Financial Instruments*. The Company adopted ASU 2011-04 and expanded its disclosures starting with its first quarter 2012 reporting. Adoption of the new guidance did not have a significant impact on the Company s consolidated financial statements.

- In June 2011, the FASB issued ASU 2011-05, *Comprehensive Income (Topic 220), Presentation of Comprehensive Income* ( ASU 2011-05 ). ASU 2011-05 revises the manner in which entities present comprehensive income in their financial statements. The new guidance requires entities to report components of comprehensive income in either (1) a continuous statement of comprehensive income or (2) two separate but consecutive statements. Under the two-statement approach, the first statement would include components of net income, which is consistent with the income statement format used today, and the second statement would include components of other comprehensive income. In December 2011, the FASB issued ASU 2011-12, *Comprehensive Income (Topic 220), Deferral of the Effective Date for Amendments to the Presentation of Reclassification of Items out of Accumulated Other Comprehensive Income in ASU 2011*-05 ( ASU 2011-12 ). ASU 2011-12 indefinitely defers the provision of ASU 2011-05 that would have required entities to present reclassification adjustments out of accumulated other comprehensive income ( AOCI ) by component in both the statement in which net income is presented and the statement in which other comprehensive income is presented. ASU 2011-05 and ASU 2011-12 became effective for the Company for first quarter 2012 reporting. The Company elected to report components of comprehensive income in two separate but consecutive statements. The new guidances were applied retrospectively for all periods presented.

- In July 2012, the FASB issued ASU 2012-02, *Intangibles Goodwill and Other (Topic 350), Testing Indefinite-Lived Intangible Assets for Impairment* ( ASU 2012-02 ), which amends the guidance in ASC 350-30 on testing indefinite-lived intangible assets, other than goodwill, for impairment. Under ASU 2012-02, an entity testing an indefinite-lived intangible asset for impairment has the option of performing a qualitative assessment before calculating the fair value of the asset. If an entity determines, on the basis of qualitative factors, that the fair value of the indefinite-lived intangible asset is not more likely than not (i.e., a likelihood of more than 50 percent) impaired, the entity would not need to calculate the fair value of the asset. ASU 2012-02 is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. Adoption of the new guidance is not expected to have a significant impact on the Company s consolidated financial statements.

- In October 2012, the FASB issued ASU 2012-06, *Business Combinations (Topic 805), Subsequent Accounting for an Indemnification Asset Recognized at the Acquisition Date as a Result of a Government-Assisted Acquisition of a Financial Institution* ( ASU 2012-06 ). ASU 2012-06 clarifies existing guidance on the subsequent measurement of an indemnification asset recognized as a result of a government-assisted acquisition of a financial institution. Existing guidance specifies that an acquirer must record an indemnification asset at the same time as it recognizes the indemnified item in a business combination. The indemnification asset is initially measured on the same basis as the indemnified item, with a valuation allowance for amounts deemed uncollectible, and is subsequently also measured on the same basis as the indemnified item, subject to any contractual limitations on the asset s amount. Under ASU 2012-06, when there is a subsequent change in the cash flows expected to be collected on the indemnified asset, the reporting entity should subsequently measure the indemnification asset on the same basis as the underlying loans by taking into account the contractual limitation of the loss-sharing agreement with the FDIC. For amortization of changes in value, the reporting entity should use the term of the loss-sharing agreement if it is shorter than the term of the acquired loans. ASU 2012-06 is effective for fiscal years, and interim periods within those years, beginning on or after December 15, 2012. 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. Business Combinations**

*Rochdale Investment Management*

On July 2, 2012, the Company acquired Rochdale Investment Management, LLC and associated entities (collectively, Rochdale ), a New York City-based investment firm with approximately $4.89 billion of assets under management at the date of acquisition. Rochdale manages assets for affluent and high-net-worth clients and their financial advisors across the nation, and will operate as a wholly owned subsidiary of the Bank. The investment firm was acquired with both cash and contingent consideration.

The Company recognized goodwill of approximately $85.5 million and a client contract intangible of $19.0 million related to the acquisition. The Company recognized a contingent consideration liability at its fair value of $45.8 million. The contingent consideration arrangements require the Company to pay additional cash consideration to Rochdale s former shareholders at certain points in time over the next six years if certain criteria, such as revenue growth and pre-tax margin, are met. The fair value of the contingent consideration was estimated using a probability-weighted discounted cash flow model. Although the agreement does not set a limit on the total payment, the Company estimates that the total consideration payment could be in the range of $32 million to $74 million, but will ultimately be determined based on actual future results.

The Company recognized acquisition-related expense of $2.0 million during the nine months ended September 30, 2012. The majority of this expense is included in Legal and professional fees in the consolidated statements of income.

The operating results of Rochdale from its acquisition date through September 30, 2012 are included in the consolidated statement of income for 2012 and are not material to total consolidated operating results for the three and nine month periods ended September 30, 2012. Further, the historical results of the acquired entity are not material to the Company s results, and consequently, no pro forma information is presented.

*First American Equipment Finance*

The Company acquired First American Equipment Finance ( FAEF ), a privately owned equipment leasing company, in an all-cash transaction on April 30, 2012. Headquartered in Rochester, New York, FAEF leases technology and office equipment nationwide. Its clients include educational institutions, hospitals and health systems, large law firms, insurance underwriters, enterprise businesses, professional service businesses and nonprofit organizations. FAEF operates as a wholly owned subsidiary of the Bank.

Excluding the effects of acquisition accounting adjustments, the Company acquired approximately $343.0 million in assets and assumed $325.0 million in liabilities. The Company acquired lease receivables with a fair value of $318.3 million and assumed borrowings and nonrecourse debt with a fair value of $320.9 million. The Company recognized goodwill of approximately $68.4 million and acquisition-related expense of $0.6 million. This expense is included in Legal and professional fees in the consolidated statements of income.

The operating results of FAEF from its acquisition date through September 30, 2012 are included in the consolidated statement of income for 2012 and are not material to total consolidated operating results for the three and nine month periods ended September 30, 2012. Further, the historical results of the acquired entity are not material to the Company s results, and consequently, no pro forma information is presented.

*Nevada Commerce Bank*

On April 8, 2011, the Bank acquired the banking operations of Nevada Commerce Bank ( NCB ), based in Las Vegas, Nevada, in a purchase and assumption agreement with the FDIC. Excluding the effects of acquisition accounting adjustments, the Bank acquired approximately $138.9 million in assets and assumed $121.9 million in liabilities. The Bank acquired most of NCB s assets, including loans and OREO with a fair value of $56.4 million and $7.5 million, respectively, and assumed deposits with a fair value of $118.4 million. The Bank received approximately $2.7 million in cash from the FDIC at acquisition and recognized a gain of $8.2 million on the acquisition of NCB in the second quarter of 2011.

In connection with the acquisition of NCB, the Bank entered into loss-sharing agreements with the FDIC under which the FDIC will reimburse the Bank for 80 percent of eligible losses with respect to covered assets. Covered assets include acquired loans ( covered loans ) and OREO ( covered OREO ) that are covered under loss-sharing agreements with the

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**Note 2. Business Combinations (Continued)**

FDIC. The term of the loss-sharing agreements is 10 years for single-family residential loans and eight years for all other loans. The expected reimbursements under the loss-sharing agreements were recorded as an indemnification asset at their estimated fair value of $33.8 million. The difference between the fair value of the FDIC indemnification asset and the undiscounted cash flow the Bank expects to collect from the FDIC is accreted into noninterest income.

**Note 3. Fair Value Measurements**

The following tables summarize assets and liabilities measured at fair value as of September 30, 2012 and December 31, 2011 by level in the fair value hierarchy:

| | | Fair Value Measurements at Reporting Date Using | | |
|---|---|---|---|---|
| **(in thousands)** | **Balance as of September 30, 2012** | **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 | $ 20,355 | $ 20,355 | $ | $ |
| Federal agency - Debt | 1,547,300 | | 1,547,300 | |
| Federal agency - MBS | 657,935 | | 657,935 | |
| CMOs - Federal agency | 4,847,471 | | 4,847,471 | |
| CMOs - Non-agency | 64,489 | | 64,489 | |
| State and municipal | 425,169 | | 378,072 | 47,097 |
| Other debt securities | 308,524 | | 290,182 | 18,342 |
| Equity securities and mutual funds | 821 | 821 | | |
| Trading securities | 64,749 | 61,883 | 2,866 | |
| Mark-to-market derivatives (1) | 70,878 | 3,068 | 67,810 | |
| **Total assets at fair value** | $ 8,007,691 | $ 86,127 | $ 7,856,125 | $ 65,439 |
| | | | | |
| **Liabilities** | | | | |
| Mark-to-market derivatives | $ 66,692 | $ 1,719 | $ 64,973 | $ |
| Contingent consideration liability | 46,283 | | $ | 46,283 |
| FDIC clawback liability | 9,914 | | | 9,914 |
| Other liabilities | 393 | | 393 | |
| **Total liabilities at fair value (2)** | $ 123,282 | $ 1,719 | $ 65,366 | $ 56,197 |
| | | | | |
| **Measured on a Nonrecurring Basis** | | | | |
| **Assets** | | | | |
| Collateral dependent impaired loans (3): | | | | |
| Commercial (4) | $ 1,658 | $ | $ | $ 1,658 |
| Commercial real estate mortgages | 11,699 | | 11,699 | |
| Residential mortgages | 4,382 | | 3,924 | 458 |

| | | | | |
|---|---|---|---|---|
| Real estate construction | 7,208 | | 7,208 | |
| Equity lines of credit | 782 | | | 782 |
| Installment | 399 | | 399 | |
| Other real estate owned (5) | 55,321 | | 49,579 | 5,742 |
| Private equity and alternative investments | 5,982 | | | 5,982 |
| **Total assets at fair value** | $ 87,431 | $ | $ 72,809 | $ 14,622 |

(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 lease financing.

(5) Other real estate owned balance of $110.7 million in the consolidated balance sheets includes $83.6 million of covered OREO and is net of estimated disposal costs.

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**Note 3. Fair Value Measurements (Continued)**

| (in thousands) | Balance as of December 31, 2011 | 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 | $ 19,182 | $ 19,182 | $ | $ |
| Federal agency - Debt | 1,973,862 | | 1,973,862 | |
| Federal agency - MBS | 681,044 | | 681,044 | |
| CMOs - Federal agency | 4,326,907 | | 4,326,907 | |
| CMOs - Non-agency | 69,001 | | 69,001 | |
| State and municipal | 401,604 | | 401,604 | |
| Other debt securities | 99,074 | | 79,491 | 19,583 |
| Equity securities and mutual funds | 1,227 | 1,227 | | |
| Trading securities | 61,975 | 61,922 | 53 | |
| Mark-to-market derivatives (1) | 62,230 | 2,552 | 59,678 | |
| **Total assets at fair value** | $ 7,696,106 | $ 84,883 | $ 7,591,640 | $ 19,583 |
| | | | | |
| **Liabilities** | | | | |
| Mark-to-market derivatives | $ 52,881 | $ 1,542 | $ 51,339 | $ |
| FDIC clawback liability | 8,103 | $ | $ | $ 8,103 |
| Other liabilities | 263 | | 263 | |
| **Total liabilities at fair value (2)** | $ 61,247 | $ 1,542 | $ 51,602 | $ 8,103 |
| | | | | |
| **Measured on a Nonrecurring Basis** | | | | |
| **Assets** | | | | |
| Collateral dependent impaired loans (3): | | | | |
| Commercial (4) | $ 2,484 | $ | $ | $ 2,484 |
| Commercial real estate mortgages | 6,830 | | 6,830 | |
| Residential mortgages | 5,555 | | 5,084 | 471 |
| Real estate construction | 18,528 | | 9,680 | 8,848 |
| Equity lines of credit | 3,471 | | 2,588 | 883 |
| Installment | 675 | | 675 | |
| Collateral dependent impaired covered loans (3): | | | | |
| Commercial | 422 | | | 422 |
| Other real estate owned (5) | 66,837 | | 56,898 | 9,939 |
| Private equity and alternative investments | 6,558 | | | 6,558 |
| **Total assets at fair value** | $ 111,360 | $ | $ 81,755 | $ 29,605 |

(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 lease financing.

(5) Other real estate owned balance of $129.3 million in the consolidated balance sheets includes $98.6 million of covered OREO and is net of estimated disposal costs.

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**Note 3. Fair Value Measurements (Continued)**

At September 30, 2012, $8.01 billion, or approximately 31 percent, of the Company s total assets were recorded at fair value on a recurring basis, compared with $7.70 billion, or 33 percent, at December 31, 2011. The majority of these financial assets were valued using Level 1 or Level 2 inputs. Less than 1 percent of total assets were measured using Level 3 inputs. At September 30, 2012, $123.3 million of the Company s total liabilities were recorded at fair value using Level 1, Level 2 or Level 3 inputs, compared with $61.2 million at December 31, 2011. 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 nine months ended September 30, 2012. At September 30, 2012, $87.4 million, or approximately 0.3 percent, of the Company s total assets, were recorded at fair value on a nonrecurring basis, compared with $111.4 million, or approximately 0.5 percent, at December 31, 2011. These assets were measured using Level 2 and Level 3 inputs.

*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 nine months ended September 30, 2012 and 2011.

**Level 3 Assets and Liabilities Measured on a Recurring Basis**

| (in thousands) | For the nine months ended September 30, 2012 Securities Available-for-Sale | For the nine months ended September 30, 2012 Contingent Consideration Liability | For the nine months ended September 30, 2012 FDIC Clawback Liability | For the nine months ended September 30, 2011 Securities Available-for-Sale | For the nine months ended September 30, 2011 FDIC Clawback Liability |
|---|---|---|---|---|---|
| Balance, beginning of period | $ 19,583 | $ | $ (8,103) | $ 20,982 | $ (6,911) |
| Total realized/unrealized gains (losses): | | | | | |
| Included in earnings | | | (1,811) | | (1,131) |
| Included in other comprehensive income | 1,770 | | | 348 | |
| Additions | | (45,768) | | | |
| Settlements | (3,152) | | | (1,960) | |
| Transfers into Level 3 | 47,165 | | | | |
| Other (1) | 73 | (515) | | (20) | |
| Balance, end of period | $ 65,439 | $ (46,283) | $ (9,914) | $ 19,350 | $ (8,042) |

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

Level 3 assets measured at fair value on a recurring basis consist of municipal auction rate securities and collateralized debt obligation senior notes that are included in securities available-for-sale. During the nine months ended September 30, 2012, municipal auction rate securities totaling $47.2 million were transferred from Level 2 to Level 3 of the fair value hierarchy as a result of a change in the method used to value these securities. The valuation methodology was revised due to the prolonged period of inactivity in the market for auction rate securities. At

September 30, 2012, these 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. Senior notes totaling $18.3 million at September 30, 2012 were valued using the discounted cash flow method with the following unobservable inputs: (1) risk-adjusted discount rate consistent with similarly-rated securities, (2) prepayment rate of 2 percent, (3) default rate of 0.75 percent of performing collateral, and (4) 15 percent recovery rate with a 2-year lag.

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. Refer to Note 3, *Business Combinations*, for further discussion of the methodology used to value the contingent consideration liability. 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.

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**Note 3. Fair Value Measurements (Continued)**

There were no purchases, sales, or transfers out of Level 3 assets measured on a recurring basis during the nine months ended September 30, 2012 and 2011. Paydowns of $3.2 million and $2.0 million were received on Level 3 assets measured on a recurring basis for the nine months ended September 30, 2012 and 2011, respectively.

*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.

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 September 30, 2012 | Valuation Method | Unobservable Inputs |
|---|---|---|---|---|
| Collateral dependent impaired loans | $ | 2,898 | Market | - Adjustments to external or internal appraised values (1)<br>- Probability weighting of broker price opinions<br>- Management assumptions regarding market trends or other relevant factors |
| Other real estate owned | $ | 5,742 | Market | - Adjustments to external or internal appraised values (1)<br>- Probability weighting of broker price opinions<br>- Management assumptions regarding market trends or other relevant factors |
| Private equity and alternative investments | $ | 5,982 | Cost Recovery | - Management s assumptions regarding recoverability of investment based on fund financial performance, market conditions and other relevant factors |

(1) Appraised values may be adjusted to reflect changes in market conditions that have occurred subsequent to the appraisal date, or for revised estimates regarding the timing or cost of the property sale. These adjustments are based on qualitative judgments made by management on a case-by-case basis.

Market-based valuation methods use prices and other relevant information generated by market transactions involving identical or comparable assets. 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.

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**Note 3. Fair Value Measurements (Continued)**

For assets measured at fair value on a nonrecurring basis, the following table presents the total net (losses) gains, 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 nine months ended September 30, 2012 and 2011:

| | For the three months ended September 30, | | For the nine months ended September 30, | |
|---|---|---|---|---|
| **(in thousands)** | **2012** | **2011** | **2012** | **2011** |
| Collateral dependent impaired loans: | | | | |
| Commercial | $ | $ 80 | $ (368) | $ (526) |
| Commercial real estate mortgages | 306 | (1,643) | (1,630) | 5,811 |
| Residential mortgages | (31) | (266) | (1,152) | (455) |
| Real estate construction | 130 | (10,413) | (6,623) | (11,612) |
| Equity lines of credit | 16 | (179) | (47) | (689) |
| Installment | (101) | (279) | (208) | (4,596) |
| Collaterial dependent impaired covered loans: | | | | |
| Commercial | | (325) | | (325) |
| Other real estate owned (1) | (4,147) | (6,585) | (16,312) | (32,575) |
| Private equity and alternative investments | (2,477) | (32) | (2,938) | (232) |
| Total net losses recognized | $ (6,304) | $ (19,642) | $ (29,278) | $ (45,199) |

(1) Net losses on OREO includes \$3.6 million and \$14.7 million of net losses related to covered OREO for the three and nine months ended September 30, 2012, respectively, and \$6.7 million and \$29.5 million of net losses for the three and nine months ended September 30, 2011, respectively. A significant portion of net losses on covered OREO is 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 2011 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 3. 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 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.

| | | | September 30, 2012 | | |
|---|---|---|---|---|---|
| | Carrying | Total | Fair Value Measurements Using | | |
| (in millions) | Amount | Fair Value | Level 1 | Level 2 | Level 3 |
| Financial Assets: | | | | | |
| Cash and due from banks | $ 235.0 | $ 235.0 | $ 235.0 | $ | $ |
| Due from banks - interest bearing | 335.3 | 335.3 | 335.3 | | |
| Federal funds sold | 19.5 | 19.5 | 19.5 | | |
| Securities held-to-maturity | 1,174.2 | 1,222.7 | | 1,222.7 | |
| Loans and leases, net of allowance | 13,456.2 | 13,903.0 | | | 13,903.0 |
| Covered loans, net of allowance | 1,099.4 | 1,173.8 | | | 1,173.8 |
| FDIC indemnification asset | 161.0 | 135.3 | | | 135.3 |
| Investment in FHLB and FRB stock | 96.1 | 96.1 | | 96.1 | |
| | | | | | |
| Financial Liabilities: | | | | | |
| Deposits | $ 22,512.3 | $ 22,516.7 | $ | $ 21,612.9 | $ 903.8 |
| Other short-term borrowings | 211.7 | 214.4 | | 211.2 | 3.2 |
| Long-term debt | 706.0 | 773.0 | | 697.4 | 75.6 |

| | | | December 31, 2011 | | |
|---|---|---|---|---|---|
| | Carrying | Total | Fair Value Measurements Using | | |
| (in millions) | Amount | Fair Value | Level 1 | Level 2 | Level 3 |
| Financial Assets: | | | | | |
| Cash and due from banks | $ 168.4 | $ 168.4 | $ 168.4 | $ | $ |
| Due from banks - interest bearing | 76.4 | 76.4 | 76.4 | | |
| Securities held-to-maturity | 467.7 | 473.9 | | 473.9 | |
| Loans and leases, net of allowance | 12,046.8 | 12,400.5 | | | 12,400.5 |
| Covered loans, net of allowance | 1,417.3 | 1,472.6 | | | 1,472.6 |
| FDIC indemnification asset | 204.3 | 184.3 | | | 184.3 |
| Investment in FHLB and FRB stock | 107.4 | 107.4 | | 107.4 | |
| | | | | | |
| Financial Liabilities: | | | | | |
| Deposits | $ 20,387.6 | $ 20,392.3 | $ | $ 19,476.2 | $ 916.1 |
| Federal funds purchased and securities sold under repurchase agreements | 50.0 | 50.0 | 50.0 | | |
| Long-term debt | 697.8 | 718.7 | | 718.7 | |

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

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**Note 3. Fair Value Measurements (Continued)**

*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 government agency 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 FRB and FHLB 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 and Securities sold under repurchase agreements* 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 4. Securities**

At September 30, 2012, the Company had total securities of $9.11 billion, comprised of securities available-for-sale at fair value of $7.87 billion, securities held-to-maturity at amortized cost of $1.17 billion and trading securities at fair value of $64.7 million. At December 31, 2011, the Company had total securities of $8.10 billion, comprised of securities available-for-sale at fair value of $7.57 billion, securities held-to-maturity at amortized cost of $467.7 million and trading securities at fair value of $62.0 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 September 30, 2012 and December 31, 2011:

| (in thousands) | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| **September 30, 2012** | | | | |
| **Securities available-for-sale:** | | | | |
| U.S. Treasury | $ 20,352 | $ 6 | $ (3) | $ 20,355 |
| Federal agency - Debt | 1,542,162 | 5,169 | (31) | 1,547,300 |
| Federal agency - MBS | 612,713 | 45,222 | | 657,935 |
| CMOs - Federal agency | 4,755,996 | 95,410 | (3,935) | 4,847,471 |
| CMOs - Non-agency | 66,431 | 1,070 | (3,012) | 64,489 |
| State and municipal | 406,127 | 19,177 | (135) | 425,169 |
| Other debt securities | 306,645 | 8,329 | (6,450) | 308,524 |
| Total debt securities | 7,710,426 | 174,383 | (13,566) | 7,871,243 |
| Equity securities and mutual funds | 336 | 485 | | 821 |
| Total securities available-for-sale | $ 7,710,762 | $ 174,868 | $ (13,566) | $ 7,872,064 |
| | | | | |
| **Securities held-to-maturity (1):** | | | | |
| Federal agency - Debt | $ 96,389 | $ 2,960 | $ | $ 99,349 |
| Federal agency - MBS | 218,085 | 11,558 | | 229,643 |
| CMOs - Federal agency | 660,196 | 28,830 | | 689,026 |
| State and municipal | 199,491 | 5,364 | (152) | 204,703 |
| Total securities held-to-maturity | $ 1,174,161 | $ 48,712 | $ (152) | $ 1,222,721 |
| | | | | |
| **December 31, 2011** | | | | |
| **Securities available-for-sale:** | | | | |
| U.S. Treasury | $ 19,163 | $ 24 | $ (5) | $ 19,182 |
| Federal agency - Debt | 1,967,928 | 6,230 | (296) | 1,973,862 |
| Federal agency - MBS | 650,091 | 31,040 | (87) | 681,044 |
| CMOs - Federal agency | 4,239,205 | 89,926 | (2,224) | 4,326,907 |
| CMOs - Non-agency | 79,999 | 322 | (11,320) | 69,001 |
| State and municipal | 383,210 | 18,767 | (373) | 401,604 |
| Other debt securities | 106,051 | 1,896 | (8,873) | 99,074 |
| Total debt securities | 7,445,647 | 148,205 | (23,178) | 7,570,674 |
| Equity securities and mutual funds | 352 | 875 | | 1,227 |
| Total securities available-for-sale | $ 7,445,999 | $ 149,080 | $ (23,178) | $ 7,571,901 |
| | | | | |
| **Securities held-to-maturity (1):** | | | | |
| Federal agency - Debt | $ 40,423 | $ 780 | $ | $ 41,203 |
| Federal agency - MBS | 75,231 | 1,632 | | 76,863 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| CMOs - Federal agency | | 292,547 | | 2,580 | | (195) | 294,932 |
| State and municipal | | 59,479 | | 1,463 | | (37) | 60,905 |
| Total securities held-to-maturity | $ | 467,680 | $ | 6,455 | $ | (232) | $ 473,903 |

(1) Securities held-to-maturity are presented in the consolidated balance sheets at amortized cost.

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**Note 4. Securities (Continued)**

Proceeds from sales of securities available-for-sale were $1.0 million and $6.2 million for the three and nine months ended September 30, 2012, respectively, compared with $48.2 million and $101.5 million for the three and nine months ended September 30, 2011, respectively. There were no sales of securities held-to-maturity during the three and nine months ended September 30, 2012 and September 30, 2011. The following table provides the gross realized gains and losses on the sales and calls of securities (including trading securities):

| (in thousands) | For the three months ended September 30, 2012 | 2011 | For the nine months ended September 30, 2012 | 2011 |
|---|---|---|---|---|
| Gross realized gains | $ 1,315 | $ 3,897 | $ 1,851 | $ 6,678 |
| Gross realized losses | (459) | (377) | (825) | (1,339) |
| Net realized gains | $ 856 | $ 3,520 | $ 1,026 | $ 5,339 |

Interest income on securities (including trading securities) for the three months ended September 30, 2012 and 2011 is comprised of: (i) taxable interest income of $40.0 million and $37.7 million, respectively (ii) nontaxable interest income of $4.1 million and $3.0 million, respectively, and (iii) dividend income of $0.1 million and $0.2 million, respectively. Interest income on securities (including trading securities) for the nine months ended September 30, 2012 and 2011 is comprised of: (i) taxable interest income of $120.8 million and $108.4 million, respectively (ii) nontaxable interest income of $12.0 million and $8.9 million, respectively, and (iii) dividend income of $0.3 million and $0.7 million, respectively.

The following table provides the expected remaining maturities of debt securities included in the securities portfolio at September 30, 2012. The maturities of mortgage-backed securities are allocated according to the average life of expected cash flows. Average expected maturities will differ from contractual maturities because of the amortizing nature of the loan collateral and prepayment behavior of borrowers.

| (in thousands) | One year or less | Over 1 year through 5 years | Over 5 years through 10 years | Over 10 years | Total |
|---|---|---|---|---|---|
| **Securities available-for-sale:** | | | | | |
| U.S. Treasury | $ 2,001 | $ 18,354 | $ | $ | $ 20,355 |
| Federal agency - Debt | 1,149,612 | 397,688 | | | 1,547,300 |
| Federal agency - MBS | 7 | 476,083 | 181,845 | | 657,935 |
| CMOs - Federal agency | 337,650 | 4,384,761 | 125,060 | | 4,847,471 |
| CMOs - Non-agency | 10,224 | 7,510 | 46,755 | | 64,489 |
| State and municipal | 93,209 | 221,996 | 85,351 | 24,613 | 425,169 |
| Other | 2,122 | 303,986 | 2,416 | | 308,524 |
| Total debt securities available-for-sale | $ 1,594,825 | $ 5,810,378 | $ 441,427 | $ 24,613 | $ 7,871,243 |
| | | | | | |
| Amortized cost | $ 1,588,623 | $ 5,692,865 | $ 404,456 | $ 24,482 | $ 7,710,426 |
| | | | | | |
| **Securities held-to-maturity:** | | | | | |
| Federal agency - Debt | $ | $ 5,068 | $ | $ 91,321 | $ 96,389 |
| Federal agency - MBS | | 2,649 | 215,436 | | 218,085 |
| CMOs - Federal agency | | 105,755 | 554,441 | | 660,196 |
| State and municipal | 500 | 15,223 | 154,277 | 29,491 | 199,491 |

| | | | | | |
|---|---|---|---|---|---|
| Total debt securities held-to-maturity at amortized cost | $ 500 | $ 128,695 | $ 924,154 | $ 120,812 | $ 1,174,161 |

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**Note 4. Securities (Continued)**

*Impairment Assessment*

The Company performs a quarterly assessment of the debt and equity securities in its investment portfolio that have an unrealized loss to determine whether the decline in the fair value of these securities below their cost is other-than-temporary. Impairment is considered other-than-temporary when it becomes probable that an investor will be unable to recover the cost of an investment. The Company s impairment assessment takes into consideration factors such as the length of time and the extent to which the market value has been less than cost; the financial condition and near-term prospects of the issuer, including events specific to the issuer or industry; defaults or deferrals of scheduled interest, principal or dividend payments; external credit ratings and recent downgrades; and whether the Company intends to sell the security and whether it is more likely than not it will be required to sell the security prior to recovery of its amortized cost basis. If a decline in fair value is judged to be other than temporary, the cost basis of the individual security is written down to fair value which then becomes the new cost basis. The new cost basis is not adjusted for subsequent recoveries in fair value.

When there are credit losses associated with an impaired debt security and the Company does not have the intent to sell the security and it is more likely than not that it will not have to sell the security before recovery of its cost basis, the Company will separate the amount of the impairment into the amount that is credit-related and the amount related to non-credit factors. The credit-related impairment is recognized in Net impairment loss recognized in earnings in the consolidated statements of income. The non-credit-related impairment is recognized in AOCI.

*Securities Deemed to be Other-Than-Temporarily Impaired*

Through the impairment assessment process, the Company determined that certain non-agency CMOs were other-than-temporarily impaired at September 30, 2012. See *Non-Agency CMOs* below. The Company recorded impairment losses in earnings on securities available-for-sale of $39 thousand and $0.2 million for the three and nine months ended September 30, 2012, respectively. Impairment losses recognized in earnings on securities available-for-sale during the three and nine months ended September 30, 2011 were $0.2 million and $0.7 million, respectively. The Company recognized $1.5 million and $4.4 million of non-credit-related other-than-temporary impairment in AOCI on securities available-for-sale at September 30, 2012 and 2011, respectively. There were no impairment losses recognized in earnings or AOCI for securities held-to-maturity during the three and nine months ended September 30, 2012.

The following table summarizes the changes in cumulative credit-related other-than-temporary impairment recognized in earnings for debt securities for the three and nine months ended September 30, 2012 and 2011. Credit-related other-than-temporary impairment that was recognized in earnings is reflected as an Initial credit-related impairment if the period reported is the first time the security had a credit impairment. A credit-related other-than-temporary impairment is reflected as a Subsequent credit-related impairment if the period reported is not the first time the security had a credit impairment. Cumulative impairment is reduced for securities with previously recognized credit-related impairment that were sold or redeemed during the period. Cumulative impairment is further adjusted for other changes in expected cash flows.

| | **For the three months ended September 30,** | | **For the nine months ended September 30,** | |
|---|---|---|---|---|
| **(in thousands)** | **2012** | **2011** | **2012** | **2011** |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Balance, beginning of period | $ | 17,366 | $ | 17,293 | $ | 17,531 | $ | 17,923 |
| Subsequent credit-related impairment | | 39 | | 193 | | 217 | | 651 |
| Reduction for securities sold or redeemed | | (537) | | | | (537) | | (455) |
| (Increase) decrease in expected cash flows on securities for which OTTI was previously recognized | | (267) | | 508 | | (610) | | (125) |
| Balance, end of period | $ | 16,601 | $ | 17,994 | $ | 16,601 | $ | 17,994 |

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**Note 4. Securities (Continued)**

*Non-Agency CMOs*

The Company held $45.9 million of variable rate non-agency CMOs at September 30, 2012, of which $16.3 million of these securities were other-than-temporarily impaired because the present value of expected cash flows was less than cost. These CMOs have a fixed interest rate for an initial period after which they become variable-rate instruments with annual rate resets. For purposes of projecting future cash flows, the current fixed coupon was used through the reset date for each security. The prevailing LIBOR/Treasury forward curve as of the measurement date was used to project all future floating-rate cash flows based on the characteristics of each security. Other factors considered in the projection of future cash flows include the current level of subordination from other CMO classes, anticipated prepayment rates, cumulative defaults and loss given default. The Company recognized credit-related impairment losses in earnings on its investments in certain variable rate non-agency CMOs totaling $39 thousand and $0.2 million for the three and nine months ended September 30, 2012, respectively. The Company recognized credit-related impairment losses of $0.2 million and $0.7 million in earnings for the three and nine months ended September 30, 2011, respectively. The non-credit portion of other-than-temporary impairment for these securities at September 30, 2012 and 2011 was recognized in AOCI and is attributed to external market conditions, primarily the lack of liquidity in these securities, resulting in an increase in interest rate spreads for these securities. The Company also holds $18.6 million in fixed rate non-agency CMOs at September 30, 2012, none of which have experienced any other-than-temporary impairment.

The following table provides a summary of the gross unrealized losses and fair value of investment securities that are not deemed to be other-than-temporarily impaired aggregated by investment category and length of time that the securities have been in a continuous unrealized loss position as of September 30, 2012 and December 31, 2011. The table also includes investment securities that had both a credit-related impairment recognized in earnings and a non-credit-related impairment recognized in AOCI.

| | Less than 12 months | | 12 months or greater | | Total | |
|---|---|---|---|---|---|---|
| **(in thousands)** | **Fair Value** | **Estimated Unrealized Loss** | **Fair Value** | **Estimated Unrealized Loss** | **Fair Value** | **Estimated Unrealized Loss** |
| **September 30, 2012** | | | | | | |
| **Securities available-for-sale:** | | | | | | |
| U.S. Treasury | $ 5,108 | $ 3 | $ | $ | $ 5,108 | $ 3 |
| Federal agency - Debt | 90,220 | 31 | | | 90,220 | 31 |
| CMOs - Federal agency | 928,673 | 3,763 | 49,923 | 172 | 978,596 | 3,935 |
| CMOs - Non-agency | | | 27,985 | 3,012 | 27,985 | 3,012 |
| State and municipal | 47,097 | 128 | 808 | 7 | 47,905 | 135 |
| Other debt securities | | | 16,220 | 6,450 | 16,220 | 6,450 |
| Total securities available-for-sale | $ 1,071,098 | $ 3,925 | $ 94,936 | $ 9,641 | $ 1,166,034 | $ 13,566 |
| | | | | | | |
| **Securities held-to-maturity:** | | | | | | |
| State and municipal | $ 20,274 | $ 152 | $ | $ | $ 20,274 | $ 152 |
| Total securities held-to-maturity | $ 20,274 | $ 152 | $ | $ | $ 20,274 | $ 152 |

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**Note 4. Securities (Continued)**

| (in thousands) | Less than 12 months Fair Value | Less than 12 months Estimated Unrealized Loss | 12 months or greater Fair Value | 12 months or greater Estimated Unrealized Loss | Total Fair Value | Total Estimated Unrealized Loss |
|---|---|---|---|---|---|---|
| **December 31, 2011** | | | | | | |
| **Securities available-for-sale:** | | | | | | |
| U.S. Treasury | $ 4,145 | $ 5 | $ | $ | $ 4,145 | $ 5 |
| Federal agency - Debt | 409,129 | 296 | | | 409,129 | 296 |
| Federal agency - MBS | 24,519 | 87 | | | 24,519 | 87 |
| CMOs - Federal agency | 744,737 | 2,224 | | | 744,737 | 2,224 |
| CMOs - Non-agency | 20,094 | 833 | 31,400 | 10,487 | 51,494 | 11,320 |
| State and municipal | 42,164 | 268 | 2,023 | 105 | 44,187 | 373 |
| Other debt securities | 34,153 | 508 | 14,718 | 8,365 | 48,871 | 8,873 |
| Total securities available-for-sale | $ 1,278,941 | $ 4,221 | $ 48,141 | $ 18,957 | $ 1,327,082 | $ 23,178 |
| | | | | | | |
| **Securities held-to-maturity:** | | | | | | |
| CMOs - Federal agency | $ 32,256 | $ 195 | $ | $ | $ 32,256 | $ 195 |
| State and municipal | 5,784 | 37 | | | 5,784 | 37 |
| Total securities held-to-maturity | $ 38,040 | $ 232 | $ | $ | $ 38,040 | $ 232 |

At September 30, 2012, the Company had $1.17 billion of securities available-for-sale in an unrealized loss position, consisting of $1.15 billion of temporarily impaired securities and $16.3 million of securities that had non-credit-related impairment recognized in AOCI. The Company had $20.3 million of securities held-to-maturity in an unrealized loss position. At September 30, 2012, the Company had 110 debt securities available-for-sale and held-to-maturity in an unrealized loss position. The debt securities in an unrealized loss position include 2 U.S. Treasury securities, 4 federal agency debt securities, 39 federal agency CMOs, 5 non-agency CMOs, 59 state and municipal securities and 1 other debt security.

The unrealized loss on non-agency CMOs reflects the lack of liquidity in this sector of the market. The Company only holds the most senior tranches of each non-agency issue which provides protection against defaults. The Company expects to receive principal and interest payments equivalent to or greater than the current cost basis of its portfolio of debt securities. Additionally, the Company does not intend to sell the securities, and it is not more likely than not that it will be required to sell the securities before it recovers the cost basis of its investment. The mortgages in these asset pools are well diversified geographically. Over the past year, the real estate market has stabilized somewhat, though performance varies substantially by geography and borrower. Though reduced, a significant weakening of economic fundamentals coupled with a return to elevated unemployment rates and substantial deterioration in the value of high-end residential properties could increase the probability of default and related credit losses. These conditions could cause the value of these securities to decline and trigger the recognition of further other-than-temporary impairment charges.

Other debt securities include the Company s investments in highly rated corporate debt and collateralized bond obligations backed by trust preferred securities ( CDOs ) issued by a geographically diverse pool of small- and medium-sized financial institutions. The CDOs held in securities available-for-sale at September 30, 2012 are the most senior tranches of each issue. Trading activity for the type of CDO held by the Company has been limited since 2008. Accordingly, the fair values of these securities were determined using an internal pricing model that incorporates assumptions about discount rates in an illiquid market, projected cash flows and collateral performance. The CDOs had a $6.4 million net unrealized loss at September 30, 2012, which the Company attributes to the illiquid credit markets. The CDOs have collateral that well exceeds the outstanding debt. Security valuations reflect the current and prospective performance of the issuers whose debt is contained in these asset pools. The Company expects to receive all contractual principal and interest payments due on its CDOs. Additionally, the Company does not intend to sell the securities, and it is not more likely than not that it will be required to sell the securities before it recovers the cost basis of its investment.

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**Note 4. Securities (Continued)**

At December 31, 2011, the Company had $1.33 billion of securities available-for-sale in an unrealized loss position consisting of $1.32 billion of temporarily impaired securities and $9.2 million of securities that had non-credit-related impairment recognized in AOCI. The Company had $38.0 million of securities held-to-maturity in an unrealized loss position. At December 31, 2011, the Company had 90 debt securities available-for-sale and held-to-maturity in an unrealized loss position. The debt securities in an unrealized loss position included 2 U.S. Treasury securities, 12 federal agency debt securities, 3 federal agency MBS, 36 federal agency CMOs, 12 non-agency CMOs, 19 state and municipal securities and 6 other debt securities.

**Note 5. Other Investments**

*Federal Home Loan Bank of San Francisco and Federal Reserve Bank Stock*

The Company s investment in stock issued by the Federal Home Loan Bank of San Francisco ( FHLB ) and Federal Reserve Bank ( FRB ) totaled $96.1 million and $107.4 million at September 30, 2012 and December 31, 2011, respectively. Ownership of government agency securities is restricted to member banks, and the securities do not have readily determinable market values. The Company records investments in FHLB and FRB stock at cost in Other assets of the consolidated balance sheets and evaluates these investments for impairment. The Company expects to recover the full amount invested in FHLB and FRB stock and does not consider its investments to be impaired at September 30, 2012.

*Private Equity and Alternative Investments*

The Company has ownership interests in a limited number of private equity, venture capital, real estate and hedge funds that are not publicly traded and do not have readily determinable fair values. These investments are carried at cost in the Other assets section of the consolidated balance sheets and are net of impairment write-downs, if applicable. The Company s investments in these funds totaled $36.5 million at September 30, 2012 and $39.9 million at December 31, 2011. A summary of investments by fund type is provided below:

| **(in thousands)**<br>**Fund Type** | **September 30, 2012** | **December 31, 2011** |
|---|---|---|
| Private equity and venture capital | $ 21,399 | $ 23,093 |
| Real estate | 8,895 | 10,541 |
| Hedge | 2,866 | 2,883 |
| Other | 3,332 | 3,402 |
| Total | $ 36,492 | $ 39,919 |

Management reviews these investments quarterly for impairment. The impairment assessment includes a review of the most recent financial statements and investment reports for each fund and discussions with fund management. An impairment loss is recognized if it is deemed probable that the Company will not recover the cost of an investment. The impairment loss is recognized in Other noninterest income in the consolidated statements of income. The new cost basis of the investment is not adjusted for subsequent recoveries in value. The Company recognized impairment losses totaling $2.5 million and $2.9 million on its investments during the three and nine months ended September 30, 2012, respectively. The Company recognized impairment losses totaling $32 thousand and $0.2 million on its investments during the three and nine months ended September 30, 2011, respectively.

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**Note 5. Other Investments (Continued)**

The table below provides information as of September 30, 2012 on private equity and alternative investments measured at fair value on a nonrecurring basis due to the recognition of impairment:

| (in thousands)<br>Fund Type | Fair Value | Unfunded Commitments | Redemption Frequency | Redemption Notice Period |
|---|---|---|---|---|
| Private equity and venture capital (2) | $ 1,909 | $ 143 | None (1) | N/A |
| Real estate (3) | 4,073 | 1,381 | None (1) | N/A |
| Total | $ 5,982 | $ 1,524 | | |

(1) Funds make periodic distributions of income but do not permit redemptions prior to the end of the investment term.
(2) Funds invest in securities and other instruments of public and private companies, including corporations, partnerships, limited liability companies and joint ventures.
(3) Funds invest in commercial, industrial and retail projects and select multi-family housing opportunities which are part of mixed use projects in low and moderate income neighborhoods.

**Note 6. Loans, Allowance for Loan and Lease Losses, and Reserve for Off-Balance Sheet Credit Commitments**

The following is a summary of the major categories of loans:

**Loans and Leases**

| (in thousands) | September 30, 2012 | December 31, 2011 |
|---|---|---|
| Commercial | $ 5,554,521 | $ 4,846,594 |
| Commercial real estate mortgages | 2,463,664 | 2,110,749 |
| Residential mortgages | 3,897,690 | 3,763,218 |
| Real estate construction | 242,137 | 315,609 |
| Equity lines of credit | 718,966 | 741,081 |
| Installment | 137,632 | 132,647 |
| Lease financing | 710,041 | 399,487 |
| Loans and leases, excluding covered loans | 13,724,651 | 12,309,385 |
| Less: Allowance for loan and lease losses | (268,440) | (262,557) |
| Loans and leases, excluding covered loans, net | 13,456,211 | 12,046,828 |
| | | |
| Covered loans | 1,144,337 | 1,481,854 |
| Less: Allowance for loan losses | (44,978) | (64,565) |
| Covered loans, net | 1,099,359 | 1,417,289 |
| | | |
| Total loans and leases | $ 14,868,988 | $ 13,791,239 |

| | | |
|---|---|---|
| Total loans and leases, net | $ 14,555,570 | $ 13,464,117 |

The loan amounts above include unamortized fees, net of deferred costs, of $5.9 million and $7.5 million as of September 30, 2012 and December 31, 2011, respectively.

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**Note 6. Loans, Allowance for Loan and Lease Losses, and Reserve for Off-Balance Sheet Credit Commitments (Continued)**

Concentrations of credit risk arise when a number of clients are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic conditions. Although the Company s lending activities are predominantly in California, and to a lesser extent, New York and Nevada, the Company has various specialty lending businesses that lend to businesses located throughout the United States of America. Excluding covered loans, at September 30, 2012, California represented 80 percent of total loans outstanding and New York and Nevada represented 7 percent and 3 percent, respectively. The remaining 10 percent of total loans outstanding represented other states. Although the Company has a diversified loan portfolio, a substantial portion of the loan portfolio and credit performance depends on the economic stability of Southern California. Credit performance also depends, to a lesser extent, on economic conditions in the San Francisco Bay area, New York and Nevada. Within the Company s covered loan portfolio at September 30, 2012, the five states with the largest concentration were California (39 percent), Texas (12 percent), Nevada (7 percent), Arizona (4 percent) and Ohio (4 percent). The remaining 34 percent of total covered loans outstanding represented other states.

*Covered Loans*

Covered loans represent loans acquired from the FDIC that are subject to loss-sharing agreements. Covered loans were $1.14 billion as of September 30, 2012 and $1.48 billion as of December 31, 2011. Covered loans, net of allowance for loan losses, were $1.10 billion at September 30, 2012 and $1.42 billion at December 31, 2011.

The following is a summary of the major categories of covered loans:

| **(in thousands)** | **September 30, 2012** | **December 31, 2011** |
|---|---|---|
| Commercial | $ 15,824 | $ 30,911 |
| Commercial real estate mortgages | 1,036,383 | 1,288,352 |
| Residential mortgages | 5,707 | 14,931 |
| Real estate construction | 81,524 | 140,992 |
| Equity lines of credit | 4,083 | 5,167 |
| Installment | 816 | 1,501 |
| Covered loans | 1,144,337 | 1,481,854 |
| Less: Allowance for loan losses | (44,978) | (64,565) |
| Covered loans, net | $ 1,099,359 | $ 1,417,289 |

The Company evaluated the acquired loans from its FDIC-assisted acquisitions and concluded that all loans, with the exception of a small population of acquired loans, would be accounted for under ASC Topic 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality* ( ASC 310-30 ). Loans are accounted for under ASC 310-30 when there is evidence of credit deterioration since origination and for which it is probable, at acquisition, that the Company would be unable to collect all contractually required payments. Interest income is recognized on all acquired impaired loans through accretion of the difference between the carrying amount of the loans and their expected cash flows.

As of NCB s acquisition date in 2011, the estimates of the contractually required payments receivable for all acquired impaired covered loans of NCB were $107.4 million, the cash flows expected to be collected were $66.2 million, and the fair value of the acquired impaired loans was $55.3 million. The above amounts were determined based on the estimated performance over the remaining life of the underlying loans, which included the effects of estimated prepayments. Fair value of the acquired loans included estimated credit losses.

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**Note 6. Loans, Allowance for Loan and Lease Losses, and Reserve for Off-Balance Sheet Credit Commitments (Continued)**

The excess of cash flows expected to be collected over the carrying value of the underlying acquired impaired loans is referred to as the accretable yield. This amount is not reported in the consolidated balance sheets, but is accreted into interest income at a level yield over the remaining estimated lives of the underlying pools of loans. Changes in the accretable yield for acquired impaired loans were as follows for the nine months ended September 30, 2012 and 2011:

| | For the nine months ended September 30, | |
|---|---|---|
| (in thousands) | 2012 | 2011 |
| Balance, beginning of period | $ 436,374 | $ 562,826 |
| Additions | | 10,871 |
| Accretion | (62,189) | (80,143) |
| Reclassifications (to) from nonaccretable yield | (4,042) | 22,577 |
| Disposals and other | (51,854) | (46,544) |
| Balance, end of period | $ 318,289 | $ 469,587 |

The factors that most significantly affect estimates of cash flows expected to be collected, and accordingly the accretable yield balance, include: (i) changes in credit assumptions, including both credit loss amounts and timing; (ii) changes in prepayment assumptions; and (iii) changes in interest rates for variable-rate loans. Reclassifications between accretable yield and nonaccretable yield may vary from period to period as the Company periodically updates its cash flow projections. The reclassification of accretable yield to nonaccretable yield during 2012 was principally driven by negative changes in future cash flows, both timing and amount, which were primarily a result of changes in credit assumptions.

The Company recorded an indemnification asset related to its FDIC-assisted acquisitions, which represents the present value of the expected reimbursement from the FDIC for expected losses on acquired loans, OREO and unfunded commitments. The FDIC indemnification asset from all FDIC-assisted acquisitions was $161.0 million at September 30, 2012 and $204.3 million at December 31, 2011.

***Credit Quality on Loans and Leases, Excluding Covered Loans***

*Allowance for Loan and Lease Losses and Reserve for Off-Balance Sheet Credit Commitments*

The Company accounts for the credit risk associated with lending activities through its allowance for loan and lease losses, reserve for off-balance sheet credit commitments and provision for credit losses. The provision is the expense recognized in the consolidated statements of income to adjust the allowance and reserve to the levels deemed appropriate by management, as determined through application of the Company s allowance methodology procedures. The provision for credit losses reflects management s judgment of the adequacy of the allowance for loan and lease losses and the reserve for off-balance sheet credit commitments. It is determined through quarterly analytical reviews of the loan and commitment portfolios and consideration of such other factors as the Company s loan and lease loss experience, trends in problem loans, concentrations of credit risk, underlying collateral values, and current economic conditions, as well as the results of the Company s ongoing credit review process. As conditions change, the Company s level of provisioning and the allowance for loan and lease losses and reserve for off-balance sheet credit commitments may change.

For commercial, non-homogenous loans that are not impaired, the Bank derives loss factors via a process that begins with estimates of probable losses inherent in the portfolio based upon various statistical analyses. The factors considered in the analysis include loan type, migration analysis, in which historical delinquency and credit loss experience is applied to the current aging of the portfolio, as well as analyses that reflect current trends and conditions. Each portfolio of smaller balance homogeneous loans, including residential first mortgages, installment, revolving credit and most other consumer loans, is collectively evaluated for loss potential. The quantitative portion of the allowance for loan and lease losses is adjusted for qualitative factors to account for model imprecision and to incorporate the range of probable outcomes inherent in the estimates used for the allowance. The qualitative portion of the allowance attempts to incorporate the risks inherent in the portfolio, economic uncertainties, competition, and regulatory requirements and other subjective factors such as changes in underwriting standards. It also considers overall portfolio indicators, including current and historical credit losses; delinquent, nonperforming and criticized loans; portfolio concentrations; trends in volumes and terms of loans; and economic trends in the broad market and in specific industries.

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**Note 6. Loans, Allowance for Loan and Lease Losses, and Reserve for Off-Balance Sheet Credit Commitments (Continued)**

A portion of the allowance for loan and lease losses is attributed to impaired loans that are individually measured for impairment. This measurement considers all available evidence, including as appropriate, the probability that a specific loan will default, the expected exposure of a loan at default, an estimate of loss given default, the present value of expected future cash flows discounted using the loan s contractual effective rate, the secondary market value of the loan and the fair value of collateral.

The relative significance of risk considerations used in measuring the allowance for loan and lease losses will vary by portfolio segment. For commercial loans, the primary risk consideration is a borrower s ability to generate sufficient cash flows to repay their loan. Secondary considerations include the creditworthiness of guarantors and the valuation of collateral. In addition to the creditworthiness of a borrower, the type and location of real estate collateral is an important risk factor for commercial real estate and real estate construction loans. The primary risk considerations for consumer loans are a borrower s personal cash flow and liquidity, as well as collateral value.

The allowance for loan and lease losses is decreased by the amount of charge-offs, net of recoveries. Generally, commercial, commercial real estate and real estate construction loans are charged off immediately when it is determined that advances to the borrower are in excess of the calculated current fair value of the collateral or if a borrower is deemed incapable of repayment of unsecured debt, there is little or no prospect for near term improvement and no realistic strengthening action of significance pending. Consumer loans are charged-off based on delinquency, ranging from 60 days for overdrafts to 180 days for secured consumer loans, or earlier when it is determined that the loan is uncollectible due to a triggering event, such as bankruptcy, fraud or death.

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**Note 6. Loans, Allowance for Loan and Lease Losses, and Reserve for Off-Balance Sheet Credit Commitments (Continued)**

The following tables provide a summary of activity in the allowance for loan and lease losses and the period-end recorded investment balances of loans evaluated for impairment, excluding covered loans, for the three and nine months ended September 30, 2012 and 2011. Activity is provided by loan portfolio segment which is consistent with the Company s methodology for determining the allowance for loan and lease losses.

| (in thousands) | Commercial (1) | Commercial Real Estate Mortgages | Residential Mortgages | Real Estate Construction | Equity Lines of Credit | Installment | Unallocated | Total |
|---|---|---|---|---|---|---|---|---|
| **Three months ended September 30, 2012** | | | | | | | | |
| **Allowance for loan and lease losses:** | | | | | | | | |
| Beginning balance | $ 93,407 | $ 47,648 | $ 12,414 | $ 17,583 | $ 7,610 | $ 1,764 | $ 89,108 | $ 269,534 |
| Provision for credit losses (2) | 6,293 | (716) | 1,318 | (4,425) | 43 | (316) | (1,106) | 1,091 |
| Charge-offs | (12,163) | (444) | (1,030) | (310) | (43) | (134) | | (14,124) |
| Recoveries | 7,227 | 203 | 495 | 3,415 | 11 | 588 | | 11,939 |
| Net (charge-offs) recoveries | (4,936) | (241) | (535) | 3,105 | (32) | 454 | | (2,185) |
| Ending balance | $ 94,764 | $ 46,691 | $ 13,197 | $ 16,263 | $ 7,621 | $ 1,902 | $ 88,002 | $ 268,440 |
| **Nine months ended September 30, 2012** | | | | | | | | |
| **Allowance for loan and lease losses:** | | | | | | | | |
| Beginning balance | $ 82,965 | $ 45,967 | $ 14,029 | $ 23,347 | $ 8,024 | $ 1,959 | $ 86,266 | $ 262,557 |
| Provision for credit losses (2) | 3,360 | 518 | 740 | (5,454) | 591 | (654) | 1,736 | 837 |
| Charge-offs | (22,382) | (1,318) | (2,333) | (9,769) | (1,077) | (959) | | (37,838) |
| Recoveries | 30,821 | 1,524 | 761 | 8,139 | 83 | 1,556 | | 42,884 |
| Net (charge-offs) recoveries | 8,439 | 206 | (1,572) | (1,630) | (994) | 597 | | 5,046 |
| Ending balance | $ 94,764 | $ 46,691 | $ 13,197 | $ 16,263 | $ 7,621 | $ 1,902 | $ 88,002 | $ 268,440 |
| Ending balance of allowance: | | | | | | | | |
| Individually evaluated for impairment | $ 1,167 | $ 1,874 | $ 185 | $ 1,467 | $ 138 | $ | $ | $ 4,831 |
| Collectively evaluated for impairment | 93,597 | 44,817 | 13,012 | 14,796 | 7,483 | 1,902 | 88,002 | 263,609 |
| **Loans and leases, excluding covered loans** | | | | | | | | |
| Ending balance of loans and leases: | | | | | | | | |
| Loans and leases, excluding covered loans | $ 6,264,562 | $ 2,463,664 | $ 3,897,690 | $ 242,137 | $ 718,966 | $ 137,632 | $ | $ 13,724,651 |
| Individually evaluated for impairment | 34,731 | 58,217 | 11,342 | 56,582 | 4,496 | 449 | | 165,817 |
| Collectively evaluated for impairment | 6,229,831 | 2,405,447 | 3,886,348 | 185,555 | 714,470 | 137,183 | | 13,558,834 |

(1) Includes lease financing loans.
(2) Provision for credit losses in the allowance rollforward for the three months ended September 30, 2012 includes total provision expense of $2.0 million, net of total transfers to the reserve for off-balance sheet credit commitments of $0.9 million. Provision for credit losses for the nine months ended September 30, 2012 includes total provision expense of $3.0 million, net of total transfers to the reserve for off-balance sheet credit commitments of $2.2 million.

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**Note 6. Loans, Allowance for Loan and Lease Losses, and Reserve for Off-Balance Sheet Credit Commitments (Continued)**

| (in thousands) | Commercial (1) | Commercial Real Estate Mortgages | Residential Mortgages | Real Estate Construction | Equity Lines of Credit | Installment | Unallocated | Total |
|---|---|---|---|---|---|---|---|---|
| **Three months ended September 30, 2011** | | | | | | | | |
| **Allowance for loan and lease losses:** | | | | | | | | |
| Beginning balance | $ 85,717 | $ 49,060 | $ 12,873 | $ 29,455 | $ 6,668 | $ 1,951 | $ 80,209 | $ 265,933 |
| Provision for credit losses (2) | 2,772 | (1,604) | (691) | 2,269 | (122) | 417 | 4,958 | 7,999 |
| Charge-offs | (6,282) | (1,231) | (245) | (6,434) | (523) | (457) | | (15,172) |
| Recoveries | 3,367 | 779 | 82 | 201 | 11 | 148 | | 4,588 |
| Net charge-offs | (2,915) | (452) | (163) | (6,233) | (512) | (309) | | (10,584) |
| Ending balance | $ 85,574 | $ 47,004 | $ 12,019 | $ 25,491 | $ 6,034 | $ 2,059 | $ 85,167 | $ 263,348 |
| **Nine months ended September 30, 2011** | | | | | | | | |
| **Allowance for loan and lease losses:** | | | | | | | | |
| Beginning balance | $ 82,451 | $ 52,516 | $ 16,753 | $ 40,824 | $ 7,229 | $ 3,931 | $ 53,303 | $ 257,007 |
| Provision for credit losses (2) | 5,359 | (12,541) | (3,703) | (13,503) | 194 | (1,467) | 31,864 | 6,203 |
| Charge-offs | (12,966) | (4,127) | (1,267) | (8,897) | (1,443) | (913) | | (29,613) |
| Recoveries | 10,730 | 11,156 | 236 | 7,067 | 54 | 508 | | 29,751 |
| Net (charge-offs) recoveries | (2,236) | 7,029 | (1,031) | (1,830) | (1,389) | (405) | | 138 |
| Ending balance | $ 85,574 | $ 47,004 | $ 12,019 | $ 25,491 | $ 6,034 | $ 2,059 | $ 85,167 | $ 263,348 |
| Ending balance of allowance: | | | | | | | | |
| Individually evaluated for impairment | $ 14,364 | $ 1,375 | $ 130 | $ 2,989 | $ 75 | $ | $ | $ 18,933 |
| Collectively evaluated for impairment | 71,210 | 45,629 | 11,889 | 22,502 | 5,959 | 2,059 | 85,167 | 244,415 |
| **Loans and leases, excluding covered loans** | | | | | | | | |
| Ending balance of loans and leases: | | | | | | | | |
| Loans and leases excluding covered loans | $ 5,166,802 | $ 2,059,114 | $ 3,742,768 | $ 335,712 | $ 728,890 | $ 130,923 | $ | $ 12,164,209 |
| Individually evaluated for impairment | 32,036 | 25,899 | 10,254 | 82,565 | 6,653 | 653 | | 158,060 |
| Collectively evaluated for impairment | 5,134,766 | 2,033,215 | 3,732,514 | 253,147 | 722,237 | 130,270 | | 12,006,149 |

(1) Includes lease financing loans.

(2) Provision for credit losses in the allowance rollforward for the three months ended September 30, 2011 includes total provision for credit losses of $7.5 million and total transfers from the reserve for off-balance sheet credit commitments of $0.5 million. Provision for credit losses for the nine months ended September 30, 2011 includes total provision expense for credit losses of $7.5 million and total transfers to the reserve for off-balance sheet credit commitments of $1.3 million.

Off-balance sheet credit exposures include loan commitments and letters of credit. The following table provides a summary of activity in the reserve for off-balance sheet credit commitments for the three and nine months ended September 30, 2012 and 2011:

| | For the three months ended September 30, | | For the nine months ended September 30, | |
|---|---|---|---|---|
| **(in thousands)** | **2012** | **2011** | **2012** | **2011** |
| Balance, beginning of period | $ 24,351 | $ 23,325 | $ 23,097 | $ 21,529 |
| Transfers from (to) allowance for loan and lease losses | 909 | (499) | 2,163 | 1,297 |
| Balance, end of period | $ 25,260 | 22,826 | $ 25,260 | 22,826 |

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**Note 6. Loans, Allowance for Loan and Lease Losses, and Reserve for Off-Balance Sheet Credit Commitments (Continued)**

*Impaired Loans and Leases*

Information on impaired loans, excluding covered loans, at September 30, 2012, December 31, 2011 and September 30, 2011 is provided in the following tables:

| | | | | For the three months ended September 30, 2012 | | For the nine months ended September 30, 2012 | |
|---|---|---|---|---|---|---|---|
| (in thousands) | Recorded Investment | Unpaid Contractual Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized | Average Recorded Investment | Interest Income Recognized |
| **September 30, 2012** | | | | | | | |
| With no related allowance recorded: | | | | | | | |
| Commercial | $ 28,575 | $ 39,624 | $ | $ 30,476 | $ | $ 24,732 | $ |
| Commercial real estate mortgages | 40,825 | 46,081 | | 34,597 | 34 | 25,767 | 158 |
| Residential mortgages: | | | | | | | |
| Fixed | 4,199 | 4,613 | | 3,014 | | 3,047 | |
| Variable | 3,528 | 3,968 | | 4,893 | 9 | 5,010 | 48 |
| Total residential mortgages | 7,727 | 8,581 | | 7,907 | 9 | 8,057 | 48 |
| Real estate construction: | | | | | | | |
| Construction | 29,446 | 42,870 | | 34,137 | 245 | 29,189 | 487 |
| Land | 19,038 | 23,606 | | 18,987 | 35 | 22,763 | 35 |
| Total real estate construction | 48,484 | 66,476 | | 53,124 | 280 | 51,952 | 522 |
| Equity lines of credit | 3,297 | 4,370 | | 3,252 | | 4,470 | |
| Installment: | | | | | | | |
| Consumer | 449 | 927 | | 500 | | 552 | |
| Total installment | 449 | 927 | | 500 | | 552 | |
| Lease financing | | | | | | 7 | |
| Total with no related allowance | $ 129,357 | $ 166,059 | $ | $ 129,856 | $ 323 | $ 115,537 | $ 728 |
| | | | | | | | |
| With an allowance recorded: | | | | | | | |
| Commercial | $ 6,156 | $ 6,922 | $ 1,167 | $ 8,461 | $ | $ 11,286 | $ |
| Commercial real estate mortgages | 17,392 | 18,962 | 1,874 | 17,257 | | 13,406 | |
| Residential mortgages: | | | | | | | |
| Fixed | 2,229 | 2,336 | 181 | 2,260 | | 1,844 | |
| Variable | 1,386 | 1,476 | 4 | 2,321 | 4 | 1,879 | 4 |
| Total residential mortgages | 3,615 | 3,812 | 185 | 4,581 | 4 | 3,723 | 4 |
| Real estate construction: | | | | | | | |
| Land | 8,098 | 18,362 | 1,467 | 8,432 | | 14,700 | |
| Total real estate construction | 8,098 | 18,362 | 1,467 | 8,432 | | 14,700 | |
| Equity lines of credit | 1,199 | 1,406 | 138 | 1,213 | | 1,166 | |
| Total with an allowance | $ 36,460 | $ 49,464 | $ 4,831 | $ 39,944 | $ 4 | $ 44,281 | $ 4 |
| | | | | | | | |
| Total impaired loans by type: | | | | | | | |
| Commercial | $ 34,731 | $ 46,546 | $ 1,167 | $ 38,937 | $ | $ 36,018 | $ |
| Commercial real estate mortgages | 58,217 | 65,043 | 1,874 | 51,854 | 34 | 39,173 | 158 |
| Residential mortgages | 11,342 | 12,393 | 185 | 12,488 | 13 | 11,780 | 52 |
| Real estate construction | 56,582 | 84,838 | 1,467 | 61,556 | 280 | 66,652 | 522 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Equity lines of credit | 4,496 | 5,776 | 138 | 4,465 | | 5,636 | |
| Installment | 449 | 927 | | 500 | | 552 | |
| Lease financing | | | | | | 7 | |
| Total impaired loans | $ 165,817 | $ 215,523 | $ 4,831 | $ 169,800 | $ 327 | $ 159,818 | $ 732 |

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**Note 6. Loans, Allowance for Loan and Lease Losses, and Reserve for Off-Balance Sheet Credit Commitments (Continued)**

| (in thousands) | Recorded Investment | Unpaid Contractual Principal Balance (1) | Related Allowance |
|---|---|---|---|
| **December 31, 2011** | | | |
| With no related allowance recorded: | | | |
| Commercial | $ 10,153 | $ 11,588 | $ |
| Commercial real estate mortgages | 19,867 | 23,983 | |
| Residential mortgages: | | | |
| Fixed | 3,493 | 4,035 | |
| Variable | 3,689 | 4,000 | |
| Total residential mortgages | 7,182 | 8,035 | |
| Real estate construction: | | | |
| Construction | 27,435 | 40,605 | |
| Land | 28,991 | 32,335 | |
| Total real estate construction | 56,426 | 72,940 | |
| Equity lines of credit | 5,341 | 6,325 | |
| Installment: | | | |
| Consumer | 658 | 976 | |
| Total installment | 658 | 976 | |
| Lease financing | 28 | 5,225 | |
| Total with no related allowance | $ 99,655 | $ 129,072 | $ |
| | | | |
| With an allowance recorded: | | | |
| Commercial | $ 15,627 | $ 21,377 | $ 7,135 |
| Commercial real estate mortgages | 10,811 | 11,215 | 1,551 |
| Residential mortgages: | | | |
| Fixed | 515 | 535 | 40 |
| Variable | 1,449 | 1,476 | 68 |
| Total residential mortgages | 1,964 | 2,011 | 108 |
| Real estate construction: | | | |
| Land | 19,385 | 29,381 | 4,377 |
| Total real estate construction | 19,385 | 29,381 | 4,377 |
| Equity lines of credit | 1,292 | 1,461 | 91 |
| Total with an allowance | $ 49,079 | $ 65,445 | $ 13,262 |
| | | | |
| Total impaired loans by type: | | | |
| Commercial | $ 25,780 | $ 32,965 | $ 7,135 |
| Commercial real estate mortgages | 30,678 | 35,198 | 1,551 |
| Residential mortgages | 9,146 | 10,046 | 108 |
| Real estate construction | 75,811 | 102,321 | 4,377 |
| Equity lines of credit | 6,633 | 7,786 | 91 |
| Installment | 658 | 976 | |
| Lease financing | 28 | 5,225 | |
| Total impaired loans | $ 148,734 | $ 194,517 | $ 13,262 |

(1) The table has been revised to present unpaid contractual principal balances, whereas the Company had previously disclosed unpaid contractual principal balances that were net of charge-offs.

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**Note 6. Loans, Allowance for Loan and Lease Losses, and Reserve for Off-Balance Sheet Credit Commitments (Continued)**

| (in thousands) | Recorded Investment | Unpaid Contractual Principal Balance | Related Allowance | For the three months ended September 30, 2011 Average Recorded Investment | For the three months ended September 30, 2011 Interest Income Recognized | For the nine months ended September 30, 2011 Average Recorded Investment | For the nine months ended September 30, 2011 Interest Income Recognized |
|---|---|---|---|---|---|---|---|
| **September 30, 2011** | | | | | | | |
| With no related allowance recorded: | | | | | | | |
| Commercial | $ 4,768 | $ 10,890 | $ | $ 4,388 | $ | $ 5,618 | $ |
| Commercial real estate mortgages | 16,461 | 19,655 | | 15,536 | 42 | 18,265 | 232 |
| Residential mortgages: | | | | | | | |
| Fixed | 4,452 | 5,258 | | 6,143 | 9 | 7,367 | 171 |
| Variable | 3,810 | 4,006 | | 3,986 | 14 | 3,823 | 48 |
| Total residential mortgages | 8,262 | 9,264 | | 10,129 | 23 | 11,190 | 219 |
| Real estate construction: | | | | | | | |
| Construction | 46,895 | 75,355 | | 43,040 | 266 | 52,779 | 671 |
| Land | 23,739 | 28,244 | | 17,505 | | 20,568 | |
| Total real estate construction | 70,634 | 103,599 | | 60,545 | 266 | 73,347 | 671 |
| Equity lines of credit | 5,695 | 6,786 | | 4,058 | | 3,603 | |
| Installment: | | | | | | | |
| Consumer | 653 | 927 | | 347 | | 194 | |
| Total installment | 653 | 927 | | 347 | | 194 | |
| Lease financing | 466 | 3,545 | | 614 | | 868 | 99 |
| Total with no related allowance | $ 106,939 | $ 154,666 | $ | $ 95,617 | $ 331 | $ 113,085 | $ 1,221 |
| | | | | | | | |
| With an allowance recorded: | | | | | | | |
| Commercial | $ 26,802 | $ 78,485 | $ 14,364 | $ 20,635 | $ | $ 14,190 | $ |
| Commercial real estate mortgages | 9,438 | 11,022 | 1,375 | 9,299 | | 11,259 | |
| Residential mortgages: | | | | | | | |
| Fixed | 528 | 542 | | 534 | | 797 | |
| Variable | 1,464 | 1,476 | 130 | 732 | | 1,078 | |
| Total residential mortgages | 1,992 | 2,018 | 130 | 1,266 | | 1,875 | |
| Real estate construction: | | | | | | | |
| Construction | | | | | | 4,417 | |
| Land | 11,931 | 63,889 | 2,989 | 11,053 | | 5,527 | |
| Total real estate construction | 11,931 | 63,889 | 2,989 | 11,053 | | 9,944 | |
| Equity lines of credit | 958 | 980 | 75 | 1,530 | | 1,471 | 6 |
| Installment: | | | | | | | |
| Commercial | | | | | | 1,724 | |
| Total installment | | | | | | 1,724 | |
| Lease financing | | | | | | 214 | |
| Total with an allowance | $ 51,121 | $ 156,394 | $ 18,933 | $ 43,783 | $ | $ 40,677 | $ 6 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Total impaired loans by type: | | | | | | | |
| Commercial | $ 31,570 | $ 89,375 | $ 14,364 | $ 25,023 | $ | $ 19,808 | $ |
| Commercial real estate mortgages | 25,899 | 30,677 | 1,375 | 24,835 | 42 | 29,524 | 232 |
| Residential mortgages | 10,254 | 11,282 | 130 | 11,395 | 23 | 13,065 | 219 |
| Real estate construction | 82,565 | 167,488 | 2,989 | 71,598 | 266 | 83,291 | 671 |
| Equity lines of credit | 6,653 | 7,766 | 75 | 5,588 | | 5,074 | 6 |
| Installment | 653 | 927 | | 347 | | 1,918 | |
| Lease financing | 466 | 3,545 | | 614 | | 1,082 | 99 |
| Total impaired loans | $ 158,060 | $ 311,060 | $ 18,933 | $ 139,400 | $ 331 | $ 153,762 | $ 1,227 |

Effective July 1, 2012, the Company increased the outstanding loan amount under which nonperforming loans are individually evaluated for impairment from $500,000 or greater to $1 million or greater. For borrowers with multiple loans totaling $1 million or more, this threshold is applied at the total relationship level. Loans under $1 million will be measured for impairment using historical loss factors. Loans under $1 million that were previously reported as impaired at June 30, 2012 will continue to be reported as impaired until the collection of principal and interest is no longer in doubt, or the loans are paid or charged-off. At September 30, 2012, impaired loans included $11.1 million of loans previously reported as impaired that are less than $1 million.

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**Note 6. Loans, Allowance for Loan and Lease Losses, and Reserve for Off-Balance Sheet Credit Commitments (Continued)**

Impaired loans at September 30, 2012 and December 31, 2011 included $70.8 million and $46.6 million, respectively, of restructured loans that are on accrual status. With the exception of restructured loans on accrual status and a limited number of loans on cash basis nonaccrual for which the full collection of principal and interest is expected, interest income is not recognized on impaired loans until the principal balance of these loans is paid off.

*Troubled Debt Restructured Loans*

The following tables provide a summary of loans modified in a troubled debt restructuring during the three and nine months ended September 30, 2012:

| (in thousands) | Number of Contracts | Pre-Modification Outstanding Principal | Period-End Outstanding Principal | Financial Effects (1) |
|---|---|---|---|---|
| **Three months ended September 30, 2012** | | | | |
| Commercial | 6 | $ 1,624 | $ 1,538 | $ 10,528 |
| Residential mortgages: | | | | |
| Fixed | 3 | 1,578 | 1,078 | 485 |
| Real estate construction: | | | | |
| Land | 1 | 8,420 | 8,098 | 264 |
| Equity lines of credit | 1 | 257 | 149 | |
| Total troubled debt restructured loans | 11 | $ 11,879 | $ 10,863 | $ 11,277 |
| | | | | |
| **Nine months ended September 30, 2012** | | | | |
| Commercial | 15 | $ 36,785 | $ 23,219 | $ 10,528 |
| Commercial real estate mortgages | 2 | 15,832 | 16,353 | |
| Residential mortgages: | | | | |
| Fixed | 4 | 2,233 | 1,078 | 485 |
| Real estate construction: | | | | |
| Construction | 3 | 14,857 | 14,226 | |
| Land | 1 | 8,420 | 8,098 | 264 |
| Total real estate construction | 4 | 23,277 | 22,324 | 264 |
| Equity lines of credit | 1 | 257 | 149 | |
| Total troubled debt restructured loans | 26 | $ 78,384 | $ 63,123 | $ 11,277 |

(1) Financial effects are comprised of charge-offs and specific reserves recognized on TDR loans at modification date.

The following table provides a summary of troubled debt restructured ( TDR ) loans that subsequently defaulted during the nine months ended September 30, 2012, that had been modified as a troubled debt restructuring during the 12 months prior to their default:

| (in thousands) | For the three months ended September 30, 2012 Number of Contracts | Period-End Outstanding Principal | Period-End Specific Reserve | For the nine months ended September 30, 2012 Number of Contracts | Period-End Outstanding Principal | Period-End Specific Reserve |
|---|---|---|---|---|---|---|
| Commercial | 1 | $ 688 | $ | 5 | $ 4,581 | $ 277 |
| Real estate construction: | | | | | | |
| Land | | | | 2 | $ 1,372 | |
| Total loans that subsequently defaulted | 1 | $ 688 | $ | 7 | $ 5,953 | $ 277 |

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**Note 6. Loans, Allowance for Loan and Lease Losses, and Reserve for Off-Balance Sheet Credit Commitments (Continued)**

A restructuring constitutes a troubled debt restructuring when a lender, for reasons related to a borrower s financial difficulties, grants a concession to the borrower it would not otherwise consider. Loans with pre-modification outstanding balances totaling $11.9 million and $78.4 million were modified in troubled debt restructurings during the three and nine months ended September 30, 2012. The concessions granted in the restructurings completed in 2012 largely consisted of interest rate concessions and modification of payment terms to interest only. The unpaid principal balance of TDR loans was $113.8 million, before specific reserves of $1.3 million, at September 30, 2012 and $89.4 million, before specific reserves of $1.7 million, at December 31, 2011. The net increase in TDR loans from the prior year-end was attributable to $80.4 million of additions that were partially offset by $39.7 million of payments received and $15.5 million of charge-offs. The remaining change in TDR loans was a result of other adjustments. Loans modified in troubled debt restructurings are impaired loans at the time of restructuring and subject to the same measurement criteria as all other impaired loans.

During the nine months ended September 30, 2012, five commercial loans and two land loans that had been restructured within the preceding 12 months were not performing in accordance with their new terms. The defaults were primarily due to missed or late payments. Additionally a land loan went into technical default in the second quarter of 2012 when the borrower failed to sell the collateral by the date specified in the restructuring agreement. All other TDR loans were performing in accordance with their restructured terms at September 30, 2012. As of September 30, 2012, there were no commitments to lend additional funds on restructured loans.

*Past Due and Nonaccrual Loans and Leases*

Loans are considered past due following the date when either interest or principal is contractually due and unpaid. The following tables provide a summary of past due and nonaccrual loans, excluding covered loans, at September 30, 2012 and December 31, 2011 based upon the length of time the loans have been past due:

| (in thousands) | 30-59 Days Past Due | 60-89 Days Past Due | Greater Than 90 Days and Accruing | Nonaccrual | Total Past Due and Nonaccrual Loans | Current | Total Loans and Leases |
|---|---|---|---|---|---|---|---|
| **September 30, 2012** | | | | | | | |
| Commercial | $ 4,993 | $ 401 | $ 35 | $ 18,728 | $ 24,157 | $ 5,530,364 | $ 5,554,521 |
| Commercial real estate mortgages | 7,118 | | | 36,580 | 43,698 | 2,419,966 | 2,463,664 |
| Residential mortgages: | | | | | | | |
| Fixed | | 3,325 | 379 | 6,530 | 10,234 | 1,478,559 | 1,488,793 |
| Variable | | | | 5,150 | 5,150 | 2,403,747 | 2,408,897 |
| Total residential mortgages | | 3,325 | 379 | 11,680 | 15,384 | 3,882,306 | 3,897,690 |
| Real estate construction: | | | | | | | |
| Construction | | | | 15,080 | 15,080 | 151,157 | 166,237 |
| Land | 2,582 | | | 13,883 | 16,465 | 59,435 | 75,900 |
| Total real estate construction | 2,582 | | | 28,963 | 31,545 | 210,592 | 242,137 |
| Equity lines of credit | | 950 | | 6,946 | 7,896 | 711,070 | 718,966 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Installment: | | | | | | | |
| Commercial | | | | | | 452 | 452 |
| Consumer | 40 | 23 | | 477 | 540 | 136,640 | 137,180 |
| Total installment | 40 | 23 | | 477 | 540 | 137,092 | 137,632 |
| Lease financing | | 112 | 19 | 120 | 251 | 709,790 | 710,041 |
| Total | $ 14,733 | $ 4,811 | $ 433 | $ 103,494 | $ 123,471 | $ 13,601,180 | $ 13,724,651 |

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**Note 6. Loans, Allowance for Loan and Lease Losses, and Reserve for Off-Balance Sheet Credit Commitments (Continued)**

| (in thousands) | 30-59 Days Past Due | 60-89 Days Past Due | Greater Than 90 Days and Accruing | Nonaccrual | Total Past Due and Nonaccrual Loans | Current | Total Loans and Leases |
|---|---|---|---|---|---|---|---|
| **December 31, 2011** | | | | | | | |
| Commercial | $ 6,817 | $ 1,003 | $ | $ 19,888 | $ 27,708 | $ 4,818,886 | $ 4,846,594 |
| Commercial real estate mortgages | 5,838 | | | 21,948 | 27,786 | 2,082,963 | 2,110,749 |
| Residential mortgages: | | | | | | | |
| Fixed | 662 | 525 | 379 | 5,572 | 7,138 | 1,574,658 | 1,581,796 |
| Variable | | 2,983 | | 4,199 | 7,182 | 2,174,240 | 2,181,422 |
| Total residential mortgages | 662 | 3,508 | 379 | 9,771 | 14,320 | 3,748,898 | 3,763,218 |
| Real estate construction: | | | | | | | |
| Construction | | | | 15,582 | 15,582 | 202,279 | 217,861 |
| Land | | | | 35,294 | 35,294 | 62,454 | 97,748 |
| Total real estate construction | | | | 50,876 | 50,876 | 264,733 | 315,609 |
| Equity lines of credit | | | 74 | 8,669 | 8,743 | 732,338 | 741,081 |
| Installment: | | | | | | | |
| Commercial | | | | 4 | 4 | 601 | 605 |
| Consumer | 150 | | | 870 | 1,020 | 131,022 | 132,042 |
| Total installment | 150 | | | 874 | 1,024 | 131,623 | 132,647 |
| Lease financing | | | | | | 399,487 | 399,487 |
| Total | $ 13,467 | $ 4,511 | $ 453 | $ 112,026 | $ 130,457 | $ 12,178,928 | $ 12,309,385 |

*Credit Quality Monitoring*

The Company closely monitors and assesses credit quality and credit risk in the loan and lease portfolio on an ongoing basis. Loan risk classifications are continuously reviewed and updated. The following tables provide a summary of the loan and lease portfolio, excluding covered loans, by loan type and credit quality classification as of September 30, 2012 and December 31, 2011. Nonclassified loans generally include those loans that are expected to be repaid in accordance with contractual loan terms. Classified loans are those loans that are classified as substandard or doubtful consistent with regulatory guidelines.

| | September 30, 2012 | | | December 31, 2011 | | |
|---|---|---|---|---|---|---|
| (in thousands) | Nonclassified | Classified | Total | Nonclassified | Classified | Total |
| Commercial | $ 5,413,587 | $ 140,934 | $ 5,554,521 | $ 4,732,663 | $ 113,931 | $ 4,846,594 |
| Commercial real estate mortgages | 2,330,210 | 133,454 | 2,463,664 | 1,930,001 | 180,748 | 2,110,749 |
| Residential mortgages: | | | | | | |
| Fixed | 1,472,865 | 15,928 | 1,488,793 | 1,565,420 | 16,376 | 1,581,796 |
| Variable | 2,390,863 | 18,034 | 2,408,897 | 2,163,458 | 17,964 | 2,181,422 |
| Total residential mortgages | 3,863,728 | 33,962 | 3,897,690 | 3,728,878 | 34,340 | 3,763,218 |
| Real estate construction: | | | | | | |
| Construction | 110,208 | 56,029 | 166,237 | 147,916 | 69,945 | 217,861 |
| Land | 44,918 | 30,982 | 75,900 | 43,717 | 54,031 | 97,748 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Total real estate construction | 155,126 | 87,011 | 242,137 | 191,633 | 123,976 | 315,609 |
| Equity lines of credit | 698,997 | 19,969 | 718,966 | 724,045 | 17,036 | 741,081 |
| Installment: | | | | | | |
| Commercial | 452 | | 452 | 601 | 4 | 605 |
| Consumer | 136,470 | 710 | 137,180 | 130,921 | 1,121 | 132,042 |
| Total installment | 136,922 | 710 | 137,632 | 131,522 | 1,125 | 132,647 |
| Lease financing | 704,040 | 6,001 | 710,041 | 396,256 | 3,231 | 399,487 |
| Total | $ 13,302,610 | $ 422,041 | $ 13,724,651 | $ 11,834,998 | $ 474,387 | $ 12,309,385 |

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**Note 6. Loans, Allowance for Loan and Lease Losses, and Reserve for Off-Balance Sheet Credit Commitments (Continued)**

***Credit Quality on Covered Loans***

The following is a summary of activity in the allowance for loan losses on covered loans:

| (in thousands) | For the three months ended September 30, 2012 | For the three months ended September 30, 2011 | For the nine months ended September 30, 2012 | For the nine months ended September 30, 2011 |
|---|---|---|---|---|
| Balance, beginning of period | $ 43,147 | $ 67,629 | $ 64,565 | $ 67,389 |
| Provision for losses | 18,089 | 5,147 | 38,848 | 25,979 |
| Charge-offs | | (325) | | (325) |
| Reduction in allowance due to loan removals | (16,258) | (10,698) | (58,435) | (31,290) |
| Balance, end of period | $ 44,978 | $ 61,753 | $ 44,978 | $ 61,753 |

The allowance for loan losses on covered loans was $45.0 million, $64.6 million and $61.8 million as of September 30, 2012, December 31, 2011 and September 30, 2011, respectively. The Company recorded provision expense of $18.1 million and $38.8 million on covered loans for the three and nine months ended September 30, 2012, respectively, and $5.1 million and $26.0 million for the three and nine months ended September 30, 2011, respectively. The Company updates its cash flow projections for covered loans accounted for under ASC 310-30 on a quarterly basis, and may recognize provision expense and an allowance for loan losses as a result of that analysis. The loss on covered loans is the result of changes in expected cash flows, both amount and timing, due to loan payments and the Company s revised loss forecasts. The revisions of the loss forecasts were based on the results of management s review of the credit quality of the outstanding covered loans and the analysis of the loan performance data since the acquisition of covered loans. The allowance for loan losses on covered loans is reduced for any loan removals. A loan is removed when it has been fully paid-off, fully charged off, sold or transferred to OREO.

Covered loans accounted for under ASC 310-30 are generally considered accruing and performing loans as the loans accrete interest income over the estimated life of the loan when cash flows are reasonably estimable. Accordingly, acquired impaired loans that are contractually past due are still considered to be accruing and performing loans. If the timing and amount of future cash flows is not reasonably estimable, the loans may be classified as nonaccrual loans and interest income is not recognized until the timing and amount of future cash flows can be reasonably estimated. At September 30, 2012 and December 31, 2011, there were no acquired impaired covered loans accounted for under ASC 310-30 that were on nonaccrual status. There were no covered loans outside the scope of ASC 310-30 that were on nonaccrual status or considered impaired as of September 30, 2012. Of the population of covered loans that are accounted for outside the scope of ASC 310-30, the Company had $0.4 million of acquired covered loans that were on nonaccrual status and were considered to be impaired as of December 31, 2011.

At September 30, 2012, covered loans that were 30 to 89 days delinquent totaled $15.6 million and covered loans that were 90 days or more past due on accrual status totaled $140.0 million. At December 31, 2011, covered loans that were 30 to 89 days delinquent totaled $49.1 million and covered loans that were 90 days or more past due on accrual status totaled $330.2 million.

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**Note 7. Other Real Estate Owned**

The following table provides a summary of OREO activity for the three months ended September 30, 2012 and 2011:

| (in thousands) | For the three months ended September 30, 2012 Non-Covered OREO | Covered OREO | Total | For the three months ended September 30, 2011 Non-Covered OREO | Covered OREO | Total |
|---|---|---|---|---|---|---|
| Balance, beginning of period | $ 34,667 | $ 82,834 | $ 117,501 | $ 47,634 | $ 114,907 | $ 162,541 |
| Additions | 1,485 | 14,989 | 16,474 | 1,647 | 15,271 | 16,918 |
| Sales | (8,364) | (9,938) | (18,302) | (3,894) | (19,804) | (23,698) |
| Valuation adjustments | (733) | (4,267) | (5,000) | (866) | (7,526) | (8,392) |
| Balance, end of period | $ 27,055 | $ 83,618 | $ 110,673 | $ 44,521 | $ 102,848 | $ 147,369 |

The following table provides a summary of OREO activity for the nine months ended September 30, 2012 and 2011:

| (in thousands) | For the nine months ended September 30, 2012 Non-Covered OREO | Covered OREO | Total | For the nine months ended September 30, 2011 Non-Covered OREO | Covered OREO | Total |
|---|---|---|---|---|---|---|
| Balance, beginning of period | $ 30,790 | $ 98,550 | $ 129,340 | $ 57,317 | $ 120,866 | $ 178,183 |
| Additions | 14,177 | 44,025 | 58,202 | 12,175 | 76,398 | 88,573 |
| Sales | (12,781) | (42,632) | (55,413) | (21,041) | (62,957) | (83,998) |
| Valuation adjustments | (5,131) | (16,325) | (21,456) | (3,930) | (31,459) | (35,389) |
| Balance, end of period | $ 27,055 | $ 83,618 | $ 110,673 | $ 44,521 | $ 102,848 | $ 147,369 |

At September 30, 2012, OREO was $110.7 million and included $83.6 million of covered OREO. At December 31, 2011, OREO was $129.3 million and included $98.6 million of covered OREO. The balance of OREO at September 30, 2012 and December 31, 2011 is net of valuation allowances of $36.9 million and $37.4 million, respectively.

Covered OREO expenses and valuation write-downs are recorded in the noninterest expense section of the consolidated statements of income. Under the loss-sharing agreements, 80 percent of eligible covered OREO expenses and valuation write-downs are reimbursable to the Company from the FDIC. The portion of these expenses that is reimbursable is recorded in FDIC loss sharing income (expense), net in the noninterest income section of the consolidated statements of income.

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**Note 8. Borrowed Funds**

Short-term borrowings consist of funds with remaining maturities of one year or less and long-term debt consists of borrowings with remaining maturities greater than one year. The components of short-term borrowings and long-term debt as of September 30, 2012 and December 31, 2011 are provided below:

| (in thousands) (1) | | September 30, 2012 | | December 31, 2011 |
|---|---|---|---|---|
| **Short-term borrowings** | | | | |
| Current portion of senior notes: | | | | |
| City National Corporation - 5.125% Senior Notes Due February 2013 | $ | 208,566 | $ | |
| Federal funds purchased | | | | 50,000 |
| Current portion of nonrecourse debt (5) | | 3,173 | | |
| Total short-term borrowings | $ | 211,739 | $ | 50,000 |
| | | | | |
| **Long-term debt** | | | | |
| Senior notes: | | | | |
| City National Corporation - 5.125% Senior Notes Due February 2013 | $ | | $ | 215,848 |
| City National Corporation - 5.25% Senior Notes Due September 2020 | | 297,537 | | 297,308 |
| Subordinated debt: | | | | |
| City National Bank - 9.00% Subordinated Notes Due July 2019 (2) | | 49,746 | | 49,718 |
| City National Bank - 9.00% Subordinated Notes Due August 2019 | | 74,872 | | 74,858 |
| City National Bank - Fixed and Floating Subordinated Notes due August 2019 (3) | | 54,906 | | 54,895 |
| City National Bank - 5.375% Subordinated Notes Due July 2022 | | 148,606 | | |
| Junior subordinated debt: | | | | |
| Floating Rate Business Bancorp Capital Trust I Securities due November 2034 (4) | | 5,151 | | 5,151 |
| Nonrecourse debt (5) | | 75,217 | | |
| Total long-term debt | $ | 706,035 | $ | 697,778 |

(1) The carrying value of certain borrowed funds is net of discount and issuance costs, which are being amortized into interest expense, as well as the impact of fair value hedge accounting, if applicable.

(2) These notes bear a fixed interest rate of 9 percent for the initial five years from the date of issuance (July 15, 2009) and thereafter the rate is reset at the Bank s option to either LIBOR plus 600 basis points or to prime plus 500 basis points.

(3) These notes bear a fixed interest rate of 9 percent for the initial five years from the date of issuance (August 12, 2009) and thereafter bear an interest rate equal to the three-month LIBOR rate plus 6 percent. The rate is reset quarterly and is subject to an interest rate cap of 10 percent throughout the term of the notes.

(4) These floating rate securities pay interest of three-month LIBOR plus 1.965 percent which is reset quarterly. As of September 30, 2012, the interest rate was 2.40 percent.

(5) Nonrecourse debt bears interest at an average rate of 4.04 percent as of September 30, 2012 and has maturity dates ranging from October 2012 to June 2018.

On April 30, 2012, the Company assumed $320.9 million in borrowings in its acquisition of FAEF. Subsequent to the acquisition date, the Company paid off a significant portion of the outstanding balance and as of September 30, 2012, FAEF borrowings were comprised of $78.4 million of nonrecourse debt. FAEF assigns the future rentals of certain lease financing loans to financial institutions on a nonrecourse basis at fixed interest rates. In return for future minimum lease rentals assigned, FAEF receives a discounted cash payment. Proceeds from discounting are reflected in the table above as nonrecourse debt.

On June 20, 2012, the Bank issued $150.0 million in subordinated notes that bear a fixed rate of interest of 5.375 percent. The notes mature on July 15, 2022. The proceeds were used for general corporate purposes.

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**Note 9. Shareholders   Equity**

The components of AOCI at September 30, 2012 and December 31, 2011 are as follows:

| (in thousands) | September 30, 2012 | December 31, 2011 |
|---|---|---|
| Net unrealized gain on securities available-for-sale | $ 93,827 | $ 73,235 |
| Net unrealized gain on cash flow hedges | 97 | 222 |
| Pension liability adjustment | | (1,085) |
| Total accumulated other comprehensive income | $ 93,924 | $ 72,372 |

The following table presents the tax effects allocated to each component of other comprehensive income for the three and nine month periods ended September 30, 2012 and 2011:

| | For the three months ended September 30, 2012 | | | For the three months ended September 30, 2011 | | |
|---|---|---|---|---|---|---|
| (in thousands) | Pre-tax | Tax expense (benefit) | Net-of-tax | Pre-tax | Tax expense (benefit) | Net-of-tax |
| Securities available-for-sale: | | | | | | |
| Net unrealized gains arising during the period | $ 20,701 | $ 8,659 | $ 12,042 | $ 52,472 | $ 21,949 | $ 30,523 |
| Reclassification adjustment for net gains included in net income | (48) | (20) | (28) | (3,060) | (1,280) | (1,780) |
| Non-credit related impairment loss | (1,471) | (615) | (856) | (4,356) | (1,823) | (2,533) |
| Net change on cash flow hedges | (42) | | (42) | 32 | | 32 |
| Pension liability adjustment | | | | (68) | | (68) |
| Total other comprehensive income | $ 19,140 | $ 8,024 | $ 11,116 | $ 45,020 | $ 18,846 | $ 26,174 |

| | For the nine months ended September 30, 2012 | | | For the nine months ended September 30, 2011 | | |
|---|---|---|---|---|---|---|
| (in thousands) | Pre-tax | Tax expense (benefit) | Net-of-tax | Pre-tax | Tax expense (benefit) | Net-of-tax |
| Securities available-for-sale: | | | | | | |
| Net unrealized gains arising during the period | $ 37,330 | $ 15,615 | $ 21,715 | $ 89,108 | $ 37,274 | $ 51,834 |
| Reclassification adjustment for net gains included in net income | (459) | (192) | (267) | (4,955) | (2,073) | (2,882) |
| Non-credit related impairment loss | (1,471) | (615) | (856) | (4,356) | (1,823) | (2,533) |
| Net change on cash flow hedges | (125) | | (125) | (903) | | (903) |
| Pension liability adjustment | 1,085 | | 1,085 | 98 | | 98 |
| | $ 36,360 | $ 14,808 | $ 21,552 | $ 78,992 | $ 33,378 | $ 45,614 |

| | |
|---|---|
| Total other comprehensive income | |

The following table summarizes the Company s share repurchases for the three months ended September 30, 2012. All repurchases relate to shares withheld or previously owned shares used to pay taxes due upon vesting of restricted stock. There were no issuer repurchases of the Corporation s common stock as part of its repurchase plan for the nine months ended September 30, 2012.

| **Period** | **Total Number of Shares (or Units) Purchased** | | **Average Price Paid per Share (or Unit)** |
|---|---|---|---|
| July 1, 2012 to July 31, 2012 | 2,180 | $ | 49.23 |
| August 1, 2012 to August 31, 2012 | 12 | | 51.35 |
| September 1, 2012 to September 30, 2012 | 2,198 | | 52.32 |
| | 4,390 | | 50.78 |

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**Note 10. Earnings per Common Share**

The Company applies the two-class method of computing basic and diluted EPS. Under the two-class method, EPS is determined for each class of common stock and participating security according to dividends declared and participation rights in undistributed earnings. The Company grants restricted stock and restricted stock units under a share-based compensation plan that qualify as participating securities.

The computation of basic and diluted EPS is presented in the following table:

| (in thousands, except per share amounts) | For the three months ended September 30, 2012 | 2011 | For the nine months ended September 30, 2012 | 2011 |
|---|---|---|---|---|
| **Basic EPS:** | | | | |
| Net income attributable to City National Corporation | $ 59,780 | $ 41,398 | $ 160,803 | $ 128,561 |
| Less: Earnings allocated to participating securities | 842 | 655 | 2,380 | 1,988 |
| Earnings allocated to common shareholders | $ 58,938 | $ 40,743 | $ 158,423 | $ 126,573 |
| Weighted average common shares outstanding | 53,425 | 52,481 | 53,092 | 52,422 |
| Basic earnings per common share | $ 1.10 | $ 0.78 | $ 2.98 | $ 2.41 |
| **Diluted EPS:** | | | | |
| Earnings allocated to common shareholders (1) | $ 58,941 | $ 40,745 | $ 158,432 | $ 126,586 |
| Weighted average common shares outstanding | 53,425 | 52,481 | 53,092 | 52,422 |
| Dilutive effect of equity awards | 286 | 239 | 284 | 460 |
| Weighted average diluted common shares outstanding | 53,711 | 52,720 | 53,376 | 52,882 |
| Diluted earnings per common share | $ 1.10 | $ 0.77 | $ 2.97 | $ 2.39 |

(1) Earnings allocated to common shareholders for basic and diluted EPS may differ under the two-class method as a result of adding common stock equivalents for options to dilutive shares outstanding, which alters the ratio used to allocate earnings to common shareholders and participating securities for the purposes of calculating diluted EPS.

The average price of the Company s common stock for the period is used to determine the dilutive effect of outstanding stock options. Antidilutive stock options are not included in the calculation of basic or diluted EPS. There were 2.4 million and 3.8 million average outstanding stock options that were antidilutive for the three months ended September 30, 2012 and 2011, respectively. There were 2.7 million and 2.5 million average outstanding stock options that were antidilutive for the nine months ended September 30, 2012 and 2011, respectively.

**Note 11. Share-Based Compensation**

On September 30, 2012, the Company had one share-based compensation plan, the Amended and Restated City National Corporation 2008 Omnibus Plan (the Plan ), which was originally approved by the Company s shareholders on April 23, 2008. No new awards have been or will be granted under predecessor plans since the adoption of the Plan. The Plan permits the grant of stock options, restricted stock, restricted stock units, performance shares, performance share units, performance units and stock appreciation rights, or any combination thereof, to the Company s eligible employees and non-employee directors. No grants of performance shares, performance share units or stock appreciation rights had been made as of September 30, 2012. At September 30, 2012, there were approximately 1.9 million shares available for future grants. Refer to the Company s Annual Report on Form 10-K for the year ended December 31, 2011 for further discussion of the Company s share-based compensation plan.

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**Note 11. Share-Based Compensation (Continued)**

The compensation cost that has been recognized for all share-based awards was $4.7 million and $13.7 million for the three and nine months ended September 30, 2012, respectively, compared with $4.7 million and $14.2 million for the three and nine months ended September 30, 2011, respectively. The total income tax benefit recognized in the consolidated statements of income for share-based compensation arrangements was $2.0 million and $5.7 million for the three and nine months ended September 30, 2012, respectively, compared with $2.0 million and $5.9 million for the three and nine months ended September 30, 2011, respectively. The Company received $21.7 million and $4.8 million in cash for the exercise of stock options during the nine months ended September 30, 2012 and 2011, respectively. The actual tax benefit realized for the tax deductions from stock option exercises was $2.0 million and $1.1 million for the nine months ended September 30, 2012 and 2011, respectively.

To estimate the fair value of stock option awards, the Company uses the Black-Scholes methodology, which incorporates the assumptions summarized in the table below:

| | For the three months ended September 30, | | For the nine months ended September 30, | |
|---|---|---|---|---|
| | **2012** | **2011** | **2012** | **2011** |
| Weighted-average volatility | | 30.87% | 30.58% | 30.90% |
| Dividend yield | | 2.65% | 2.14% | 1.66% |
| Expected term (in years) | | 6.51 | 6.11 | 6.11 |
| Risk-free interest rate | | 2.35% | 1.44% | 2.87% |

Using the Black-Scholes methodology, the weighted-average grant-date fair values of options granted during the nine months ended September 30, 2012 and 2011 were $11.64 and $17.67, respectively. The total intrinsic values of options exercised during the nine months ended September 30, 2012 and 2011 were $7.6 million and $2.6 million, respectively.

A summary of option activity and related information for the nine months ended September 30, 2012 is presented below:

| **Options** | **Number of Shares (in thousands)** | **Weighted Average Exercise Price (per share)** | **Aggregate Intrinsic Value (in thousands) (1)** | **Weighted Average Remaining Contractual Term** |
|---|---|---|---|---|
| Outstanding at January 1, 2012 | 4,990 | $ 52.61 | | |
| Granted | 603 | 46.66 | | |
| Exercised | (575) | 37.65 | | |
| Forfeited or expired | (550) | 51.84 | | |
| Outstanding at September 30, 2012 | 4,468 | $ 53.83 | $ 240,491 | 5.81 |
| Exercisable at September 30, 2012 | 2,927 | $ 57.15 | $ 167,249 | 4.50 |

(1) Includes in-the-money options only.

A summary of changes in unvested options and related information for the nine months ended September 30, 2012 is presented below:

| **Unvested Options** | **Number of Shares (in thousands)** | | **Weighted Average Grant Date Fair Value (per share)** |
|---|---|---|---|
| Unvested at January 1, 2012 | 1,641 | $ | 13.57 |
| Granted | 603 | | 11.64 |
| Vested | (669) | | 12.32 |
| Forfeited | (34) | | 13.07 |
| Unvested at September 30, 2012 | 1,541 | $ | 13.36 |

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**Note 11. Share-Based Compensation (Continued)**

The number of options vested during the nine months ended September 30, 2012 and 2011 was 669,241 and 635,675, respectively. The total fair value of options vested during the nine months ended September 30, 2012 and 2011 was $8.2 million and $7.6 million, respectively. As of September 30, 2012, there was $14.4 million of unrecognized compensation cost related to unvested stock options granted under the Company s plans. That cost is expected to be recognized over a weighted-average period of 2.5 years.

A summary of changes in restricted stock and related information for the nine months ended September 30, 2012 is presented below:

| Restricted Stock (1) | Number of Shares (in thousands) | | Weighted Average Grant Date Fair Value (per share) |
|---|---|---|---|
| Unvested at January 1, 2012 | 875 | $ | 50.12 |
| Granted | 81 | | 47.04 |
| Vested | (188) | | 46.39 |
| Forfeited | (14) | | 48.66 |
| Unvested at September 30, 2012 | 754 | $ | 50.74 |

(1) Includes restricted stock units.

Restricted stock is valued at the closing price of the Company s stock on the date of award. The weighted-average grant-date fair value of restricted stock granted during the nine months ended September 30, 2012 and 2011 was $47.04 and $60.66, respectively. The number of restricted shares vested during the nine months ended September 30, 2012 and 2011 was 187,898 and 152,663, respectively. The total fair value of restricted stock vested during the nine months ended September 30, 2012 and 2011 was $8.7 million and $7.5 million, respectively. As of September 30, 2012, the unrecognized compensation cost related to restricted stock granted under the Company s plans was $22.4 million. That cost is expected to be recognized over a weighted-average period of 3.1 years.

In February 2012, the Company amended the Plan to permit the grant of cash-settled restricted stock units. In general, twenty-five percent of the cash-settled restricted stock units vests two years from the date of grant, then twenty-five percent vests on each of the next three consecutive grant anniversary dates. The units are subject to forfeiture until the restrictions lapse or terminate. Upon vesting, the units are converted to cash based on the closing stock price at vesting date and distributed to plan participants. Plan participants are entitled to dividends, which vest and are paid at the same time as the underlying cash-settled restricted stock units. Dividends are subject to forfeiture in the same manner as the underlying cash-settled restricted stock units. A summary of changes in cash-settled restricted stock units for the nine months ended September 30, 2012 is presented below:

| Cash-Settled Restricted Stock Units | Number of Shares (in thousands) |
|---|---|
| Unvested at January 1, 2012 | |
| Granted | 99 |

| | |
|---|---|
| Forfeited | (1) |
| Unvested at September 30, 2012 | 98 |

Cash-settled restricted stock units are initially valued at the closing price of the Company s stock on the date of award and subsequently remeasured at each reporting date until settlement. The compensation expense related to cash-settled restricted stock units for the three and nine months ended September 30, 2012 was $0.4 million and $0.8 million, respectively.

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**Note 12. Derivative Instruments**

The following table summarizes the fair value and balance sheet classification of derivative instruments as of September 30, 2012 and December 31, 2011. The notional amount of the contract is not recorded on the consolidated balance sheets, but is used as the basis for determining the amount of interest payments to be exchanged between the counterparties. If a counterparty fails to perform, the Company s counterparty credit risk is equal to the amount reported as a derivative asset.

**Notional Amounts and Fair Values of Derivative Instruments**

| (in millions) (1) | September 30, 2012 Notional Amount | September 30, 2012 Derivative Assets | September 30, 2012 Derivative Liabilities | December 31, 2011 Notional Amount | December 31, 2011 Derivative Assets | December 31, 2011 Derivative Liabilities |
|---|---|---|---|---|---|---|
| **Derivatives designated as hedging instruments** | | | | | | |
| Interest-rate swaps - fair value: | | | | | | |
| Long-term and subordinated debt | 205.5 | 4.2 | | 207.4 | 9.8 | |
| Total derivatives designated as hedging instruments | $ 205.5 | $ 4.2 | $ | $ 207.4 | $ 9.8 | $ |
| **Derivatives not designated as hedging instruments** | | | | | | |
| Interest rate contracts: | | | | | | |
| Swaps | $ 1,963.1 | $ 64.7 | $ 66.3 | $ 1,482.1 | $ 51.3 | $ 52.5 |
| Interest-rate caps, floors and collars | 210.7 | 0.1 | 0.1 | 267.1 | 0.3 | 0.3 |
| Options purchased | 2.0 | 0.2 | 0.2 | 2.0 | 0.1 | 0.1 |
| Options written | 2.0 | | | 2.0 | | |
| Total interest-rate contracts | $ 2,177.8 | $ 65.0 | $ 66.6 | $ 1,753.2 | $ 51.7 | $ 52.9 |
| Option contracts | $ | $ 1.3 | $ | $ | $ 0.7 | $ |
| Foreign exchange contracts: | | | | | | |
| Spot and forward contracts | $ 298.5 | $ 1.8 | $ 1.6 | $ 203.8 | $ 2.1 | $ 2.1 |
| Options purchased | 1.9 | | | | | |
| Options written | 1.9 | 0.1 | 0.1 | | | |
| Total foreign exchange contracts | $ 302.3 | $ 1.9 | $ 1.7 | $ 203.8 | $ 2.1 | $ 2.1 |
| Total derivatives not designated as hedging instruments | $ 2,480.1 | $ 68.2 | $ 68.3 | $ 1,957.0 | $ 54.5 | $ 55.0 |

(1) Derivative assets include the estimated gain to settle a derivative contract net of cash collateral received from counterparties plus net interest receivable. Derivative liabilities include the estimated loss to settle a derivative contract.

*Derivatives Designated as Hedging Instruments*

As of September 30, 2012, the Company had $205.5 million notional amount of interest-rate swap hedge transactions, all of which were designated as fair value hedges. There were no cash flow hedges at September 30, 2012. The positive fair value of the fair value hedges of $4.2 million is recorded in other assets. It includes a mark-to-market asset of $3.1 million and net interest receivable of $1.1 million. The balance of borrowings reported in the consolidated balance sheet includes a $3.1 million mark-to-market adjustment associated with interest-rate hedge transactions.

As of December 31, 2011, the Company had $207.4 million notional amount of interest-rate swap hedge transactions, all of which were designated as fair value hedges. There were no cash flow hedges outstanding at December 31, 2011. The positive fair value of the fair value hedges of $9.8 million is recorded in other assets. It includes a mark-to-market asset of $8.8 million and net interest receivable of $1.0 million. The balance of deposits and borrowings reported in the consolidated balance sheet include a $8.8 million mark-to-market adjustment associated with interest-rate hedge transactions.

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**Note 12. Derivative Instruments (Continued)**

The periodic net settlement of interest-rate swaps is recorded as an adjustment to interest income or interest expense. The impact of interest-rate swaps on interest income and interest expense for the three and nine months ended September 30, 2012 and 2011 is provided below:

| **(in millions)**<br>**Derivatives Designated as Hedging Instruments** | **Location in Consolidated Statements of Income** | **For the three months ended September 30,** | | **For the nine months ended September 30,** | |
|---|---|---|---|---|---|
| | | **2012** | **2011** | **2012** | **2011** |
| Interest-rate swaps-fair value | Interest expense | $ (2.1) | $ (3.5) | $ (6.2) | $ (12.0) |
| Interest-rate swaps-cash flow | Interest income | | 0.1 | 0.1 | 0.9 |
| Total income | | $ 2.1 | $ 3.6 | $ 6.3 | $ 12.9 |

Fair value interest-rate swaps increased net interest income by $2.1 million and $6.3 million for the three and nine months ended September 30, 2012, respectively, and by $3.6 million and $12.9 million for the three and nine months ended September 30, 2011, respectively.

Changes in fair value of the effective portion of cash flow hedges are reported in AOCI. When the cash flows associated with the hedged item are realized, the gain or loss included in AOCI is recognized in Interest income on loans and leases, the same location in the consolidated statements of income as the income on the hedged item. There were no cash flow hedges outstanding during the nine month periods ended September 30, 2012 and September 30, 2011. The $0.1 million of gain on cash flow hedges reclassified from AOCI to interest income for the nine months ended September 30, 2012 represents the amortization of deferred gains on cash flow hedges that were terminated in 2010 prior to their respective maturity dates for which the hedge transactions had yet to occur. The amount of gains on cash flow hedges reclassified from AOCI to interest income for the three and nine months ended September 30, 2011 was $0.1 million and $0.9 million, respectively. At September 30, 2012, the balance of deferred gain on terminated swaps reported in AOCI was $0.1 million. This balance will be amortized into interest income within the next 12 months.

*Derivatives Not Designated as Hedging Instruments*

Derivative contracts not designated as hedges are composed primarily of interest rate contracts with clients that are offset by paired trades with unrelated bank counterparties and foreign exchange contracts. Derivative contracts not designated as hedges are marked-to-market each reporting period with changes in fair value recorded as a part of Noninterest income in the consolidated statements of income. The table below provides the amount of gains and losses on these derivative contracts for the three and nine months ended September 30, 2012 and 2011:

| **(in millions)**<br>**Derivatives Not Designated as Hedging Instruments** | **Location in Consolidated Statements of Income** | **For the three months ended September 30,** | | **For the nine months ended September 30,** | |
|---|---|---|---|---|---|
| | | **2012** | **2011** | **2012** | **2011** |
| Interest-rate contracts | Other noninterest income | $ 0.1 | $ (1.0) | $ (0.5) | $ (1.3) |
| Option contracts | Other noninterest income | (0.3) | 0.6 | (1.0) | 0.5 |
| Foreign exchange contracts | International services income | 6.3 | 7.1 | 18.6 | 18.4 |
| Total income | | $ 6.1 | $ 6.7 | $ 17.1 | $ 17.6 |

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**Note 12. Derivative Instruments (Continued)**

*Credit Risk Exposure and Collateral*

The Company s swap agreements require the deposit of cash or marketable debt securities as collateral based on certain risk thresholds. These requirements apply individually to the Corporation and to the Bank. Additionally, certain of the Company s swap contracts contain security agreements that include credit-risk-related contingent features. Under these agreements, the collateral requirements are based on the Company s credit rating from the major credit rating agencies. The amount of collateral required may vary by counterparty based on a range of credit ratings that correspond with exposure thresholds established in the derivative agreements. If the credit ratings on the Company s debt were to fall below the level associated with a particular exposure threshold and the derivatives with a counterparty are in a net liability position that exceeds that threshold, the counterparty could request immediate payment or delivery of collateral for the difference between the net liability amount and the exposure threshold. The aggregate fair value of all derivative instruments with credit-risk-related contingent features that were in a net liability position on September 30, 2012 was $42.7 million. The Company delivered collateral valued at $29.9 million on swap agreements that had credit-risk contingent features and were in a net liability position at September 30, 2012.

The Company s interest-rate swaps had $2.3 million and $5.3 million of credit risk exposure at September 30, 2012 and December 31, 2011, respectively. The credit exposure represents the cost to replace, on a present value basis and at current market rates, all contracts by trading counterparty having an aggregate positive market value, net of margin collateral received. The Company enters into master netting agreements with swap counterparties to mitigate credit risk. Under these agreements, the net amount due from or payable to each counterparty is settled on the contract payment date. Collateral in the form of securities valued at $2.0 million and $5.0 million had been received from swap counterparties at September 30, 2012 and December 31, 2011, respectively. The Company delivered collateral valued at $20.9 million on swap agreements that did not have credit-risk contingent features at September 30, 2012.

**Note 13. Income Taxes**

The Company recognized income tax expense of $29.1 million and $78.0 million for the three and nine months ended September 30, 2012, respectively. The Company recognized income tax expense of $16.3 million and $54.8 million for the same periods in 2011.

The Company recognizes accrued interest and penalties relating to uncertain tax positions as an income tax provision expense. The Company recognized interest and penalties expense of approximately $0.2 million and $0.4 million for the nine months ended September 30, 2012 and 2011, respectively. The Company had approximately $3.3 million and $3.2 million of accrued interest and penalties as of September 30, 2012 and December 31, 2011.

The Company and its subsidiaries file a consolidated federal income tax return and also file income tax returns in various state jurisdictions. The Company is currently being audited by the Internal Revenue Service for the tax years 2011 and 2012. The Company is also under audit with the California Franchise Tax Board for the tax years 2005 to 2007. The potential financial statement impact, if any, resulting from completion of these audits is expected to be minimal.

From time to time, there may be differences in opinion with respect to the tax treatment of certain transactions. If a tax position which was previously recognized on the consolidated financial statements is no longer more likely than not to be sustained upon a challenge from the taxing authorities, the tax benefit from the tax position will be derecognized. The Company did not have any tax positions for which previously recognized benefits were derecognized during the nine month period ended September 30, 2012.

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**Note 14. Employee Benefit Plans**

*Defined Contribution Plan*

The Company has a profit-sharing retirement plan with an Internal Revenue Code Section 401(k) feature covering eligible employees. Employer contributions are made annually into a trust fund and are allocated to participants based on their salaries. The profit sharing contribution requirement is based on a percentage of annual operating income subject to a percentage of salary cap. Eligible employees may contribute up to 50 percent of their salary to the 401(k) plan, but not more than the maximum allowed under Internal Revenue Service ( IRS ) regulations. The Company matches 50 percent of the first 6 percent of covered compensation. The Company recorded total profit sharing and matching contribution expense of $4.8 million and $14.3 million for the three and nine months ended September 30, 2012, respectively. Profit sharing and matching contribution expense was $4.5 million and $13.5 million for the same periods in 2011, respectively.

*Deferred Compensation Plan*

The Company offers a deferred compensation plan for eligible employees and non-employee directors. Participants under the employee plan may make an annual irrevocable election to defer a portion of base salary and up to 100 percent of commission and incentive compensation while employed with the Company. Participants under the non-employee director plan also may make an annual irrevocable election to defer all or part of annual retainers, annual awards, committee chair retainers and meeting fees (collectively, directors fees ) until board service with the Company ceases. The deferred compensation plans are nonqualified plans under IRS regulations. Deferrals are made on a pretax basis and are allocated among the investment options available under the plans as directed by the plan participants. The Company funds plan benefits through the purchase of life insurance policies which are recorded in Other assets on the consolidated balance sheets. Participant deferrals are recorded in Other liabilities on the consolidated balance sheets. Employee salaries and non-employee directors fees deferred under the plan are charged to Salaries and employee benefits and Other operating expense, respectively, on the consolidated statements of income. Earnings on plan assets, net of benefits payable to plan participants, are reported in Salaries and employee benefits on the consolidated statements of income, and were $0.1 million and $0.4 million for the three and nine months ended September 30, 2012, respectively. Earnings on plan assets, net of benefits payable to plan participants, were $0.3 million and $0.7 million for the same periods in 2011, respectively.

*Other Plans*

The Company administers a Supplemental Executive Retirement Plan ( SERP ) for one of its executive officers. On March 14, 2012, the SERP was amended. In exchange for cancellation of the executive officer s rights to receive supplemental retirement benefits under the SERP, the executive officer would receive fully vested interests in a deferred compensation stock fund under the amended plan. The present value of the accumulated SERP benefit under the amended plan at March 14, 2012 was deemed to be invested in the deferred compensation stock fund, with the number of units being determined by the closing price of the Company s stock on March 14, 2012. The benefit was converted to 167,423 units in the deferred compensation stock fund at March 14, 2012. Distributions to the executive officer from the stock fund will be made solely in Company stock upon termination of employment. As a result of this conversion, the Company reversed its $8.3 million pension liability related to the SERP, recorded the fully vested interests in the deferred compensation stock fund in equity for the same amount, and recognized expense of $1.7 million in the consolidated statements of income for the nine months ended September 30, 2012. The Company recognized total expense related to this SERP of $1.9 million for the nine months ended September 30, 2012. There was no expense recognized during the three months ended September 30, 2012. Expense for the three and nine months ended September 30, 2011 was $0.2 million and $0.7 million, respectively.

The Company also has a SERP covering three former executives of Pacific Bank, which the Company acquired in 2000. As of September 30, 2012, there was an unfunded pension liability for this SERP of $2.3 million. Expense for the three months ended September 30, 2012 and 2011 was insignificant. Expense for the nine months ended September 30, 2012 and 2011 was $0.1 million and $0.3 million, respectively.

**Note 15. Contingencies**

In connection with the liquidation of an investment acquired in a previous bank merger, the Company has an outstanding long-term indemnity. The maximum liability under the indemnity is $23.0 million, but the Company does not expect to make any payments of more than nominal amounts under the terms of this indemnity.

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**Note 16. Variable Interest Entities**

The Company holds ownership interests in certain special-purpose entities formed to provide affordable housing. The Company evaluates its interest in these entities to determine whether they meet the definition of a VIE and whether the Company is required to consolidate these entities. The Company is not the primary beneficiary of the affordable housing VIEs in which it holds interests and is therefore not required to consolidate these entities. The investment in these entities is initially recorded at cost, which approximates the maximum exposure to loss as a result of the Company s involvement with these unconsolidated entities. Subsequently, the carrying value is amortized over the stream of available tax credits and benefits. The Company expects to recover its investments over time, primarily through realization of federal low-income housing tax credits. The balance of the investments in these entities was $157.0 million and $121.0 million at September 30, 2012 and December 31, 2011, respectively, and is included in Affordable housing investments in the consolidated balance sheets. Unfunded commitments for affordable housing investments were $66.5 million at September 30, 2012. These unfunded commitments are recorded in Other liabilities in the consolidated balance sheets.

Of the affordable housing investments held as of September 30, 2012, the Company had a significant variable interest in four affordable housing partnerships. These interests were acquired at various times from 1998 to 2001. The Company s maximum exposure to loss as a result of its involvement with these entities is limited to the $2.2 million aggregate carrying value of these investments at September 30, 2012. There were no unfunded commitments for these affordable housing investments at September 30, 2012.

The Company also has ownership interests in several private equity and alternative investment funds that are VIEs. The Company is not a primary beneficiary and, therefore, is not required to consolidate these VIEs. The investment in these entities is carried at cost and net of impairments, which approximates the maximum exposure to loss as a result of the Company s involvement with these entities. The Company expects to recover its investments over time, primarily through the allocation of fund income, gains or losses on the sale of fund assets, dividends or interest income. The balance in these entities was $36.5 million and $39.9 million at September 30, 2012 and December 31, 2011, respectively, and is included in Other assets in the consolidated balance sheets. Income associated with these investments is reported in Other noninterest income in the consolidated statements of income.

**Note 17. Noncontrolling Interest**

In accordance with ASC Topic 810, *Consolidation*, and EITF Topic D-98, *Classification and Measurement of Redeemable Securities* ( Topic D-98 ), the Company reports noncontrolling interest in its majority-owned affiliates as either a separate component of equity in Noncontrolling interest in the consolidated balance sheets or as Redeemable noncontrolling interest in the mezzanine section between liabilities and equity in the consolidated financial statements. Topic D-98 specifies that securities that are redeemable at the option of the holder or outside the control of the issuer are not considered permanent equity and should be classified in the mezzanine section.

The Bank previously had two real estate investment trust subsidiaries that had issued preferred stock to third-party investors. The ownership interests of third-party investors were included in Noncontrolling interest in the equity section of the consolidated balance sheets. In July and August 2011, the Company liquidated or redeemed all outstanding shares of preferred stock held by noncontrolling interest owners.

*Redeemable Noncontrolling Interest*

The Corporation holds a majority ownership interest in five investment management and wealth advisory affiliates that it consolidates. In general, the management of each majority-owned affiliate has a significant noncontrolling ownership position in its firm and supervises the day-to-day operations of the affiliate. The Corporation is in regular contact with each affiliate regarding its operations and is an active participant in the management of the affiliates through its position on each firm s board.

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**Note 17. Noncontrolling Interest (Continued)**

The Corporation s investment in each affiliate is governed by operating agreements and other arrangements which provide the Corporation certain rights, benefits and obligations. The Corporation determines the appropriate method of accounting based upon these agreements and the factors contained therein. All majority-owned affiliates that have met the criteria for consolidation are included in the consolidated financial statements. All material intercompany balances and transactions are eliminated. The Company applies the equity method of accounting for certain investments where it holds a noncontrolling interest. For equity method investments, the Company s portion of income before taxes is included in Trust and investment fees in the consolidated statements of income.

As of September 30, 2012, affiliate noncontrolling owners held equity interests with an estimated fair value of $41.4 million. This estimate reflects the maximum obligation to purchase equity interests in the affiliates. The events which would require the Company to purchase the equity interests may occur in the near term or over a longer period of time. The terms of the put provisions vary by agreement, but the value of the put is at the approximate fair value of the interests. The parent company carries key man life insurance policies to fund a portion of these conditional purchase obligations in the event of the death of certain key holders.

The following is a summary of activity for redeemable noncontrolling interest for the nine months ended September 30, 2012 and 2011:

| | For the nine months ended September 30, | |
|---|---|---|
| **(in thousands)** | **2012** | **2011** |
| Balance, beginning of period | $ 44,643 | $ 45,676 |
| Net income | 1,024 | 1,511 |
| Distributions to redeemable noncontrolling interest | (1,261) | (1,612) |
| Additions and redemptions, net | (1,987) | (2,948) |
| Adjustments to fair value | (1,033) | 704 |
| Other | | (627) |
| Balance, end of period | $ 41,386 | $ 42,704 |

**Note 18. Segment Results**

The Company has three reportable segments: Commercial and Private Banking, Wealth Management and Other. The factors considered in determining whether individual operating segments could be aggregated include that the operating segments: (i) offer the same products and services, (ii) offer services to the same types of clients, (iii) provide services in the same manner and (iv) operate in the same regulatory environment. The management accounting process measures the performance of the operating segments based on the Company s management structure and is not necessarily comparable with similar information for other financial services companies. If the management structures and/or the allocation process changes, allocations, transfers and assignments may change.

The Commercial and Private Banking reportable segment is the aggregation of the Commercial and Private Banking, Real Estate, Entertainment, Corporate Banking and Core Branch Banking operating segments. The Commercial and Private Banking segment provides banking products and services, including commercial and mortgage lending, lines of credit, equipment lease financing, deposits, cash management services, international trade finance and letters of credit to small and medium-sized businesses, entrepreneurs and affluent individuals. This segment primarily serves clients in California, New York, Nevada, Tennessee and Georgia.

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**Note 18. Segment Results (Continued)**

The Wealth Management segment includes the Corporation s investment advisory affiliates and the Bank s Wealth Management Services. The asset management affiliates and the Wealth Management division of the Bank make the following investment advisory and wealth management resources and expertise available to individual and institutional clients: investment management, wealth advisory services, brokerage, estate and financial planning and personal, business, custodial and employee trust services. The Wealth Management segment also advises and makes available mutual funds under the name of CNI Charter Funds and Rochdale Investment Trust. Both the asset management affiliates and the Bank s Wealth Management division provide proprietary and nonproprietary products to offer a full spectrum of investment solutions in all asset classes and investment styles, including fixed-income instruments, mutual funds, domestic and international equities and alternative investments such as hedge funds. This segment serves clients nationwide.

The Other segment includes all other subsidiaries of the Company, the corporate departments, including the Treasury Department and the Asset Liability Funding Center, that have not been allocated to the other segments, and inter-segment eliminations for revenue recognized in multiple segments for management reporting purposes. The Company uses traditional matched-maturity funds transfer pricing methodology. However, both positive and negative variances occur over time when transfer pricing non-maturing balance sheet items such as demand deposits. These variances, offset in the Funding Center, are evaluated annually by management and allocated back to the business segments as deemed necessary.

Business segment earnings are the primary measure of the segment s performance as evaluated by management. Business segment earnings include direct revenue and expenses of the segment as well as corporate and inter-company cost allocations. Allocations of corporate expenses, such as data processing and human resources, are calculated based on estimated activity levels for the fiscal year. Costs associated with intercompany support and services groups, such as Operational Services, are allocated to each business segment based on actual services used. Capital is allocated based on the estimated risk within each business segment. The methodology of allocating capital is based on each business segment s credit, market, and operational risk profile. If applicable, any provision for credit losses is allocated based on various credit factors, including but not limited to, credit risk ratings, credit rating fluctuation, charge-offs and recoveries and loan growth.

Income taxes are charged to the business segments at the statutory rate. The Other segment includes an adjustment to reconcile to the Company s overall effective tax rate.

Exposure to market risk is managed in the Company s Treasury department. Interest rate risk is mostly removed from the Commercial and Private Banking segment and transferred to the Funding Center through a fund transfer pricing ( FTP ) methodology and allocating model. The FTP model records a cost of funds or credit for funds using a combination of matched maturity funding for fixed term assets and liabilities and a blended rate for the remaining assets and liabilities with varying maturities.

The Bank s investment portfolio and unallocated equity are included in the Other segment. Amortization expense associated with customer-relationship intangibles is charged to the affected operating segments.

Selected financial information for each segment is presented in the following tables. Commercial and Private Banking includes all revenue and costs from products and services utilized by clients of Commercial and Private Banking, including both revenue and costs for Wealth

Management products and services. The revenues and costs associated with Wealth Management products and services that are allocated to Commercial and Private Banking for management reporting purposes are eliminated in the Other segment. The current period reflects any changes made in the process or methodology for allocations to the reportable segments. Prior period segment results have been revised to conform with current period presentation.

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**Note 18. Segment Results (Continued)**

| (in thousands) | Commercial and Private Banking | Wealth Management | Other | Consolidated Company |
|---|---|---|---|---|
| | For the three months ended September 30, 2012 | | | |
| **Earnings Summary:** | | | | |
| Net interest income | $ 184,597 | $ 1,133 | $ 24,192 | $ 209,922 |
| Provision for credit losses on loans and leases, excluding covered loans | 2,000 | | | 2,000 |
| Provision for losses on covered loans | 18,089 | | | 18,089 |
| Noninterest income | 60,203 | 54,405 | (7,351) | 107,257 |
| Depreciation and amortization | 3,569 | 1,996 | 4,691 | 10,256 |
| Noninterest expense | 170,040 | 45,233 | (17,643) | 197,630 |
| Income before income taxes | 51,102 | 8,309 | 29,793 | 89,204 |
| Provision for income taxes | 21,463 | 3,334 | 4,255 | 29,052 |
| Net income | 29,639 | 4,975 | 25,538 | 60,152 |
| Less: Net income attributable to noncontrolling interest | | 372 | | 372 |
| Net income attributable to City National Corporation | $ 29,639 | $ 4,603 | $ 25,538 | $ 59,780 |
| | | | | |
| **Selected Average Balances:** | | | | |
| Loans and leases, excluding covered loans | $ 13,526,284 | $ | $ 61,224 | $ 13,587,508 |
| Covered loans | 1,207,031 | | | 1,207,031 |
| Total assets | 15,098,090 | 638,445 | 9,918,059 | 25,654,594 |
| Deposits | 21,298,105 | 104,195 | 538,520 | 21,940,820 |
| Goodwill | 393,176 | 239,297 | | 632,473 |
| Customer-relationship intangibles, net | 7,392 | 47,359 | | 54,751 |

| (in thousands) | Commercial and Private Banking | Wealth Management | Other | Consolidated Company |
|---|---|---|---|---|
| | For the three months ended September 30, 2011 | | | |
| **Earnings Summary:** | | | | |
| Net interest income | $ 189,999 | $ 479 | $ 8,838 | $ 199,316 |
| Provision for credit losses on loans and leases, excluding covered loans | 7,500 | | | 7,500 |
| Provision for losses on covered loans | 5,147 | | | 5,147 |
| Noninterest income | 39,139 | 41,070 | (10,574) | 69,635 |
| Depreciation and amortization | 3,689 | 1,525 | 3,821 | 9,035 |
| Noninterest expense | 169,073 | 34,613 | (15,084) | 188,602 |
| Income before income taxes | 43,729 | 5,411 | 9,527 | 58,667 |
| Provision (benefit) for income taxes | 18,367 | 1,852 | (3,952) | 16,267 |
| Net income | 25,362 | 3,559 | 13,479 | 42,400 |
| Less: Net income attributable to noncontrolling interest | | 1,002 | | 1,002 |
| Net income attributable to City National Corporation | $ 25,362 | $ 2,557 | $ 13,479 | $ 41,398 |
| | | | | |
| **Selected Average Balances:** | | | | |
| Loans and leases, excluding covered loans | $ 11,747,735 | $ | $ 48,909 | $ 11,796,644 |
| Covered loans | 1,664,349 | | | 1,664,349 |
| Total assets | 13,882,867 | 556,584 | 8,559,111 | 22,998,562 |
| Deposits | 19,274,187 | 58,884 | 391,527 | 19,724,598 |

| | | | |
|---|---|---|---|
| Goodwill | 324,761 | 161,622 | 486,383 |
| Customer-relationship intangibles, net | 11,597 | 27,320 | 38,917 |

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**Note 18. Segment Results (Continued)**

| (in thousands) | Commercial and Private Banking | Wealth Management | Other | Consolidated Company |
|---|---|---|---|---|
| | For the nine months ended September 30, 2012 | | | |
| **Earnings Summary:** | | | | |
| Net interest income | $ 541,163 | $ 2,399 | $ 83,552 | $ 627,114 |
| Provision for credit losses on loans and leases, excluding covered loans | 3,000 | | | 3,000 |
| Provision for losses on covered loans | 38,848 | | | 38,848 |
| Noninterest income | 157,758 | 133,743 | (33,776) | 257,725 |
| Depreciation and amortization | 10,565 | 4,980 | 13,556 | 29,101 |
| Noninterest expense | 507,450 | 117,336 | (50,765) | 574,021 |
| Income before income taxes | 139,058 | 13,826 | 86,985 | 239,869 |
| Provision for income taxes | 58,405 | 5,377 | 14,260 | 78,042 |
| Net income | 80,653 | 8,449 | 72,725 | 161,827 |
| Less: Net income attributable to noncontrolling interest | | 1,024 | | 1,024 |
| Net income attributable to City National Corporation | $ 80,653 | $ 7,425 | $ 72,725 | $ 160,803 |
| **Selected Average Balances:** | | | | |
| Loans and leases, excluding covered loans | $ 12,994,726 | $ | $ 55,797 | $ 13,050,523 |
| Covered loans | 1,328,484 | | | 1,328,484 |
| Total assets | 14,656,195 | 569,043 | 9,332,792 | 24,558,030 |
| Deposits | 20,469,604 | 100,038 | 469,149 | 21,038,791 |
| Goodwill | 362,868 | 188,197 | | 551,065 |
| Customer-relationship intangibles, net | 8,173 | 33,240 | | 41,413 |

| (in thousands) | Commercial and Private Banking | Wealth Management | Other | Consolidated Company |
|---|---|---|---|---|
| | For the nine months ended September 30, 2011 | | | |
| **Earnings Summary:** | | | | |
| Net interest income | $ 543,719 | $ 1,578 | $ 26,136 | $ 571,433 |
| Provision for credit losses on loans and leases, excluding covered loans | 7,500 | | | 7,500 |
| Provision for losses on covered loans | 25,979 | | | 25,979 |
| Noninterest income | 162,470 | 124,011 | (31,016) | 255,465 |
| Depreciation and amortization | 10,976 | 4,471 | 11,512 | 26,959 |
| Noninterest expense | 513,215 | 111,334 | (44,642) | 579,907 |
| Income before income taxes | 148,519 | 9,784 | 28,250 | 186,553 |
| Provision (benefit) for income taxes | 62,378 | 2,770 | (10,345) | 54,803 |
| Net income | 86,141 | 7,014 | 38,595 | 131,750 |
| Less: Net income attributable to noncontrolling interest | | 3,189 | | 3,189 |
| Net income attributable to City National Corporation | $ 86,141 | $ 3,825 | $ 38,595 | $ 128,561 |
| **Selected Average Balances:** | | | | |
| Loans and leases, excluding covered loans | $ 11,468,231 | $ | $ 56,590 | $ 11,524,821 |
| Covered loans | 1,748,033 | | | 1,748,033 |
| Total assets | 13,718,262 | 554,570 | 7,861,843 | 22,134,675 |
| Deposits | 18,463,503 | 55,659 | 384,021 | 18,903,183 |

| | | | |
|---|---|---|---|
| Goodwill | 324,910 | 161,633 | 486,543 |
| Customer-relationship intangibles, net | 12,200 | 28,106 | 40,306 |

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**Note 19. Subsequent Event**

On November 5, 2012, the Corporation announced the public offering of $175 million (excluding over-allotment shares) in 5.50 percent Non-Cumulative Perpetual Preferred Stock, Series C ( Series C Preferred Stock ), which qualifies as Tier 1 capital. The Corporation offered 7 million depositary shares at a price of $25 per share, each representing a 1/40th interest in a share of Series C Preferred Stock. Net proceeds from the offering will be used for general corporate purposes, including debt repayment. The offering is expected to close on or about November 13, 2012, subject to customary closing conditions.

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## ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITIONS AND RESULTS OF OPERATIONS

### CAUTIONARY STATEMENT FOR PURPOSES OF THE SAFE HARBOR PROVISIONS

### OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

We have made forward-looking statements in this document about the Company, for which the Company claims the protection of the safe harbor provisions contained in the Private Securities Litigation Reform Act of 1995.

A number of factors, many of which are beyond the Company s ability to control or predict, could cause future results to differ materially from those contemplated by such forward-looking statements. These factors include: (1) changes in general economic, political, or industry conditions and the related credit and market conditions and the impact they have on the Company and its customers, including changes in consumer spending, borrowing and savings habits; (2) the impact on financial markets and the economy of the level of U.S. and European debt; (3) the effects of and changes in trade and monetary and fiscal policies and laws, including the interest rate policies of the Board of Governors of the Federal Reserve System; (4) continued delay in the pace of economic recovery and continued stagnant or decreasing employment levels, including the potential adverse impact on the economy generally of the pending combination of expiring tax cuts and mandatory reductions in federal spending at the end of 2012, referred to as the Fiscal Cliff ; (5) the effect of the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 and the rules and regulations to be promulgated by supervisory and oversight agencies implementing the new legislation, taking into account that the precise timing, extent and nature of such rules and regulations and the impact on the Company is uncertain; (6) the impact of revised capital requirements under Basel III; (7) significant changes in applicable laws and regulations, including those concerning taxes, banking and securities; (8) volatility in the municipal bond market; (9) changes in the level of nonperforming assets, charge-offs, other real estate owned and provision expense; (10) incorrect assumptions in the value of the loans acquired in FDIC-assisted acquisitions resulting in greater than anticipated losses in the acquired loan portfolios exceeding the losses covered by the loss-sharing agreements with the FDIC; (11) changes in inflation, interest rates, and market liquidity which may impact interest margins and impact funding sources; (12) adequacy of the Company s enterprise risk management framework; (13) the Company s ability to attract new employees and retain and motivate existing employees; (14) increased competition in the Company s markets and our ability to increase market share and control expenses; (15) changes in the financial performance and/or condition of the Company s borrowers, including adverse impact on loan utilization rates, delinquencies, defaults and customers ability to meet certain credit obligations, changes in customers suppliers, and other counterparties performance and creditworthiness; (16) a substantial and permanent loss of either client accounts and/or assets under management at the Company s investment advisory affiliates or its wealth management division; (17) soundness of other financial institutions which could adversely affect the Company; (18) protracted labor disputes in the Company s markets; (19) the impact of natural disasters, terrorist activities or international hostilities on the operations of our business or the value of collateral; (20) the effect of acquisitions and integration of acquired businesses and de novo branching efforts; (21) changes in accounting policies or procedures as may be required by the Financial Accounting Standards Board or regulatory agencies; (22) the impact of cyber security attacks or other disruptions to the Company s information systems and any resulting compromise of data or disruptions in service; and (23) the success of the Company at managing the risks involved in the foregoing.

Forward-looking statements speak only as of the date they are made, and the Company does not undertake to update forward-looking statements to reflect circumstances or events that occur after the date the statements are made, or to update earnings guidance, including the factors that influence earnings.

For a more complete discussion of these risks and uncertainties, see the Company s Annual Report on Form 10-K for the year ended December 31, 2011 and particularly, Item 1A, titled Risk Factors, as updated in our subsequently filed Quarterly Reports on Form 10-Q.

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**CITY NATIONAL CORPORATION**

**FINANCIAL HIGHLIGHTS**

| (in thousands, except per share amounts) | At or for the three months ended September 30, 2012 (Unaudited) | June 30, 2012 (Unaudited) | September 30, 2011 (Unaudited) | Percent change September 30, 2012 from June 30, 2012 | September 30, 2011 |
|---|---|---|---|---|---|
| **For The Quarter** | | | | | |
| Net income attributable to City National Corporation | $ 59,780 | $ 54,758 | $ 41,398 | 9% | 44% |
| Net income per share, basic | 1.10 | 1.02 | 0.78 | 8 | 41 |
| Net income per share, diluted | 1.10 | 1.01 | 0.77 | 9 | 43 |
| Dividends per share | 0.25 | 0.25 | 0.20 | | 25 |
| **At Quarter End** | | | | | |
| Assets | $ 26,251,528 | $ 24,801,973 | $ 23,104,260 | 6 | 14 |
| Securities | 9,110,974 | 8,028,695 | 7,278,995 | 13 | 25 |
| Loans and leases, excluding covered loans | 13,724,651 | 13,507,209 | 12,164,209 | 2 | 13 |
| Covered loans (1) | 1,144,337 | 1,260,135 | 1,611,856 | (9) | (29) |
| Deposits | 22,512,316 | 21,109,052 | 19,909,081 | 7 | 13 |
| Shareholders equity | 2,330,324 | 2,255,365 | 2,120,465 | 3 | 10 |
| Book value per share | 43.81 | 42.70 | 40.40 | 3 | 8 |
| **Average Balances** | | | | | |
| Assets | $ 25,654,594 | $ 24,362,546 | $ 22,998,562 | 5 | 12 |
| Securities | 8,631,430 | 7,755,330 | 6,954,084 | 11 | 24 |
| Loans and leases, excluding covered loans | 13,587,508 | 13,125,867 | 11,796,644 | 4 | 15 |
| Covered loans (1) | 1,207,031 | 1,341,041 | 1,664,349 | (10) | (27) |
| Deposits | 21,940,820 | 20,948,246 | 19,724,598 | 5 | 11 |
| Shareholders equity | 2,296,755 | 2,234,411 | 2,093,428 | 3 | 10 |
| Total equity | 2,296,755 | 2,234,411 | 2,117,249 | 3 | 8 |
| **Selected Ratios** | | | | | |
| Return on average assets (annualized) | 0.93% | 0.90% | 0.71% | 3 | 31 |
| Return on average shareholders equity (annualized) | 10.35 | 9.86 | 7.85 | 5 | 32 |
| Corporation s tier 1 leverage | 6.29 | 6.74 | 6.82 | (7) | (8) |
| Corporation s tier 1 risk-based capital | 9.15 | 9.58 | 10.28 | (4) | (11) |
| Corporation s total risk-based capital | 12.42 | 12.91 | 12.88 | (4) | (4) |
| Period-end shareholders equity to period-end assets | 8.88 | 9.09 | 9.18 | (2) | (3) |
| Dividend payout ratio, per share | 22.63 | 24.57 | 25.70 | (8) | (12) |
| Net interest margin | 3.58 | 3.91 | 3.79 | (8) | (6) |
| Expense to revenue ratio (2) | 61.96 | 63.28 | 67.68 | (2) | (8) |
| **Asset Quality Ratios (3)** | | | | | |
| Nonaccrual loans to total loans and leases | 0.75% | 0.73% | 1.20% | 3 | (38) |
| Nonaccrual loans and OREO to total loans and leases and OREO | 0.95 | 0.98 | 1.56 | (3) | (39) |
| Allowance for loan and lease losses to total loans and leases | 1.96 | 2.00 | 2.16 | (2) | (9) |
| | 259.38 | 273.21 | 180.21 | (5) | 44 |

| | | | | | |
|---|---|---|---|---|---|
| Allowance for loan and lease losses to nonaccrual loans | | | | | |
| Net (charge-offs) recoveries to average total loans and leases (annualized) | (0.06) | 0.08 | (0.36) | (175) | (83) |
| | | | | | |
| **At Quarter End** | | | | | |
| Assets under management (4) | $ 38,043,068 | $ 32,105,076 | $ 33,590,547 | 18 | 13 |
| Assets under management or administration (4) (5) | 56,671,844 | 50,040,119 | 48,507,432 | 13 | 17 |

(1) Covered loans represent acquired loans that are covered under loss-sharing agreements with the Federal Deposit Insurance Corporation ( FDIC ).

(2) The expense to revenue ratio is defined as noninterest expense excluding other real estate owned ( OREO ) expense divided by total revenue (net interest income on a fully taxable-equivalent basis and noninterest income).

(3) Excludes covered assets, which consist of acquired loans and OREO that are covered under loss-sharing agreements with the FDIC.

(4) Excludes $19.81 billion, $18.39 billion and $16.09 billion of assets under management for asset managers in which the Company held a noncontrolling ownership interest as of September 30, 2012, June 30, 2012 and September 30, 2011, respectively.

(5) Assets under administration have been revised to exclude the Company s investments that are held in custody and serviced by the Company s wealth management business. Prior period balances have been reclassified to conform to current period presentation.

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**CRITICAL ACCOUNTING POLICIES**

The accounting and reporting policies of the Company conform with U.S. generally accepted accounting principles. The Company s accounting policies are fundamental to understanding management s discussion and analysis of results of operations and financial condition. The Company has identified 11 policies as being critical because they require management to make estimates, assumptions and judgments that affect the reported amount of assets and liabilities, contingent assets and liabilities, and revenues and expenses included in the consolidated financial statements. The judgments and assumptions used by management are based on historical experience and other factors, which are believed to be reasonable under the circumstances. Circumstances and events that differ significantly from those underlying the Company s estimates, assumptions and judgments could cause the actual amounts reported to differ significantly from these estimates.

The Company s critical accounting policies include those that address accounting for business combinations, financial assets and liabilities reported at fair value, securities, acquired impaired loans, allowance for loan and lease losses and reserve for off-balance sheet credit commitments, OREO, goodwill and other intangible assets, noncontrolling interest, share-based compensation plans, income taxes, and derivatives and hedging activities. The Company has not made any significant changes in its critical accounting policies or its estimates and assumptions from those disclosed in its 2011 Annual Report. Management has applied its critical accounting policies and estimation methods consistently in all periods presented in these financial statements.

**RECENT DEVELOPMENTS**

On July 2, 2012, the Company acquired Rochdale Investment Management, LLC and associated entities (collectively, Rochdale ), a New York City-based investment firm that manages assets for affluent and high-net-worth clients and their financial advisors across the nation. Rochdale had approximately $4.89 billion of assets under management at the date of acquisition.

On November 5, 2012, the Corporation announced the public offering of $175 million (excluding over-allotment shares) in 5.50 percent Non-Cumulative Perpetual Preferred Stock, Series C ( Series C Preferred Stock ), which qualifies as Tier 1 capital. The Corporation offered 7 million depositary shares at a price of $25 per share, each representing a 1/40th interest in a share of Series C Preferred Stock. Net proceeds from the offering will be used for general corporate purposes, including debt repayment. The offering is expected to close on or about November 13, 2012, subject to customary closing conditions.

**HIGHLIGHTS**

- For the quarter ended September 30, 2012, consolidated net income attributable to City National Corporation ( CNC ) was $59.8 million, or $1.10 per diluted share, compared to $41.4 million, or $0.77 per diluted share, for the year-earlier quarter. During the nine month period ended September 30, 2012, consolidated net income attributable to CNC was $160.8 million, or $2.97 per diluted share, compared to $128.6 million, or $2.39 per diluted share, for the year-earlier period. The growth in net income during the three months and nine months ended September 30, 2012 was primarily attributable to an increase in net interest income as a result of higher interest income from securities and loans and lower interest expense on deposits. The increase in net interest income, combined with lower provision for losses on non-covered loans, was partially offset by higher provision for losses on covered loans. Net income during the third quarter of 2012 also increased as a result of higher noninterest income. Third quarter 2012 earnings included pretax gains of $4.8 million related to investments and $1.8 million of income, net of expense, from FDIC-covered assets, excluding the base yield. Base yield is the yield on covered assets, excluding income related to covered loans that are repaid or charged off.

- Revenue, which consists of net interest income and noninterest income, was $317.2 million for the third quarter of 2012, up 9 percent from $291.2 million in the second quarter of 2012 and 18 percent from $269.0 million in the year-earlier quarter.

- Fully taxable-equivalent net interest income, including dividend income, amounted to $214.8 million for the third quarter of 2012, down 3 percent from the second quarter of 2012 and up 6 percent from the year-earlier period.

- The Company s net interest margin in the third quarter of 2012 was 3.58 percent, down from 3.91 percent in the second quarter of 2012 and 3.79 percent in the third quarter of 2011.

- Noninterest income was $107.3 million for the third quarter of 2012, up 43 percent from the second quarter of 2012 and 54 percent from the year-earlier quarter. The increases were due to the acquisition of Rochdale and FAEF, higher FDIC loss sharing income and net gains of $4.8 million from private equity and other alternative investments.

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- Noninterest expense for the third quarter of 2012 was $207.9 million, up 7 percent from the second quarter of 2012 and 5 percent from the year-earlier quarter. The increases were due largely to the acquisitions of Rochdale and FAEF.

- The Company s effective tax rate was 32.6 percent for the third quarter of 2012 compared with 33.1 percent for the second quarter of 2012 and 27.7 percent from the year-earlier period.

- Total assets were $26.25 billion at September 30, 2012, up 6 percent from $24.80 billion at June 30, 2012 and 14 percent from $23.10 billion at September 30, 2011. Total average assets were $25.65 billion for the third quarter of 2012, compared to $24.36 billion for the second quarter of 2012 and $23.00 billion for the third quarter of 2011.

- Loans and leases, excluding covered loans, were $13.72 billion at September 30, 2012, an increase of 2 percent from June 30, 2012 and 13 percent from September 30, 2011. Average loans for the third quarter of 2012, excluding covered loans, were $13.59 billion, up 4 percent from the second quarter of 2012 and 15 percent from the same period of last year. Average commercial loan balances grew 5 percent from the second quarter of 2012 and 24 percent from the year-earlier period.

- Excluding covered loans, results for the third quarter of 2012 included a $2.0 million provision for loan and lease losses. The Company recorded a $1.0 million provision in the second quarter of 2012, and a $7.5 million provision in the year-earlier quarter. The allowance for loan and lease losses on non-covered loans was $268.4 million at September 30, 2012 compared with $269.5 million at June 30, 2012 and $263.3 million at September 30, 2011. The Company remains adequately reserved at 1.96 percent of total loans and leases, excluding covered loans, at September 30, 2012, compared with 2.00 percent at June 30, 2012 and 2.16 percent at September 30, 2011.

- In the third quarter of 2012, net loan charge-offs totaled $2.2 million, or 0.06 percent of average total loans and leases, excluding covered loans, on an annualized basis, compared with net recoveries of $2.7 million, or 0.08 percent, for the second quarter of 2012, and net charge-offs of $10.6 million, or 0.36 percent, in the year-earlier quarter. Nonaccrual loans, excluding covered loans, totaled $103.5 million at September 30, 2012, up from $98.7 million at June 30, 2012 and down from $146.1 million at September 30, 2011. At September 30, 2012, nonperforming assets, excluding covered assets, were $130.5 million, down from $133.3 million at June 30, 2012 and $190.7 million at September 30, 2011.

- Average securities for the third quarter of 2012 totaled $8.63 billion, up 11 percent from the second quarter of 2012 and 24 percent from the third quarter of 2011 as deposit growth outpaced loan growth.

- Period-end deposits at September 30, 2012 were $22.51 billion, up 7 percent from $21.11 billion at June 30, 2012 and 13 percent from $19.91 billion at September 30, 2011. Average deposit balances for the third quarter of 2012 grew to $21.94 billion, up 5 percent from $20.95 billion for the second quarter of 2012 and 11 percent from $19.72 billion for the third quarter of 2011. Average core deposits, which equal 97 percent of total deposit balances, were up 5 percent from the second quarter of 2012 and 12 percent from the third quarter of 2011.

- The Company s ratio of Tier 1 common shareholders equity to risk-based assets was 9.1 percent at September 30, 2012 compared with 9.6 percent at June 30, 2012 and 10.2 percent at September 30, 2011. The change from prior periods is a reflection of both asset growth and the acquisitions of Rochdale and FAEF. Refer to the Capital section of Management s Discussion and Analysis for further discussion of this non-GAAP measure.

**OUTLOOK**

The Company s management continues to anticipate net income growth in 2012, as loans and deposits continue to increase and credit quality remains stable. This outlook reflects management s expectations for modest economic growth and loan-loss provisions as well as low interest rates for the remainder of the year.

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**RESULTS OF OPERATIONS**

**Net Interest Income**

Net interest income is the difference between interest income (which includes yield-related loan fees) and interest expense. Net interest income on a fully taxable-equivalent basis expressed as a percentage of average total earning assets is referred to as the net interest margin, which represents the average net effective yield on earning assets. The following tables present the components of net interest income on a fully taxable-equivalent basis for the three and nine months ended September 30, 2012 and 2011:

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**Net Interest Income Summary**

| (in thousands) (1) | For the three months ended September 30, 2012 Average balance | Interest income/ expense (2)(4) | Average interest rate | For the three months ended September 30, 2011 Average balance | Interest income/ expense (2)(4) | Average interest rate |
|---|---|---|---|---|---|---|
| **Assets** | | | | | | |
| Interest-earning assets | | | | | | |
| Loans and leases | | | | | | |
| Commercial | $ 6,127,844 | $ 61,191 | 3.97% | $ 4,927,877 | $ 50,744 | 4.09% |
| Commercial real estate mortgages | 2,463,945 | 27,531 | 4.45 | 1,944,554 | 25,976 | 5.30 |
| Residential mortgages | 3,864,910 | 39,666 | 4.11 | 3,716,650 | 44,041 | 4.74 |
| Real estate construction | 265,388 | 3,780 | 5.67 | 346,562 | 4,062 | 4.65 |
| Equity lines of credit | 731,009 | 6,463 | 3.52 | 731,040 | 6,545 | 3.55 |
| Installment | 134,412 | 1,525 | 4.51 | 129,961 | 1,619 | 4.94 |
| Total loans and leases, excluding covered loans (3) | 13,587,508 | 140,156 | 4.10 | 11,796,644 | 132,987 | 4.47 |
| Covered loans | 1,207,031 | 41,995 | 13.92 | 1,664,349 | 44,305 | 10.65 |
| Total loans and leases | 14,794,539 | 182,151 | 4.90 | 13,460,993 | 177,292 | 5.23 |
| Due from banks - interest-bearing | 246,983 | 163 | 0.26 | 641,566 | 474 | 0.29 |
| Federal funds sold and securities purchased under resale agreements | 105,352 | 74 | 0.28 | 130,148 | 90 | 0.28 |
| Securities | 8,631,430 | 46,603 | 2.16 | 6,954,084 | 42,647 | 2.45 |
| Other interest-earning assets | 113,711 | 685 | 2.40 | 129,855 | 683 | 2.09 |
| Total interest-earning assets | 23,892,015 | 229,676 | 3.82 | 21,316,646 | 221,186 | 4.12 |
| Allowance for loan and lease losses | (319,074) | | | (330,313) | | |
| Cash and due from banks | 184,175 | | | 203,420 | | |
| Other non-earning assets | 1,897,478 | | | 1,808,809 | | |
| Total assets | $ 25,654,594 | | | $ 22,998,562 | | |
| | | | | | | |
| **Liabilities and Equity** | | | | | | |
| Interest-bearing deposits | | | | | | |
| Interest checking accounts | $ 1,981,177 | $ 462 | 0.09 | $ 1,726,948 | $ 650 | 0.15 |
| Money market accounts | 5,838,060 | 1,681 | 0.11 | 6,899,846 | 6,074 | 0.35 |
| Savings deposits | 370,858 | 129 | 0.14 | 329,053 | 243 | 0.29 |
| Time deposits - under $100,000 | 219,662 | 281 | 0.51 | 280,113 | 341 | 0.48 |
| Time deposits - $100,000 and over | 732,316 | 763 | 0.41 | 801,009 | 1,227 | 0.61 |
| Total interest-bearing deposits | 9,142,073 | 3,316 | 0.14 | 10,036,969 | 8,535 | 0.34 |
| | | | | | | |
| Federal funds purchased and securities sold under repurchase agreements | 24,687 | 9 | 0.15 | 326 | | 0.07 |
| Other borrowings | 921,913 | 11,521 | 4.97 | 803,503 | 9,041 | 4.46 |
| Total interest-bearing liabilities | 10,088,673 | 14,846 | 0.59 | 10,840,798 | 17,576 | 0.64 |
| Noninterest-bearing deposits | 12,798,747 | | | 9,687,629 | | |
| Other liabilities | 470,419 | | | 352,886 | | |
| Total equity | 2,296,755 | | | 2,117,249 | | |
| Total liabilities and equity | $ 25,654,594 | | | $ 22,998,562 | | |
| | | | | | | |
| Net interest spread | | | 3.23% | | | 3.48% |
| Fully taxable-equivalent net interest and dividend income | | $ 214,830 | | | $ 203,610 | |

| | | | | |
|---|---|---|---|---|
| Net interest margin | | 3.58% | | 3.79% |
| Less: Dividend income included in other income | | 685 | | 683 |
| Fully taxable-equivalent net interest income | $ | 214,145 | $ | 202,927 |

(1) Certain prior period balances have been reclassified to conform to the current period presentation.

(2) Net interest income is presented on a fully taxable-equivalent basis.

(3) Includes average nonaccrual loans of $107,096 and $141,433 for 2012 and 2011, respectively.

(4) Loan income includes loan fees of $6,146 and $4,551 for 2012 and 2011, respectively.

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**Net Interest Income Summary**

| (in thousands) (1) | For the nine months ended September 30, 2012 Average balance | Interest income/ expense (2)(4) | Average interest rate | For the nine months ended September 30, 2011 Average balance | Interest income/ expense (2)(4) | Average interest rate |
|---|---|---|---|---|---|---|
| **Assets** | | | | | | |
| Interest-earning assets | | | | | | |
| Loans and leases | | | | | | |
| Commercial | $ 5,765,023 | $ 173,748 | 4.03% | $ 4,687,896 | $ 147,154 | 4.20% |
| Commercial real estate mortgages | 2,308,803 | 80,567 | 4.66 | 1,924,239 | 79,251 | 5.51 |
| Residential mortgages | 3,819,405 | 121,625 | 4.25 | 3,647,958 | 130,721 | 4.78 |
| Real estate construction | 296,453 | 11,271 | 5.08 | 396,254 | 14,126 | 4.77 |
| Equity lines of credit | 729,698 | 19,344 | 3.54 | 731,343 | 19,545 | 3.57 |
| Installment | 131,141 | 4,509 | 4.59 | 137,131 | 5,002 | 4.88 |
| Total loans and leases, excluding covered loans (3) | 13,050,523 | 411,064 | 4.21 | 11,524,821 | 395,799 | 4.59 |
| Covered loans | 1,328,484 | 128,866 | 12.93 | 1,748,033 | 118,072 | 9.01 |
| Total loans and leases | 14,379,007 | 539,930 | 5.02 | 13,272,854 | 513,871 | 5.18 |
| Due from banks - interest-bearing | 235,841 | 429 | 0.24 | 553,328 | 1,179 | 0.28 |
| Federal funds sold and securities purchased under resale agreements | 85,629 | 181 | 0.28 | 167,611 | 342 | 0.27 |
| Securities | 8,107,277 | 140,115 | 2.30 | 6,295,203 | 123,186 | 2.61 |
| Other interest-earning assets | 117,074 | 2,070 | 2.36 | 134,523 | 2,086 | 2.07 |
| Total interest-earning assets | 22,924,828 | 682,725 | 3.98 | 20,423,519 | 640,664 | 4.19 |
| Allowance for loan and lease losses | (328,303) | | | (334,249) | | |
| Cash and due from banks | 158,001 | | | 196,235 | | |
| Other non-earning assets | 1,803,504 | | | 1,849,170 | | |
| Total assets | $ 24,558,030 | | | $ 22,134,675 | | |
| | | | | | | |
| **Liabilities and Equity** | | | | | | |
| Interest-bearing deposits | | | | | | |
| Interest checking accounts | $ 1,941,333 | $ 1,441 | 0.10 | $ 1,734,912 | $ 2,207 | 0.17 |
| Money market accounts | 5,903,516 | 5,760 | 0.13 | 6,679,960 | 20,402 | 0.41 |
| Savings deposits | 363,087 | 382 | 0.14 | 319,899 | 763 | 0.32 |
| Time deposits - under $100,000 | 229,984 | 863 | 0.50 | 304,325 | 1,167 | 0.51 |
| Time deposits - $100,000 and over | 720,709 | 2,468 | 0.46 | 818,769 | 4,203 | 0.69 |
| Total interest-bearing deposits | 9,158,629 | 10,914 | 0.16 | 9,857,865 | 28,742 | 0.39 |
| | | | | | | |
| Federal funds purchased and securities sold under repurchase agreements | 64,706 | 42 | 0.09 | 3,619 | 2 | 0.07 |
| Other borrowings | 805,709 | 30,179 | 5.00 | 838,742 | 27,661 | 4.41 |
| Total interest-bearing liabilities | 10,029,044 | 41,135 | 0.55 | 10,700,226 | 56,405 | 0.70 |
| Noninterest-bearing deposits | 11,880,162 | | | 9,045,318 | | |
| Other liabilities | 415,288 | | | 332,460 | | |
| Total equity | 2,233,536 | | | 2,056,671 | | |
| Total liabilities and equity | $ 24,558,030 | | | $ 22,134,675 | | |
| | | | | | | |
| Net interest spread | | | 3.43% | | | 3.49% |
| Fully taxable-equivalent net interest and dividend income | | $ 641,590 | | | $ 584,259 | |
| Net interest margin | | | 3.74% | | | 3.82% |

| | | | | |
|---|---|---|---|---|
| Less: Dividend income included in other income | | 2,070 | | 2,086 |
| Fully taxable-equivalent net interest income | $ | 639,520 | $ | 582,173 |

(1) Certain prior period balances have been reclassified to conform to the current period presentation.

(2) Net interest income is presented on a fully taxable-equivalent basis.

(3) Includes average nonaccrual loans of $109,823 and $151,258 for 2012 and 2011, respectively.

(4) Loan income includes loan fees of $18,437 and $14,446 for 2012 and 2011, respectively.

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Net interest income is impacted by the volume (changes in volume multiplied by prior rate), interest rate (changes in rate multiplied by prior volume), and mix of interest-earning assets and interest-bearing liabilities. The following table provides a breakdown of the changes in net interest income on a fully taxable-equivalent basis and dividend income due to volume and rate between the third quarter and first nine months of 2012 and 2011. The impact of interest rate swaps, which affect interest income on loans and leases and interest expense on deposits and borrowings, is included in rate changes.

**Changes In Net Interest Income**

| | For the three months ended September 30, 2012 vs 2011 | | | For the three months ended September 30, 2011 vs 2010 | | |
|---|---|---|---|---|---|---|
| | Increase (decrease) due to | | Net increase | Increase (decrease) due to | | Net increase |
| **(in thousands) (1)** | **Volume** | **Rate** | **(decrease)** | **Volume** | **Rate** | **(decrease)** |
| Interest earned on: | | | | | | |
| Total loans and leases (2) | $ 16,605 | $ (11,746) | $ 4,859 | $ 375 | $ (1,820) | $ (1,445) |
| Securities | 9,458 | (5,502) | 3,956 | 13,088 | (7,602) | 5,486 |
| Due from banks - interest-bearing | (267) | (44) | (311) | (132) | 60 | (72) |
| Federal funds sold and securities purchased under resale agreements | (16) | | (16) | (166) | 17 | (149) |
| Other interest-earning assets | (91) | 93 | 2 | (104) | 32 | (72) |
| Total interest-earning assets | 25,689 | (17,199) | 8,490 | 13,061 | (9,313) | 3,748 |
| | | | | | | |
| Interest paid on: | | | | | | |
| Interest checking deposits | 89 | (277) | (188) | 11 | (176) | (165) |
| Money market deposits | (832) | (3,561) | (4,393) | 331 | (3,127) | (2,796) |
| Savings deposits | 27 | (141) | (114) | 33 | (80) | (47) |
| Time deposits | (173) | (351) | (524) | (629) | (245) | (874) |
| Total borrowings | 1,698 | 791 | 2,489 | (2,888) | (1,999) | (4,887) |
| Total interest-bearing liabilities | 809 | (3,539) | (2,730) | (3,142) | (5,627) | (8,769) |
| | $ 24,880 | $ (13,660) | $ 11,220 | $ 16,203 | $ (3,686) | $ 12,517 |

(1) Certain prior period balances have been reclassified to conform to current period presentation.

(2) Includes covered loans.

**Changes In Net Interest Income**

| | For the nine months ended September 30, 2012 vs 2011 | | | For the nine months ended September 30, 2011 vs 2010 | | |
|---|---|---|---|---|---|---|
| | Increase (decrease) due to | | Net increase | Increase (decrease) due to | | Net increase |
| **(in thousands) (1)** | **Volume** | **Rate** | **(decrease)** | **Volume** | **Rate** | **(decrease)** |
| Interest earned on: | | | | | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| Total loans and leases (2) | $ 42,203 | $ (16,144) | $ 26,059 | $ (13,048) | $ 1,943 | $ (11,105) |
| Securities | 32,302 | (15,373) | 16,929 | 38,955 | (20,904) | 18,051 |
| Due from banks - interest-bearing | (602) | (148) | (750) | (97) | (39) | (136) |
| Federal funds sold and securities purchased under resale agreements | (173) | 12 | (161) | (71) | 17 | (54) |
| Other interest-earning assets | (289) | 273 | (16) | (198) | 230 | 32 |
| Total interest-earning assets | 73,441 | (31,380) | 42,061 | 25,541 | (18,753) | 6,788 |
| Interest paid on: | | | | | | |
| Interest checking deposits | 236 | (1,002) | (766) | (534) | (807) | (1,341) |
| Money market deposits | (2,123) | (12,519) | (14,642) | 3,966 | (7,509) | (3,543) |
| Savings deposits | 93 | (474) | (381) | (25) | (470) | (495) |
| Time deposits | (746) | (1,293) | (2,039) | (2,545) | (1,499) | (4,044) |
| Other borrowings | 943 | 1,615 | 2,558 | (7,234) | (5,649) | (12,883) |
| Total interest-bearing liabilities | (1,597) | (13,673) | (15,270) | (6,372) | (15,934) | (22,306) |
| | $ 75,038 | $ (17,707) | $ 57,331 | $ 31,913 | $ (2,819) | $ 29,094 |

(1) Certain prior period balances have been reclassified to conform to the current period presentation.

(2) Includes covered loans.

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Net interest income was $209.9 million for the third quarter of 2012, a decrease from $216.5 million for the second quarter of 2012 and an increase from $199.3 million for the third quarter of 2011. The decrease from the second quarter of 2012 was primarily the result of lower interest income on total loans. The increase from the year-earlier quarter was largely due to higher interest income on total loans and securities and lower interest expense on deposits.

Interest income on total loans was $180.3 million for the third quarter of 2012, down 3 percent from the second quarter of 2012 and up 3 percent from the year-earlier quarter. The decrease in interest income from the second quarter of 2012 was due to lower income from the net accelerated accretable yield recognition on covered loans that were paid off or fully charged off in the third quarter of 2012. The growth in loan interest income during the current quarter compared with the year-earlier quarter was a result of higher income from the net accelerated accretable yield recognition on covered loans, as well as interest income recognized on lease financing loans from the acquisition of FAEF in April 2012. Income from accelerated accretable yield recognition during the third quarter of 2012 was $22.2 million, down from $27.4 million in the second quarter of 2012 and up from $18.3 million in the year-earlier quarter.

Interest income on securities was $44.2 million for the third quarter of 2012, a 1 percent increase from $43.5 million for the second quarter of 2012 and an 8 percent increase from $40.9 million for the third quarter of 2011. The growth in securities income is a result of higher average securities, partially offset by lower yields.

Total interest expense was $14.8 million for the third quarter of 2012, up from $13.4 million for the second quarter of 2012, but down from $17.6 million for the third quarter of 2011. Interest expense on deposits was $3.3 million for the third quarter of 2012, down 7 percent from $3.6 million for the second quarter of 2012 primarily as a result of lower interest rates. Interest expense on deposits was down 61 percent from $8.5 million for the year-earlier quarter due to lower interest rates as well as a 9 percent decrease in average interest-bearing deposits. Interest expense on borrowings was $11.5 million for the third quarter of 2012, up 17 percent from the second quarter of 2012 and 28 percent from the same period in 2011. The growth in interest expense on borrowings was primarily attributable to debt assumed in the acquisition of FAEF and the issuance of $150.0 million in subordinated notes during the second quarter of 2012.

The net settlement of interest-rate swaps increased net interest income by $2.1 million for the third quarter of 2012, compared to $2.1 million for the second quarter of 2012 and $3.6 million for the year-earlier quarter.

The fully taxable net interest margin was 3.58 percent for the third quarter of 2012, down from 3.91 percent for the second quarter of 2012 and 3.79 percent for the third quarter of 2011. The average yield on earning assets for the third quarter of 2012 was 3.82 percent, down 33 basis points from 4.15 percent for the second quarter of 2012 and down 30 basis points from 4.12 percent for the year-earlier quarter. The average cost of interest-bearing liabilities was 0.59 percent, up 4 basis points from 0.55 percent for the second quarter of 2012, but down 5 basis points from 0.64 percent for the same period in 2011. The second quarter net interest margin of 3.91 percent reflected interest income from the recovery of a previously charged-off loan, and the decline in the third quarter of 2012 was due primarily to lower interest income related to covered loans that were repaid or charged off in the third quarter, lower loan yields, and continuing deposit growth. The Company continued to invest a large share of its growing deposits in securities and other liquid assets.

Fully taxable-equivalent net interest income, which includes amounts to convert nontaxable income to fully taxable-equivalent amounts, was $214.1 million for the third quarter of 2012 compared to $220.7 million for the second quarter of 2012 and $202.9 million for the third quarter of 2011. Fully taxable-equivalent net interest income and dividend income was $214.8 million for the third quarter of 2012 compared with $221.4 million for the second quarter of 2012 and $203.6 million for the same period in 2011. The $11.2 million increase in fully taxable-equivalent net interest and dividend income from the year-ago quarter was primarily generated through loans and securities growth (volume variance) and lower rates on interest-bearing deposits offset by lower yields on loans and securities (rate variance).

Average loans and leases, excluding covered loans, totaled $13.59 billion for the third quarter of 2012, an increase of 4 percent from $13.13 billion for the second quarter of 2012 and 15 percent from $11.80 billion for the third quarter of 2011. The increases were primarily driven by a growth in commercial loans, which grew 5 percent and 24 percent from the second quarter of 2012 and year-earlier quarter, respectively, and commercial real estate loans, which grew 7 percent and 27 percent for the same periods. The growth in commercial loans from the year-earlier quarter was partly a result of lease financing loans that were acquired in the FAEF acquisition during the second quarter of 2012. Average covered loans were $1.21 billion for the third quarter of 2012, a decrease of 10 percent from $1.34 billion in the second quarter of 2012 and 27 percent from $1.66 billion for the year-ago quarter.

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Average total securities, which include trading securities, were $8.63 billion for the third quarter of 2012, up 11 percent from the third quarter of 2011 and 24 percent from the year-earlier quarter as deposit growth outpaced loan growth.

Average deposits were $21.94 billion for the third quarter of 2012, a 5 percent increase from $20.95 billion for the second quarter of 2012 and an 11 percent increase from $19.72 billion for the third quarter of 2011. Average core deposits, which do not include certificates of deposits of $100,000 or more, were $21.21 billion for the third quarter of 2012 and represented 97 percent of the total average deposit balance, compared to $20.22 billion and 97 percent in the second quarter of 2012 and $18.92 billion and 96 percent for the year-earlier quarter. Average interest-bearing deposits were $9.14 billion for the third quarter of 2012, up 1 percent from the second quarter of 2012 and down 9 percent from the year-earlier quarter. Average noninterest-bearing deposits were $12.80 billion, up 8 percent from the second quarter of 2012 and 32 percent from the third quarter of 2011.

**Provision for Credit Losses**

The Company accounts for the credit risk associated with lending activities through its allowance for loan and lease losses, reserve for off-balance sheet credit commitments and provision for credit losses. The provision for credit losses on loans and leases, excluding covered loans, is the expense recognized in the consolidated statements of income to adjust the allowance and the reserve for off-balance sheet credit commitments to the levels deemed appropriate by management, as determined through application of the Company s allowance methodology procedures. See Critical Accounting Policies Allowance for Loan and Lease Losses and Reserve for Off-Balance Sheet Credit Commitments in the Company s Form 10-K for the year ended December 31, 2011.

The Company recorded expense of $2.0 million and $3.0 million through the provision for credit losses on loans and leases, excluding covered loans, for the three and nine months ended September 30, 2012, respectively. The Company recorded a $7.5 million provision for credit losses on loans and leases, excluding covered loans, for the same periods in 2011. The provision reflects management s continuing assessment of the credit quality of the Company s loan portfolio, which is affected by a broad range of economic factors. Additional factors affecting the provision include net loan charge-offs, nonaccrual loans, specific reserves, risk rating migration and changes in the portfolio size and composition. See Balance Sheet Analysis Allowance for Loan and Lease Losses and Reserve for Off-Balance Sheet Credit Commitments for further information on factors considered by the Company in assessing the credit quality of the loan portfolio and establishing the allowance for loan and lease losses.

Covered loans represent loans acquired from the FDIC that are subject to loss-sharing agreements, and are primarily accounted for as acquired impaired loans under ASC Topic 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality* ( ASC 310-30 ). The provision for losses on covered loans is the expense recognized in the consolidated statements of income related to impairment losses resulting from the Company s quarterly review and update of cash flow projections on its covered loan portfolio. The Company recorded provision for losses on covered loans of $18.1 million during the third quarter of 2012, compared to $13.3 million in the second quarter of 2012 and $5.1 million in the third quarter of 2011. Provision for losses on covered loans was $38.8 million for the nine months ended September 30, 2012 compared to $26.0 million for the year-earlier period. The provision for losses on covered loans is the result of changes in expected cash flows, both amount and timing, due to loan payments and the Company s revised loss forecasts. The revisions of the loss forecasts were based on the results of management s review of the credit quality of the outstanding covered loans and the analysis of the loan performance data since the acquisition of covered loans. The Company will continue updating cash flow projections on covered loans on a quarterly basis. Due to the uncertainty in the future performance of the covered loans, additional impairments may be recognized in the future.

Credit quality will be influenced by underlying trends in the economic cycle, particularly in California and Nevada, and other factors which are beyond management s control. Consequently, no assurances can be given that the Company will not sustain loan or lease losses, in any particular period, that are sizable in relation to the allowance for loan and lease losses.

Refer to Loans and Leases Asset Quality on page 76 for further discussion of credit quality.

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**Noninterest Income**

Noninterest income was $107.3 million in the third quarter of 2012, an increase of 43 percent from the second quarter of 2012 and 54 percent from the third quarter of 2011. The increase from the prior quarters was largely a result of the Company s acquisition of Rochdale, higher net FDIC loss sharing income and distribution income from private equity investments. Noninterest income represented 34 percent of the Company s revenue in the third quarter of 2012, an increase from 26 percent in the second quarter of 2012 and the year-earlier quarter.

The following table provides a summary of noninterest income by category:

| | For the three months ended | | |
|---|---|---|---|
| (in thousands) | September 30, 2012 | June 30, 2012 | September 30, 2011 |
| Trust and investment fees | 43,477 | $ 34,067 | $ 35,412 |
| Brokerage and mutual fund fees | 9,059 | 5,293 | 5,079 |
| Total wealth management fees | 52,536 | 39,360 | 40,491 |
| Cash management and deposit transaction charges | 11,526 | 11,475 | 10,986 |
| International services | 9,819 | 10,017 | 10,352 |
| FDIC loss sharing income (expense), net | 1,667 | (6,026) | (14,191) |
| Other noninterest income | 27,693 | 17,388 | 13,479 |
| Total noninterest income before gain (loss) | 103,241 | 72,214 | 61,117 |
| Gain on disposal of assets | 3,199 | 3,011 | 5,191 |
| Gain (loss) on sale of securities | 856 | (279) | 3,520 |
| Impairment loss on securities | (39) | (178) | (193) |
| Total noninterest income | $ 107,257 | $ 74,768 | $ 69,635 |

*Wealth Management*

The Company provides various trust, investment and wealth advisory services to its individual and business clients. The Company delivers these services through the Bank s wealth management division as well as through its wealth management affiliates. Trust services are provided only by the Bank. Trust and investment fee revenue includes fees from trust, investment and asset management, and other wealth advisory services. The majority of these fees are based on the market value of client assets managed, advised, administered or held in custody. The remaining portion of these fees is based on the specific service provided, such as estate and financial planning services, or may be fixed fees. For those fees based on market valuations, the mix of assets held in client accounts, as well as the type of managed account, impacts how closely changes in trust and investment fee income correlate with changes in the financial markets. Changes in market valuations are reflected in fee income primarily on a trailing-quarter basis. Also included in total trust and investment fees is the Company s portion of income from certain investments accounted for under the equity method. Trust and investment fees were $43.5 million for the third quarter of 2012, an increase of 28 percent from $34.1 million for the second quarter of 2012 and 23 percent from $35.4 million for the third quarter of 2011. The increase in trust and investment fees was due primarily to the Rochdale acquisition. Brokerage and mutual fund fees were $9.1 million for the quarter, up 71 percent from $5.3 million for the second quarter of 2012 and 78 percent from $5.1 million for the year-earlier quarter. The increases in mutual fund fees were due primarily to slightly higher short-term interest rates. The increases in brokerage fees were due to both the acquisition of Rochdale and improved performance from the rest of the Company s wealth management business.

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Assets under management ( AUM ) include assets for which the Company makes investment decisions on behalf of its clients and assets under advisement for which the Company receives advisory fees from its clients. Assets under administration ( AUA ) are assets the Company holds in a fiduciary capacity or for which it provides non-advisory services. The table below provides a summary of AUM and AUA for the dates indicated:

| (in millions) (1) | September 30, 2012 | September 30, 2011 | % Change | June 30, 2012 | % Change |
|---|---|---|---|---|---|
| **Assets Under Management** | $ 38,043 | $ 33,591 | 13 | 32,105 | 18 |
| **Assets Under Administration** | | | | | |
| Brokerage | 5,603 | 5,543 | 1 | 5,357 | 5 |
| Custody and other fiduciary | 13,026 | 9,373 | 39 | 12,578 | 4 |
| Subtotal | 18,629 | 14,916 | 25 | 17,935 | 4 |
| Total assets under management or administration | $ 56,672 | $ 48,507 | 17 | $ 50,040 | 13 |

(1) Excludes $19.81 billion, $18.39 billion and $16.09 billion of assets under management for asset managers in which the Company held a noncontrolling ownership interest as of September 30, 2012, June 30, 2012 and September 30, 2011, respectively.

During the third quarter of 2012, assets under administration were revised to exclude the Company s investments that were held in custody and serviced by the Company s wealth management business. Prior period balances were reclassified to conform to current period presentation.

AUM totaled $38.04 billion as of September 30, 2012, up 13 percent from the year-earlier quarter and 18 percent from the second quarter of 2012. Assets under management or administration were $56.67 billion at September 30, 2012, up 17 percent from the year-earlier quarter and 13 percent from the second quarter of 2012. The growth in AUM from the year-earlier quarter was primarily attributable to the acquisition of Rochdale in July 2012.

A distribution of AUM by type of investment is provided in the following table:

| | % of AUM | | |
|---|---|---|---|
| **Investment** | **September 30, 2012** | **June 30, 2012** | **September 30, 2011** |
| Equities | 43% | 40% | 40% |
| U.S. fixed income | 27 | 26 | 25 |
| Cash and cash equivalents | 18 | 21 | 21 |
| Other (1) | 12 | 13 | 14 |
| | 100% | 100% | 100% |

(1) Includes private equity and other alternative investments.

*Other Noninterest Income*

Cash management and deposit transaction fees for the third quarter of 2012 were $11.5 million, up 5 percent from the third quarter of 2011 but virtually unchanged from the second quarter of this year.

International services income for the third quarter of 2012 was $9.8 million, down 2 percent from the second quarter of 2012 and 5 percent from the third quarter of 2011. International services income includes foreign exchange fees, fees on commercial letters of credit and standby letters of credit, foreign collection fees and gains and losses associated with fluctuations in foreign currency exchange rates.

Net FDIC loss sharing income was $1.7 million for the third quarter of 2012, compared to net FDIC loss sharing expense of $6.0 million for the second quarter of 2012 and expense of $14.2 million for the year-earlier quarter. See Noninterest Income and Expense Related to Covered Assets for further discussion of FDIC loss sharing income and expense.

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Net gain on disposal of assets was $3.2 million in the third quarter of 2012, compared with net gains of $3.0 million in the second quarter of 2012 and $5.2 million in the year-earlier quarter. The net gain is primarily due to gains recognized on the sale of covered and non-covered OREO.

The Company recognized $0.9 million of net gain on the sale of securities in the third quarter of 2012, compared with a net loss of $0.3 million for the second quarter of 2012 and a net gain of $3.5 million for the third quarter of 2011.

Impairment losses on securities available-for-sale recognized in earnings were $39 thousand for the third quarter of 2012, compared with $0.2 million for the second quarter of 2012 and for the year-earlier quarter. See Balance Sheet Analysis Securities for a discussion of impairment on securities available-for-sale.

Other income for the third quarter of 2012 was $27.7 million, an increase of 59 percent from $17.4 million for the second quarter of 2012 and 105 percent from $13.5 million for the third quarter of 2011. The increase in other income reflects $7.3 million of distribution income, net of $2.5 million of impairment losses on private equity and other alternative investments. The increase was also the result of higher gains from trading securities, lease income from the acquisition of FAEF and the growth of income from client swap transactions.

***Noninterest Expense***

Noninterest expense was $207.9 million for the third quarter of 2012, an increase of 7 percent from $194.5 million for the second quarter of 2012 and 5 percent from $197.6 million for the third quarter of 2011. The increases were due largely to the acquisition of Rochdale and FAEF.

The following table provides a summary of noninterest expense by category:

| | For the three months ended | | |
|---|---|---|---|
| **(in thousands)** | **September 30, 2012** | **June 30, 2012** | **September 30, 2011** |
| Salaries and employee benefits | $ 120,210 | $ 115,035 | $ 112,729 |
| All other: | | | |
| Net occupancy of premises | 16,238 | 14,056 | 13,713 |
| Legal and professional fees | 11,757 | 11,359 | 14,242 |
| Information services | 8,660 | 8,539 | 7,906 |
| Depreciation and amortization | 8,324 | 8,013 | 6,930 |
| Amortization of intangibles | 1,932 | 1,518 | 2,105 |
| Marketing and advertising | 7,141 | 7,597 | 6,675 |
| Office services and equipment | 4,673 | 4,492 | 4,456 |
| Other real estate owned | 8,749 | 7,541 | 13,160 |
| FDIC assessments | 4,616 | 4,523 | 6,670 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Other operating | | 15,586 | | 11,842 | | 9,051 |
| Total all other | | 87,676 | | 79,480 | | 84,908 |
| Total noninterest expense | $ | 207,886 | $ | 194,515 | $ | 197,637 |

Salaries and employee benefits expense was $120.2 million for the third quarter of 2012, up 4 percent from $115.0 million for the second quarter of 2012 and 7 percent from $112.7 million for the year-earlier quarter. Full-time equivalent employees totaled 3,439 at September 30, 2012, up from 3,330 at June 30, 2012 and 3,287 at September 30, 2011. The increase in salaries and employee benefits and employee count during the third quarter of 2012 was primarily attributable to the acquisition of Rochdale in July 2012 and FAEF in April 2012.

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Salaries and employee benefits expense for the third quarter of 2012 includes $4.7 million of share-based compensation expense compared with $4.3 million for the second quarter of 2012 and $4.7 million for the year-earlier quarter. At September 30, 2012, there was $14.4 million of unrecognized compensation cost related to unvested stock options granted under the Company s plans. That cost is expected to be recognized over a weighted average period of 2.5 years. At September 30, 2012, there was $22.4 million of unrecognized compensation cost related to restricted shares granted under the Company s plans. That cost is expected to be recognized over a weighted average period of 3.1 years. In February 2012, the Company granted cash-settled restricted stock units to employees. Cash-settled restricted stock units are initially valued at the closing price of the Company s stock on the date of award and subsequently remeasured at each reporting date until settlement. See Note 11, *Share-Based Compensation*, of the Notes to the Unaudited Consolidated Financial Statements for further discussion.

The remaining noninterest expense categories totaled $87.7 million for the third quarter of 2012, up from $79.5 million for the second quarter of 2012 and $84.9 million for the third quarter of 2011. The increase from the year-earlier quarter and the second quarter of 2012 reflects operating expenses from the Company s recent acquisitions. The growth in noninterest expense from the second quarter of 2012 was also a result of higher occupancy costs, legal settlement expense and an increase in OREO expense. OREO expense was $8.7 million for the third quarter of 2012, up 16 percent from the second quarter of 2012 and down 34 percent from the year earlier quarter. OREO expense was comprised mostly of expense related to covered OREO. Of the qualified covered asset-related expenses, 80 percent is reimbursable by the FDIC and reflected in FDIC loss sharing income (expense), net in the noninterest income section of the consolidated statements of income.

The following table provides OREO expense for non-covered OREO and covered OREO:

| (in thousands) | For the three months ended September 30, 2012 | For the three months ended September 30, 2011 | For the nine months ended September 30, 2012 | For the nine months ended September 30, 2011 |
|---|---|---|---|---|
| **Non-covered OREO expense** | | | | |
| Valuation write-downs | $ 732 | $ 876 | $ 1,881 | $ 3,375 |
| Holding costs and foreclosure expense | 228 | 1,309 | 653 | 2,471 |
| Total non-covered OREO expense | $ 960 | $ 2,185 | $ 2,534 | $ 5,846 |
| **Covered OREO expense** | | | | |
| Valuation write-downs | $ 4,267 | $ 7,526 | $ 16,325 | $ 31,459 |
| Holding costs and foreclosure expense | 3,522 | 3,449 | 9,525 | 12,506 |
| Total covered OREO expense | $ 7,789 | $ 10,975 | $ 25,850 | $ 43,965 |
| | | | | |
| Total OREO expense | $ 8,749 | $ 13,160 | $ 28,384 | $ 49,811 |

Legal and professional fees were $11.8 million for the third quarter of 2012, up 4 percent from $11.4 million in the second quarter of 2012 and down 17 percent from $14.2 million in the year-earlier quarter. The increase in legal and professional fees from the second quarter of 2012 reflects the second quarter reimbursement of $3.6 million in legal expenses related to the recovery of a previously charged-off loan, partially offset by $2.8 million of acquisition-related transactions costs that were also recognized during the second quarter. Legal and professional fees associated with covered loans and OREO were approximately $2.5 million for the third quarter of 2012, $2.2 million for the second quarter of 2012 and $3.0 million for the third quarter of 2011. Qualifying legal and professional fees for covered assets are also reimbursable by the FDIC at 80 percent.

Net income attributable to noncontrolling interest, representing noncontrolling ownership interests in the net income of affiliates, was $0.4 million for the third quarter of 2012, compared to $0.4 million for the second quarter of 2012 and $1.0 million for the year-earlier quarter.

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***Noninterest Income and Expense Related to Covered Assets***

The following table summarizes the components of noninterest income and noninterest expense related to covered assets for the three and nine months ended September 30, 2012 and 2011:

| (in thousands) | For the three months ended September 30, 2012 | For the three months ended September 30, 2011 | For the nine months ended September 30, 2012 | For the nine months ended September 30, 2011 |
|---|---|---|---|---|
| ***Noninterest income related to covered assets*** | | | | |
| **FDIC loss sharing income (expense), net** | | | | |
| Gain (loss) on indemnification asset | $ 21,426 | $ (384) | $ 49,987 | $ 16,351 |
| Indemnification asset accretion | (4,258) | (4,043) | (12,416) | (11,793) |
| Net FDIC reimbursement for OREO and loan expenses | 7,612 | 10,496 | 24,777 | 39,467 |
| Removal of indemnification asset for loans paid-off or fully charged-off | (9,731) | (10,228) | (26,901) | (20,047) |
| Removal of indemnification asset for unfunded loan commitments and loans transferred to OREO | (2,834) | (3,703) | (9,720) | (20,231) |
| Removal of indemnification asset for OREO and net reimbursement to FDIC for OREO sales | (1,219) | (2,823) | (5,064) | (11,324) |
| Loan recoveries shared with FDIC | (8,631) | (3,153) | (22,344) | (8,321) |
| Increase in FDIC clawback liability | (698) | (353) | (1,812) | (1,131) |
| Other | | | | 759 |
| Total FDIC loss sharing income (expense), net | 1,667 | (14,191) | (3,493) | (16,270) |
| **Gain on disposal of assets** | | | | |
| Net gain on sale of OREO | 1,524 | 3,625 | 5,147 | 14,345 |
| **Gain on acquisition** | | | | 8,164 |
| **Other income** | | | | |
| Net gain on transfers of covered loans to OREO | 4,907 | 3,887 | 14,254 | 27,034 |
| Amortization of fair value on acquired unfunded loan commitments | 192 | 1,088 | 1,164 | 2,546 |
| OREO income | 428 | 379 | 1,948 | 1,677 |
| Other | (632) | (503) | (2,514) | (1,164) |
| Total other income | 4,895 | 4,851 | 14,852 | 30,093 |
| **Total noninterest income related to covered assets** | $ 8,086 | $ (5,715) | $ 16,506 | $ 36,332 |
| ***Noninterest expense related to covered assets (1)*** | | | | |
| **Other real estate owned** | | | | |
| Valuation write-downs | $ 4,267 | $ 7,526 | $ 16,325 | $ 31,459 |
| Holding costs and foreclosure expense | 3,522 | 3,449 | 9,525 | 12,506 |
| Total other real estate owned | 7,789 | 10,975 | 25,850 | 43,965 |
| **Legal and professional fees** | 2,541 | 2,961 | 7,019 | 7,612 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **Other operating expense** | | | | | | | | |
| Other covered asset expenses | | 29 | | 18 | | 69 | | 39 |
| **Total noninterest expense related to covered assets (2)** | $ | 10,359 | $ | 13,954 | $ | 32,938 | $ | 51,616 |

(1) OREO, legal and professional fees and other expenses related to covered assets must meet certain FDIC criteria in order for the expense amounts to be reimbursed. Certain amounts reflected in these categories may not be reimbursed by the FDIC.

(2) Excludes personnel and other corporate overhead expenses that the Company incurs to service covered assets and costs associated with the branches acquired in FDIC-assisted acquisitions.

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*Noninterest Income*

Income and expense from FDIC loss-sharing agreements is reflected in FDIC loss sharing income (expense), net. This balance includes FDIC indemnification asset accretion or amortization, gain or loss on the FDIC indemnification asset, and expense from the reduction of the FDIC indemnification asset upon the removal of loans, OREO and unfunded loan commitments. Loans are removed when they have been fully paid off, fully charged off, sold or transferred to OREO. Net FDIC loss sharing income (expense) also includes income recognized on the portion of expenses related to covered assets that are reimbursable by the FDIC, net of income due to the FDIC, as well as the income statement effects of other loss-share transactions.

Net FDIC loss sharing income was $1.7 million for the third quarter of 2012 compared to net FDIC loss sharing expense of $6.0 million in the second quarter of 2012 and expense of $14.2 million in the year-earlier quarter. The change in net FDIC loss sharing expense to income from the year-earlier quarter was primarily attributable to higher gains on the indemnification asset from a revision of the Company s projected cash flows forecast on its covered loans. The increase was partially offset by higher expense from loan recoveries on loans paid-off or fully charged-off that are shared with the FDIC, as well as lower FDIC reimbursement for covered OREO and loan expenses resulting from an overall decline in OREO and loan expense. The change in net FDIC loss sharing expense to income from the second quarter of 2012 was also due to higher gains on the indemnification asset, as well as lower expense from the reduction of the FDIC indemnification asset upon the removal of covered loans.

The Company recognized a net gain on sales of covered OREO of $1.5 million in the third quarter of 2012 compared to $1.5 million in the second quarter of 2012 and $3.6 million in the third quarter of 2011. Other income related to covered assets was $4.9 million in the current quarter and consists primarily of net gain on transfers of covered loans to OREO, the amortization of fair value on acquired unfunded loan commitments and OREO income. Total other income was virtually unchanged from the year-earlier quarter, but decreased from $7.0 million in the second quarter of 2012 primarily because of lower net gains on the transfers of covered loans to OREO. Net gains on the transfer of covered loans to OREO were $4.9 million during the third quarter of 2012 compared to $6.9 million during the second quarter of 2012. The gain or loss recognized on transfer of covered loans to OREO is calculated as the difference between the carrying value of the covered loan and the fair value of the underlying foreclosed collateral. Refer to the above table for additional information on the components of other income related to covered assets for the three and nine months ending September 30, 2012, and 2011.

*Noninterest Expense*

Noninterest expense related to covered assets includes OREO expense, legal and professional expense and other covered asset-related expenses, and may be subject to FDIC reimbursement. Expenses must meet certain FDIC criteria in order for the expense amounts to be reimbursed. Certain amounts reflected in these balances may not be reimbursed by the FDIC if they do not meet the criteria. Total covered OREO expense, which includes valuation write-downs, holding costs and foreclosure expenses was $7.8 million for the third quarter of 2012, up from $7.0 million for the second quarter of 2012 and down from $11.0 million for the year-earlier quarter.

***Segment Operations***

The Company s reportable segments are Commercial and Private Banking, Wealth Management and Other. For a more complete description of the segments, including summary financial information, see Note 18 to the Unaudited Consolidated Financial Statements.

*Commercial and Private Banking*

Net income for the Commercial and Private Banking segment increased to $29.6 million for the third quarter of 2012 from $25.4 million for the third quarter of 2011. Net income for the nine months ended September 30, 2012 was $80.7 million, down from $86.1 million for the year-earlier period. The increase in net income from the prior-year quarter was due to an increase in noninterest income and a decrease in provision for credit losses on loans and leases, partially offset by higher provision for losses on covered loans. The decrease in net income for the nine months ended September 30, 2012 was primarily attributable to a decrease in noninterest income and an increase in provision for losses on covered loans. Net interest income decreased to $184.6 million for the third quarter of 2012 from $190.0 million for the year-earlier quarter. Net interest income for the nine months ended September 30, 2012 was $541.2 million compared to $543.7 million for the same period in 2011. The decline in net interest income from the year-earlier quarter was a result of lower funds transfer pricing

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income on deposits combined with lower covered loan balances, and was partially offset by income from FAEF, which was acquired by the Company in April 2012. Average loans, excluding covered loans, increased by 15 percent to $13.53 billion for the third quarter of 2012 compared with the year-earlier quarter. Average loans, excluding covered loans, for the nine months ended September 30, 2012 grew 13 percent to $12.99 billion. The increase in loans was a result of organic loan growth and the acquisition of FAEF. Average covered loans were $1.21 billion for the third quarter of 2012 compared to $1.66 billion for the third quarter of 2011, and $1.33 billion for the nine months of 2012 compared to $1.75 billion for the same period in 2011. Average deposits increased by 11 percent to $21.30 billion for the third quarter of 2012 from $19.27 billion for the year-earlier quarter. Average deposits increased by 11 percent to $20.47 billion for the nine months ended September 30, 2012 from $18.46 billion for the same period in 2011. The growth in average deposits compared with the prior-year period was driven by new client relationships and growth in deposits of existing clients.

Provision for credit losses on loans and leases, excluding covered loans, was $2.0 million and $3.0 million for the three months and nine months ended September 30, 2012, respectively, compared to $7.5 million for the same periods in 2011. Provision for losses on covered loans was $18.1 million and $38.8 million for the three months and nine months ended September 30, 2012, compared to $5.1 million and $26.0 million for both respective periods in 2011. Refer to Results of Operations Provision for Credit Losses for further discussion of the provision.

Noninterest income for the third quarter of 2012 was $60.2 million, up 54 percent from $39.1 million for the prior-year quarter. Noninterest income for the nine months ended September 30, 2012 decreased 3 percent to $157.8 million compared to $162.5 million for the year-earlier period. The increase from the prior-year quarter was primarily due to higher FDIC loss sharing income and lease income from FAEF. Noninterest income for the nine months ended September 30, 2011 included an $8.2 million gain from an FDIC-assisted acquisition during the second quarter of 2011. Noninterest expense, including depreciation and amortization, increased slightly to $173.6 million for the third quarter of 2012 from $172.8 million for the year-earlier quarter. Noninterest expense, including depreciation and amortization, decreased 1 percent to $518.0 million for the first nine months of 2012 from $524.2 million for the same period in 2011.

*Wealth Management*

The Wealth Management segment had net income attributable to CNC of $4.6 million for the third quarter of 2012, an increase from $2.6 million for the year-earlier quarter. Net income attributable to CNC for the nine months ended September 30, 2012 was $7.4 million compared to $3.8 million for the year-earlier period. Noninterest income increased to $54.4 million, or by 32 percent, for the third quarter of 2012 from $41.1 million for the year-earlier quarter. Noninterest income was $133.7 million for the nine months ended September 30, 2012, up 8 percent from $124.0 million for the year-earlier period. The increase in the current periods reflects income from Rochdale, which the Company acquired in July 2012. Refer to Results of Operations Noninterest Income Wealth Management for further discussion of the factors impacting fee income for the Wealth Management segment. Noninterest expense, including depreciation and amortization, was $47.2 million for the third quarter of 2012, up by 31 percent from $36.1 million for the year-earlier quarter. Noninterest expense, including depreciation and amortization, increased 6 percent to $122.3 million in the first nine months of 2012 from $115.8 million in the year-earlier period. The increase in expense compared with the year-earlier periods was primarily due to higher costs attributable to the acquisition of Rochdale.

*Other*

Net income attributable to CNC for the Other segment increased to $25.5 million for the third quarter of 2012, from $13.5 million for the third quarter of 2011. Net income attributable to CNC increased to $72.7 million for the nine months ended September 30, 2012, from $38.6 million for the same period in 2011. The Asset Liability Funding Center, which is included in the Other segment, is used for funds transfer pricing. The Funding Center charges the business line units for loans and pays them for generating deposits. In general, net interest income decreases in the

Funding Center when loan and securities balances decrease or when deposit balances increase. However, in periods of extremely low interest rates, the funding credit given on deposits to the Commercial and Private Banking segment declines considerably which may cause net interest income in the Funding Center to increase. Net interest income was $24.2 million and $83.6 million for the three and nine months ended September 30, 2012, respectively, an increase from $8.8 million and $26.1 million for the three and nine months ended September 30, 2011, respectively. The increase in net interest income was due to higher funds transfer income due to loan and securities portfolio growth, and to a reduction in the funds transfer rate paid to business line units on deposit balances. Although deposits have increased from the prior-year quarter, the transfer pricing rate paid on deposits declined as a result of the continuing low interest rate environment.

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Noninterest income (loss) was ($7.4) million for the current quarter compared with ($10.6) million for the year-earlier quarter. Noninterest income (loss) was ($33.8) million for the nine months ended September 30, 2012 compared with ($31.0) million for the year-earlier period. The change in noninterest income (loss) compared with the year-earlier quarter was primarily due to gains on private equity investments during the third quarter of 2012. The change in noninterest income (loss) for the nine months ended September 30, 2012 reflects an increase in the elimination of inter-segment revenues (recorded in Other segment) due to higher wealth management fee income compared to the year-earlier period, as well as lower net gains on the sale of securities.

**Income Taxes**

The Company recognized income tax expense of $29.1 million during the third quarter of 2012, compared with tax expense of $27.3 million in the second quarter of 2012 and $16.3 million in the year-earlier quarter. The effective tax rate was 32.6 percent of pretax income for the third quarter of 2012, compared with 33.1 percent for the second quarter of 2012 and 27.7 percent for the year-earlier quarter. The effective tax rates differ from the applicable statutory federal and state tax rates due to various factors, including tax benefits from investments in affordable housing partnerships, tax-exempt income on municipal bonds, bank-owned life insurance and other adjustments.

The Company recognizes accrued interest and penalties relating to uncertain tax positions as an income tax provision expense. The Company recognized interest and penalties expense of approximately $0.2 million and $0.4 million for the nine months ended September 30, 2012 and 2011, respectively. The Company had approximately $3.3 million, $3.2 million and $3.3 million of accrued interest and penalties as of September 30, 2012, December 31, 2011 and September 30, 2011.

The Company and its subsidiaries file a consolidated federal income tax return and also file income tax returns in various state jurisdictions. The Company is currently being audited by the Internal Revenue Service for 2011 and 2012. The Company is also currently under audit with the California Franchise Tax Board for the tax years 2005 to 2007. The potential financial statement impact, if any, resulting from completion of these audits is expected to be minimal.

From time to time, there may be differences in opinion with respect to the tax treatment of certain transactions. If a tax position which was previously recognized on the consolidated financial statements is no longer more likely than not to be sustained upon a challenge from the taxing authorities, the tax benefit from the tax position will be derecognized. The Company did not have any tax positions for which previously recognized benefits were derecognized during the nine months September 30, 2012.

See Note 13 to the Consolidated Financial Statements for further discussion of income taxes.

**BALANCE SHEET ANALYSIS**

Total assets were $26.25 billion at September 30, 2012, an increase of 14 percent from $23.10 billion at September 30, 2011 and 11 percent from $23.67 billion at December 31, 2011. Average assets for the third quarter of 2012 increased to $25.65 billion from $23.00 billion for the third quarter of 2011. The increase in period-end and average assets from the year-earlier quarter largely reflects loan growth and an increase in the securities portfolio due to deposit growth.

Total average interest-earning assets for the third quarter of 2012 were $23.89 billion, up from $21.32 billion for the third quarter of 2011.

***Securities***

At September 30, 2012, the Company had total securities of $9.11 billion, comprised of securities available-for-sale at fair value of $7.87 billion, securities held-to-maturity at amortized cost of $1.17 billion and trading securities at fair value of $64.7 million. The Company had total securities of $8.10 billion at December 31, 2011, comprised of securities available-for-sale at fair value of $7.57 billion, securities held-to-maturity at amortized cost of $467.7 million and trading securities at fair value of $62.0 million. At September 30, 2011, the Company had total securities of $7.28 billion, comprised of securities available-for-sale at fair value of $7.19 billion and trading securities at fair value of $93.7 million.

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The following is a summary of amortized cost and estimated fair value for the major categories of securities available-for-sale and held-to-maturity:

| (in thousands) | September 30, 2012 Amortized Cost | September 30, 2012 Fair Value | December 31, 2011 Amortized Cost | December 31, 2011 Fair Value | September 30, 2011 Amortized Cost | September 30, 2011 Fair Value |
|---|---|---|---|---|---|---|
| **Securities available-for-sale:** | | | | | | |
| U.S. Treasury | $ 20,352 | $ 20,355 | $ 19,163 | $ 19,182 | $ 19,193 | $ 19,213 |
| Federal agency - Debt | 1,542,162 | 1,547,300 | 1,967,928 | 1,973,862 | 1,896,839 | 1,903,688 |
| Federal agency - MBS | 612,713 | 657,935 | 650,091 | 681,044 | 511,533 | 541,225 |
| CMOs - Federal agency | 4,755,996 | 4,847,471 | 4,239,205 | 4,326,907 | 4,122,663 | 4,227,653 |
| CMOs - Non-agency | 66,431 | 64,489 | 79,999 | 69,001 | 86,578 | 76,430 |
| State and municipal | 406,127 | 425,169 | 383,210 | 401,604 | 357,109 | 373,632 |
| Other debt securities | 306,645 | 308,524 | 106,051 | 99,074 | 48,619 | 41,632 |
| Total available-for-sale debt securities | 7,710,426 | 7,871,243 | 7,445,647 | 7,570,674 | 7,042,534 | 7,183,473 |
| Equity securities and mutual funds | 336 | 821 | 352 | 1,227 | 400 | 1,815 |
| Total available-for-sale securities | $ 7,710,762 | $ 7,872,064 | $ 7,445,999 | $ 7,571,901 | $ 7,042,934 | $ 7,185,288 |
| **Securities held-to-maturity (1):** | | | | | | |
| Federal agency - Debt | $ 96,389 | $ 99,349 | $ 40,423 | $ 41,203 | $ | $ |
| Federal agency - MBS | 218,085 | 229,643 | 75,231 | 76,863 | | |
| CMOs - Federal agency | 660,196 | 689,026 | 292,547 | 294,932 | | |
| State and municipal | 199,491 | 204,703 | 59,479 | 60,905 | | |
| Total held-to-maturity securities | $ 1,174,161 | $ 1,222,721 | $ 467,680 | $ 473,903 | $ | $ |

(1) Securities held-to-maturity are presented in the consolidated balance sheets at amortized cost.

The duration of securities available-for-sale and held-to-maturity at September 30, 2012 was 2.8 years compared to 3.0 years at June 30, 2012 and 2.1 years at September 30, 2011. The duration of the $7.87 billion available-for-sale portfolio was 2.2 years at September 30, 2012. Changes in the fair value of securities available-for-sale will impact other comprehensive income, and thus shareholders equity, on an after-tax basis. Securities held-to-maturity are presented in the consolidated balance sheets at amortized cost. Changes in the fair value of securities held-to-maturity do not have an impact on other comprehensive income.

At September 30, 2012, the available-for-sale securities portfolio had a net unrealized gain of $161.3 million, comprised of $174.9 million of unrealized gains and $13.6 million of unrealized losses. At December 31, 2011, the available-for-sale securities portfolio had a net unrealized gain of $125.9 million, comprised of $149.1 million of unrealized gains and $23.2 million of unrealized losses. At September 30, 2011, the available-for-sale securities portfolio had a net unrealized gain of $142.4 million, comprised of $164.6 million of unrealized gains and $22.2 million of unrealized losses.

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The following table provides the expected remaining maturities of debt securities included in the securities portfolio at September 30, 2012. The maturities of mortgage-backed securities are allocated according to the average life of expected cash flows. Average expected maturities will differ from contractual maturities because of the amortizing nature of the loan collateral and prepayment behavior of borrowers.

| (in thousands) | One year or less | Over 1 year through 5 years | Over 5 years through 10 years | Over 10 years | Total |
|---|---|---|---|---|---|
| **Securities available-for-sale:** | | | | | |
| U.S. Treasury | $ 2,001 | $ 18,354 | $ | $ | $ 20,355 |
| Federal agency - Debt | 1,149,612 | 397,688 | | | 1,547,300 |
| Federal agency - MBS | 7 | 476,083 | 181,845 | | 657,935 |
| CMOs - Federal agency | 337,650 | 4,384,761 | 125,060 | | 4,847,471 |
| CMOs - Non-agency | 10,224 | 7,510 | 46,755 | | 64,489 |
| State and municipal | 93,209 | 221,996 | 85,351 | 24,613 | 425,169 |
| Other | 2,122 | 303,986 | 2,416 | | 308,524 |
| Total debt securities available-for-sale | $ 1,594,825 | $ 5,810,378 | $ 441,427 | $ 24,613 | $ 7,871,243 |
| Amortized cost | $ 1,588,623 | | | | |