CITY NATIONAL CORP
Form 10-Q
August 08, 2013
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2013

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

FOR THE TRANSITION PERIOD FROM TO

COMMISSION FILE NUMBER: 1-10521

CITY NATIONAL CORPORATION

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

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

City National Plaza

555 South Flower Street, Los Angeles, California, 90071

(Address of principal executive offices)(Zip Code)

(213) 673-7700

(Registrant s telephone number, including area code)

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

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

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

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

Large accelerated filer x	Accelerated filer o	Non-accelerated filer o (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 July 31, 2013, there were 54,366,640 shares of Common Stock outstanding (including unvested restricted shares).

Table of Contents

TABLE OF CONTENTS

Table of Contents

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CITY NATIONAL CORPORATION

CONSOLIDATED BALANCE SHEETS

(in thousands, except share amounts)	June 30, 2013 (Unaudited)	December 31, 2012
Assets		
Cash and due from banks	$ 146,338	$ 151,969
Due from banks - interest-bearing	156,221	246,336
Federal funds sold and securities purchased under resale agreements	200,000	17,100
Securities available-for-sale - cost $7,033,250 and $9,057,238 at June 30, 2013 and December 31, 2012, respectively:		
Securities pledged as collateral	13,909	48,697
Held in portfolio	7,030,662	9,157,292
Securities held-to-maturity - fair value $1,466,557 and $1,446,599 at June 30, 2013 and December 31, 2012, respectively	1,503,973	1,398,403
Trading securities	48,655	115,059
Loans and leases, excluding covered loans	15,819,252	14,818,295
Less: Allowance for loan and lease losses	289,914	277,888
Loans and leases, excluding covered loans, net	15,529,338	14,540,407
Covered loans, net of allowance for loan losses	843,582	986,223
Net loans and leases	16,372,920	15,526,630
Premises and equipment, net	162,535	149,433
Deferred tax asset	183,464	124,461
Goodwill	642,622	642,622
Customer-relationship intangibles, net	44,275	48,139
Affordable housing investments	166,781	154,011
Customers acceptance liability	2,742	7,859
Other real estate owned ($41,801 and $58,276 covered by FDIC loss share at June 30, 2013 and December 31, 2012, respectively)	61,477	79,303
FDIC indemnification asset	117,295	150,018
Other assets	525,633	601,160
Total assets	$ 27,379,502	$ 28,618,492
Liabilities		
Demand deposits	$ 14,288,001	$ 14,264,797
Interest checking deposits	2,270,298	2,459,972
Money market deposits	5,821,737	5,610,844
Savings deposits	399,223	398,824
Time deposits-under $100,000	224,734	203,422
Time deposits-$100,000 and over	647,764	564,496
Total deposits	23,651,757	23,502,355
Short-term borrowings	2,675	1,423,798
Long-term debt	706,537	706,051
Reserve for off-balance sheet credit commitments	25,124	24,837
Acceptances outstanding	2,742	7,859
Other liabilities	405,956	407,162
Total liabilities	24,794,791	26,072,062
Redeemable noncontrolling interest	39,943	41,112

Commitments and contingencies				
Shareholders equity				
Preferred stock, par value $1.00 per share; 5,000,000 shares authorized; 175,000 shares issued at June 30, 2013 and December 31, 2012		169,920		169,920
Common stock, par value $1.00 per share; 75,000,000 shares authorized; 54,273,594 and 53,885,886 shares issued at June 30, 2013 and December 31, 2012, respectively		54,274		53,886
Additional paid-in capital		507,560		490,339
Accumulated other comprehensive income		6,585		86,582
Retained earnings		1,831,725		1,738,957
Treasury shares, at cost - 492,294 and 669,454 shares at June 30, 2013 and December 31, 2012, respectively		(25,296)		(34,366)
Total common shareholders equity		2,374,848		2,335,398
Total shareholders equity		2,544,768		2,505,318
Total liabilities and shareholders equity	$	27,379,502	$	28,618,492

See accompanying Notes to the Unaudited Consolidated Financial Statements.

Table of Contents

CITY NATIONAL CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

(in thousands, except per share amounts)	For the three months ended June 30, 2013	For the three months ended June 30, 2012	For the six months ended June 30, 2013	For the six months ended June 30, 2012
Interest income				
Loans and leases	$ 174,059	$ 186,071	$ 344,349	$ 354,173
Securities	41,223	43,549	85,486	88,935
Due from banks - interest-bearing	158	173	270	266
Federal funds sold and securities purchased under resale agreements	1,555	96	2,690	107
Total interest income	216,995	229,889	432,795	443,481
Interest expense				
Deposits	2,990	3,566	5,930	7,599
Federal funds purchased and securities sold under repurchase agreements	123	1	400	32
Subordinated debt	6,117	4,308	12,223	8,369
Other long-term debt	4,722	5,535	9,701	10,289
Other short-term borrowings	124		549	
Total interest expense	14,076	13,410	28,803	26,289
Net interest income	202,919	216,479	403,992	417,192
Provision for credit losses on loans and leases, excluding covered loans		1,000		1,000
Provision for losses on covered loans	(11,927)	13,293	(2,035)	20,759
Net interest income after provision	214,846	202,186	406,027	395,433
Noninterest income				
Trust and investment fees	49,830	34,067	96,483	67,721
Brokerage and mutual fund fees	8,107	5,293	16,173	10,321
Cash management and deposit transaction charges	12,880	11,475	25,889	22,643
International services	10,911	10,017	20,530	18,802
FDIC loss sharing expense, net	(26,477)	(6,026)	(30,829)	(5,160)
Gain on disposal of assets	949	3,011	2,063	5,202
Gain (loss) on sale of securities	5,790	(279)	6,836	170
Other	20,401	17,388	38,774	30,947
Impairment loss on securities:				
Total other-than-temporary impairment loss on securities	(422)	(4,129)	(422)	(4,129)
Less: Portion of loss recognized in other comprehensive income	240	3,951	240	3,951
Net impairment loss recognized in earnings	(182)	(178)	(182)	(178)
Total noninterest income	82,209	74,768	175,737	150,468
Noninterest expense				
Salaries and employee benefits	127,168	115,035	255,363	235,280
Net occupancy of premises	16,205	14,056	32,194	27,742
Legal and professional fees	13,163	11,359	24,775	23,239
Information services	9,183	8,539	18,574	16,688
Depreciation and amortization	8,249	8,013	16,421	15,441
Amortization of intangibles	1,931	1,518	3,863	3,404
Marketing and advertising	8,644	7,597	16,960	14,413

Office services and equipment		5,034		4,492		9,980		8,440
Other real estate owned		4,385		7,541		9,635		19,635
FDIC assessments		3,663		4,523		9,144		9,002
Other operating		13,804		11,843		25,860		21,952
Total noninterest expense		211,429		194,516		422,769		395,236
Income before income taxes		85,626		82,438		158,995		150,665
Income taxes		25,422		27,271		46,683		48,990
Net income	$	60,204	$	55,167	$	112,312	$	101,675
Less: Net income attributable to noncontrolling interest		463		409		1,048		652
Net income attributable to City National Corporation	$	59,741	$	54,758	$	111,264	$	101,023
Less: Dividends on preferred stock		2,406				4,812		
Net income available to common shareholders	$	57,335	$	54,758	$	106,452	$	101,023
Net income per common share, basic	$	1.05	$	1.02	$	1.95	$	1.88
Net income per common share, diluted	$	1.04	$	1.01	$	1.94	$	1.87
Weighted average common shares outstanding, basic		54,105		53,105		53,919		52,923
Weighted average common shares outstanding, diluted		54,477		53,373		54,280		53,217
Dividends per common share	$	0.25	$	0.25	$	0.25	$	0.50

See accompanying Notes to the Unaudited Consolidated Financial Statements.

Table of Contents

CITY NATIONAL CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME

(Unaudited)

(in thousands)	For the three months ended June 30, 2013	2012	For the six months ended June 30, 2013	2012
Net income	$ 60,204	$ 55,167	$ 112,312	$ 101,675
Other comprehensive (loss) income, net of tax:				
Securities available-for-sale:				
Net unrealized (losses) gains arising during the period	(64,693)	3,815	(76,502)	11,971
Reclassification adjustment for net gains included in net income	(2,783)	(10)	(3,299)	(239)
Non-credit related impairment loss	(140)	(2,299)	(140)	(2,299)
Net change on cash flow hedges (1)	(21)	(41)	(56)	(83)
Pension liability adjustment				1,085
Total other comprehensive (loss) income	(67,637)	1,465	(79,997)	10,435
Comprehensive (loss) income	$ (7,433)	$ 56,632	$ 32,315	$ 112,110
Less: Comprehensive income attributable to noncontrolling interest	463	409	1,048	652
Comprehensive (loss) income attributable to City National Corporation	$ (7,896)	$ 56,223	$ 31,267	$ 111,458

(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.

Table of Contents

CITY NATIONAL CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(in thousands)	For the six months ended June 30, 2013	2012
Cash Flows From Operating Activities		
Net income	$ 112,312	$ 101,675
Adjustments to net income:		
Provision for credit losses on loans and leases, excluding covered loans		1,000
Provision for losses on covered loans	(2,035)	20,759
Amortization of intangibles	3,863	3,404
Depreciation and amortization	16,421	15,441
Share-based employee compensation expense	10,535	8,968
Deferred income tax (benefit) expense	(1,514)	1,276
Gain on disposal of assets	(2,063)	(5,202)
Gain on sale of securities	(6,836)	(170)
Impairment loss on securities	182	178
Other, net	23,488	(19,467)
Net change in:		
Trading securities	67,568	(851)
Other assets and other liabilities, net	45,924	40,111
Net cash provided by operating activities	267,845	167,122
Cash Flows From Investing Activities		
Purchase of securities available-for-sale	(698,457)	(1,331,692)
Sales of securities available-for-sale	1,251,056	5,189
Maturities and paydowns of securities available-for-sale	1,454,644	2,031,596
Purchase of securities held-to-maturity	(123,549)	(638,006)
Maturities and paydowns of securities held-to-maturity	16,336	4,617
Loan originations, net of principal collections	(813,453)	(671,623)
Net payments for premises and equipment	(29,523)	(14,703)
Net cash paid in acquisitions		(69,987)
Other investing activities, net	31,527	28,527
Net cash provided by (used in) investing activities	1,088,581	(656,082)
Cash Flows From Financing Activities		
Net increase in deposits	149,402	721,470
Net (decrease) increase in federal funds purchased	(1,214,200)	60,000
Issuance of long-term debt	16,456	156,829
Repayment of long-term debt	(221,899)	(244,813)
Proceeds from exercise of stock options	17,838	9,044
Tax benefit from exercise of stock options	3,383	1,180
Cash dividends paid	(18,351)	(26,632)
Other financing activities, net	(1,901)	(1,930)
Net cash (used in) provided by financing activities	(1,269,272)	675,148
Net increase in cash and cash equivalents	87,154	186,188
Cash and cash equivalents at beginning of year	415,405	244,814
Cash and cash equivalents at end of period	$ 502,559	$ 431,002
Supplemental Disclosures of Cash Flow Information:		
Cash paid during the period for:		
Interest	$ 32,147	$ 25,674
Income taxes	11,471	30,373

Non-cash investing activities:				
Transfer of loans to other real estate owned	$	14,629	$	41,728
Transfer of SERP liability to equity				8,348
Assets acquired (liabilities assumed) in acquisitions:				
Loans and leases	$		$	318,301
Other borrowings				(320,856)

See accompanying Notes to the Unaudited Consolidated Financial Statements.

Table of Contents

CITY NATIONAL CORPORATION

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY

(Unaudited)

(in thousands, except share amounts)	Common shares issued	Preferred stock	Common stock	Additional paid-in capital	Accumulated other comprehensive income	Retained earnings	Treasury shares	Total shareholders equity
Balance, January 1, 2012	53,885,886	$	$ 53,886	$ 489,200	$ 72,372	$ 1,611,969	$ (82,578)	$ 2,144,849
Net income (1)						101,023		101,023
Other comprehensive income, net of tax					10,435			10,435
Issuance of shares under share-based compensation plans				(16,506)			23,646	7,140
Share-based employee compensation expense				8,502				8,502
Tax benefit from share-based compensation plans				400				400
Common stock dividends						(26,829)		(26,829)
Net change in deferred compensation plans				703			2	705
Change in redeemable noncontrolling interest				792				792
Other (2)				8,348				8,348
Balance, June 30, 2012	53,885,886	$	$ 53,886	$ 491,439	$ 82,807	$ 1,686,163	$ (58,930)	$ 2,255,365
Balance, January 1, 2013	53,885,886	$ 169,920	$ 53,886	$ 490,339	$ 86,582	$ 1,738,957	$ (34,366)	$ 2,505,318
Net income (1)						111,264		111,264
Other comprehensive loss, net of tax					(79,997)			(79,997)
Issuance of shares under share-based compensation plans	387,708		388	5,291			9,070	14,749
Share-based employee compensation expense				8,737				8,737
Tax benefit from share-based compensation plans				2,919				2,919
Dividends:								
Preferred						(4,812)		(4,812)
Common						(13,684)		(13,684)
Net change in deferred compensation plans				690				690
Change in redeemable noncontrolling interest				(416)				(416)
Balance, June 30, 2013	54,273,594	$ 169,920	$ 54,274	$ 507,560	$ 6,585	$ 1,831,725	$ (25,296)	$ 2,544,768

(1) Net income excludes net income attributable to redeemable noncontrolling interest of $1,048 and $652 for the six month periods ended June 30, 2013 and 2012, respectively. Redeemable noncontrolling interest is reflected in the mezzanine section of the consolidated balance sheets. See Note 18 of the Notes to the Unaudited Consolidated Financial Statements.

(2) Conversion of pension liability to equity due to SERP amendment. See Note 15 for additional information.

See accompanying Notes to the Unaudited Consolidated Financial Statements.

Table of Contents

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 June 30, 2013, 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. Redeemable noncontrolling interests are noncontrolling ownership interests that are redeemable at the option of the holder or outside the control of the issuer. The redeemable noncontrolling interests of third parties in the Corporation s investment advisory affiliates are not considered to be permanent equity and are reflected in the mezzanine section between liabilities and equity in the consolidated balance sheets. Noncontrolling interests share of subsidiary earnings is reflected as Net income attributable to noncontrolling interest in the consolidated statements of income.

The Company s investment management and wealth advisory affiliates are organized as limited liability companies. The Corporation generally owns a majority position in each affiliate and certain management members of each affiliate own the remaining shares. The Corporation has contractual arrangements with its affiliates whereby a percentage of revenue is allocable to fund affiliate operating expenses (operating share) while the remaining portion of revenue (distributable revenue) is allocable to the Corporation and the noncontrolling owners. All majority-owned affiliates that meet the prescribed criteria for consolidation are consolidated. The Corporation s interests in investment management affiliates in which it holds a noncontrolling share are accounted for using the equity method. Additionally, the Company has various interests in variable interest entities (VIEs) that are not required to be consolidated. See Note 17 for a more detailed discussion on VIEs.

Use of Estimates

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

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

Table of Contents

Note 1. Summary of Significant Accounting Policies (Continued)

Basis of Presentation

The Company is on the accrual basis of accounting for income and expenses. The results of operations reflect any adjustments, all of which are of a normal recurring nature, unless otherwise disclosed in this Form 10-Q, and which, in the opinion of management, are necessary for a fair presentation of the results for the periods presented. In accordance with the usual practice of banks, assets and liabilities of individual trust, agency and fiduciary funds have not been included in the financial statements. These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2012.

The results for the 2013 interim periods are not necessarily indicative of the results expected for the full year. The Company has not made any significant changes in its critical accounting policies or in its estimates and assumptions from those disclosed in its 2012 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, 2013. Refer to *Accounting Pronouncements* for discussion of accounting pronouncements adopted in 2013.

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

Accounting Pronouncements

The following is a summary of accounting pronouncements that became effective during the six months ended June 30, 2013:

• In October 2012, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (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 and subsequently measured on the same basis as the indemnified item, subject to any contractual limitations on its amount or management s assessment of its collectability. 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 indemnification agreement. Any amortization of changes in value shall be limited to the lesser of the contractual term of the indemnification agreement and the remaining life of the indemnified assets. Adoption of ASU 2012-06 on January 1, 2013 did not have a significant impact on the Company s consolidated financial statements.

• In January 2013, the FASB issued ASU 2013-01, *Balance Sheet (Topic 210): Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities* (ASU 2013-01 *).* ASU 2013-01 clarifies that ordinary trade receivables and other receivables are not in the scope of ASU

2011-11, *Balance Sheet (Topic 210), Disclosures about Offsetting Assets and Liabilities*. Specifically, ASU 2011-11 applies only to derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions that are either offset in accordance with specific criteria contained in the Accounting Standards Codification (ASC) or subject to a master netting arrangement or similar agreement. The Company adopted ASU 2013-01 in its first quarter 2013 reporting. Refer to Note 13 for balance sheet offsetting disclosures.

Table of Contents

Note 1. Summary of Significant Accounting Policies (Continued)

- In February 2013, the FASB issued ASU 2013-02, *Other Comprehensive Income (Topic 220): Reporting of Amounts Reclassified out of Other Comprehensive Income* (ASU 2013-02). The provisions in the ASU supersede and replace the presentation requirements for reclassifications out of accumulated other comprehensive income (AOCI) in ASU 2011-05 and 2011-12. ASU 2013-02 requires entities to disclose additional information about reclassification adjustments, including (1) changes in AOCI balances by component and (2) significant items reclassified out of AOCI. The new disclosure requirements are effective for fiscal years, and interim periods within those years, beginning after December 15, 2012. The Company adopted ASU 2013-02 for its first quarter 2013 reporting. Adoption of the new guidance did not have a significant impact on the Company s consolidated financial statements.

The following is a summary of recently issued accounting pronouncements:

- In February 2013, the FASB issued ASU 2013-04, *Liabilities (Topic 405): Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation is Fixed at the Reporting Date* (ASU 2013-04). ASU 2013-04 provides guidance for the recognition, measurement and disclosure of obligations resulting from joint and several liability arrangements. Examples of obligations within the scope of the ASU include debt arrangements, other contractual obligations and settled litigation. ASU 2013-04 requires entities to measure obligations resulting from joint and several liability arrangements for which the total amount of the obligation within the scope of the guidance is fixed at the reporting date, as the sum of (1) the amount the reporting entity agreed to pay on the basis of its arrangement among its co-obligors, and (2) any additional amount the reporting entity expects to pay on behalf of its co-obligors. Required disclosures include a description of the joint-and-several arrangement and the total outstanding amount of the obligation for all joint parties. The ASU is effective for public entities for fiscal years, and interim periods within those years, beginning after December 15, 2013. Adoption of the new guidance is not expected to have a significant impact on the Company s consolidated financial statements.

- In July 2013, the FASB issued ASU 2013-10, *Derivatives and Hedging (Topic 815): Inclusion of the Fed Funds Effective Swap Rate as a Benchmark Interest Rate for Hedge Accounting Purposes*. The new guidance permits the Fed Funds Effective Swap Rate to be used as a U.S. benchmark interest rate for hedge accounting purposes in addition to U.S. Government Treasury rates and LIBOR. The ASU is effective prospectively for qualifying new or redesignated hedging relationships entered into on or after July 17, 2013. The Company periodically enters into interest-rate swap agreements to reduce cash flow variability on pools of floating rate loans. The swaps are tied to either the Prime rate or LIBOR consistent with the pricing index on the underlying loans. The Company does not use the Fed Funds rate for loan pricing. Adoption of the new guidance is not expected to have a significant impact on the Company s consolidated financial statements.

- In July 2013, the FASB issued ASU 2013-11, *Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*. The new guidance requires an entity to present an unrecognized tax benefit, or portion thereof, in the statement of financial position as a reduction to a deferred tax asset for a net operating loss carryforward or a tax credit carryforward, except as follows. To the extent a net operating loss carryforward or tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position, or the the tax law of the applicable jurisdiction does not require the entity to use and the entity does not intend to use the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the statement of financial position as a liability and should not be combined with deferred tax assets. The ASU is effective for annual periods, and interim periods within those years, beginning after December 15, 2013. Adoption of the new guidance is not expected to have a significant impact on the Company s consolidated financial statements.

10

Table of Contents

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 that manages assets for affluent and high-net-worth clients and their financial advisors across the nation. The investment firm was acquired with both cash and contingent consideration, and operates as a wholly owned subsidiary of the Bank.

The Company recognized goodwill of approximately $86.5 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 $46.7 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 acquisition 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 contingent consideration liability is remeasured to fair value at each reporting date until its settlement.

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.

Table of Contents

Note 3. Fair Value Measurements

The following tables summarize assets and liabilities measured at fair value as of June 30, 2013 and December 31, 2012 by level in the fair value hierarchy:

(in thousands)	Balance as of June 30, 2013	Fair Value Measurements at Reporting Date Using: Quoted Prices in Active Markets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
Measured on a Recurring Basis				
Assets				
Securities available-for-sale:				
U.S. Treasury	$ 30,285	$ 30,285	$	$
Federal agency - Debt	980,025		980,025	
Federal agency - MBS	438,182		438,182	
CMOs - Federal agency	4,728,613		4,728,613	
CMOs - Non-agency	45,327		45,327	
State and municipal	466,760		420,594	46,166
Other debt securities	350,244		334,571	15,673
Equity securities and mutual funds	5,135	5,135		
Trading securities	48,655	38,411	10,244	
Derivatives (1)	40,066	1,963	38,103	
Total assets at fair value	$ 7,133,292	$ 75,794	$ 6,995,659	$ 61,839
Liabilities				
Derivatives	$ 38,771	$ 2,490	$ 36,281	$
Contingent consideration liability	48,800			48,800
FDIC clawback liability	11,053			11,053
Other liabilities	319		319	
Total liabilities at fair value (2)	$ 98,943	$ 2,490	$ 36,600	$ 59,853
Redeemable noncontrolling interest	$ 39,943	$	$	$ 39,943
Measured on a Nonrecurring Basis				
Assets				
Collateral dependent impaired loans (3):				
Commercial (4)	$ 17	$	$	$ 17
Commercial real estate mortgages	7,300			7,300
Residential mortgages	1,457			1,457
Other real estate owned (5)	19,525		16,494	3,031
Private equity and alternative investments	686			686
Total assets at fair value	$ 28,985	$	$ 16,494	$ 12,491

(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) Includes covered OREO.

Table of Contents

Note 3. Fair Value Measurements (Continued)

(in thousands)	Balance as of December 31, 2012	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	$ 20,397	$ 20,397	$	$
Federal agency - Debt	2,349,202		2,349,202	
Federal agency - MBS	693,032		693,032	
CMOs - Federal agency	5,318,253		5,318,253	
CMOs - Non-agency	61,513		61,513	
State and municipal	454,474		407,429	47,045
Other debt securities	307,417		289,275	18,142
Equity securities and mutual funds	1,701	1,701		
Trading securities	115,059	113,010	2,049	
Derivatives (1)	67,496	218	67,278	
Total assets at fair value	$ 9,388,544	$ 135,326	$ 9,188,031	$ 65,187
Liabilities				
Derivatives	$ 64,432	$	$ 64,432	$
Contingent consideration liability	47,724			47,724
FDIC clawback liability	9,970			9,970
Other liabilities	368		368	
Total liabilities at fair value (2)	$ 122,494	$	$ 64,800	$ 57,694
Redeemable noncontrolling interest	$ 41,112	$	$	$ 41,112
Measured on a Nonrecurring Basis				
Assets				
Collateral dependent impaired loans (3):				
Commercial (4)	$ 2,655	$	$	$ 2,655
Commercial real estate mortgages	10,963		3,950	7,013
Residential mortgages	1,811			1,811
Real estate construction	7,918			7,918
Home equity loans and lines of credit	780			780
Installment	550		550	
Other real estate owned (5)	44,396		34,624	9,772
Private equity and alternative investments	6,178			6,178
Total assets at fair value	$ 75,251	$	$ 39,124	$ 36,127

(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) Includes covered OREO.

Table of Contents

Note 3. Fair Value Measurements (Continued)

At June 30, 2013, $7.13 billion, or approximately 26 percent, of the Company s total assets were recorded at fair value on a recurring basis, compared with $9.39 billion, or 33 percent, at December 31, 2012. The majority of these financial assets were valued using Level 1 or Level 2 inputs. Less than one percent of total assets were measured using Level 3 inputs. At June 30, 2013, $98.9 million of the Company s total liabilities were recorded at fair value using mostly Level 2 or Level 3 inputs, compared with $122.5 million at December 31, 2012. There were no transfers between Level 1 and Level 2 of the fair value hierarchy for assets or liabilities measured on a recurring basis during the six months ended June 30, 2013. At June 30, 2013, $29.0 million of the Company s total assets were recorded at fair value on a nonrecurring basis, compared with $75.3 million at December 31, 2012. These assets represent less than one percent of total assets and 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 six months ended June 30, 2013 and 2012.

Level 3 Assets and Liabilities Measured on a Recurring Basis

	For the six months ended June 30, 2013			For the six months ended June 30, 2012	
(in thousands)	**Securities Available-for-Sale**	**Contingent Consideration Liability**	**FDIC Clawback Liability**	**Securities Available-for-Sale**	**FDIC Clawback Liability**
Balance, beginning of period	$ 65,187	$ (47,724)	$ (9,970)	$ 19,583	$ (8,103)
Total realized/unrealized gains (losses):					
Included in earnings			(1,083)		(1,114)
Included in other comprehensive income	233			1,221	
Settlements	(3,655)			(1,664)	
Transfers into Level 3				47,165	
Other (1)	74	(1,076)		46	
Balance, end of period	$ 61,839	$ (48,800)	$ (11,053)	$ 66,351	$ (9,217)

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

Redeemable noncontrolling interest is classified as Level 3 in the fair value hierarchy and measured on a recurring basis. Refer to Note 18, *Noncontrolling Interest*, for a rollforward of activity for the six months ended June 30, 2013 and 2012.

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. At June 30, 2013, municipal auction rate securities were valued using an average yield on California variable rate notes that were comparable in credit rating and maturity to the securities held, plus a liquidity premium. Senior notes totaling $15.7 million at June 30, 2013 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 2, *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.

There were no purchases, sales, or transfers out of Level 3 assets measured on a recurring basis during the six months ended June 30, 2013 and 2012. Paydowns of $3.7 million and $1.7 million were received on Level 3 assets measured on a recurring basis for the six months ended June 30, 2013 and 2012, respectively.

Table of Contents

Note 3. Fair Value Measurements (Continued)

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 June 30, 2013	Valuation Method	Unobservable Inputs
Collateral dependent impaired loans	$ 8,774	Market	- Adjustments to external or internal appraised values (1) - Probability weighting of broker price opinions - Management assumptions regarding market trends or other relevant factors
Other real estate owned	$ 3,031	Market	- Adjustments to external or internal appraised values (1) - Probability weighting of broker price opinions - Management assumptions regarding market trends or other relevant factors
Private equity and alternative investments	$ 686	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.

Table of Contents

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 six months ended June 30, 2013 and 2012:

(in thousands)	For the three months ended June 30, 2013	For the three months ended June 30, 2012	For the six months ended June 30, 2013	For the six months ended June 30, 2012
Collateral dependent impaired loans:				
Commercial	$	$	$	$ (367)
Commercial real estate mortgages	148	(1,572)	293	(1,937)
Residential mortgages	(230)	(540)	(221)	(1,122)
Real estate construction		(281)		(6,753)
Home equity loans and lines of credit		(115)	116	(62)
Installment			(138)	(107)
Other real estate owned (1)	(1,857)	(3,700)	(4,711)	(12,165)
Private equity and alternative investments		(333)	(399)	(460)
Total net losses recognized	$ (1,939)	$ (6,541)	$ (5,060)	$ (22,973)

(1) Net losses on OREO includes $1.9 million and $4.7 million of net losses related to covered OREO for the three and six months ended June 30, 2013, respectively, and $3.5 million and $11.0 million of net losses for the three and six months ended June 30, 2012, 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 2012 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.

Table of Contents

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 determining the fair value of those financial instruments. Most financial assets and financial liabilities for which carrying amount equals fair value are considered by the Company to be Level 1 measurements in the fair value hierarchy.

	June 30, 2013				
	Carrying	Total	Fair Value Measurements Using		
(in millions)	Amount	Fair Value	Level 1	Level 2	Level 3
Financial Assets:					
Cash and due from banks	$ 146.3	$ 146.3	$ 146.3	$	$
Due from banks - interest bearing	156.2	156.2	156.2		
Federal funds sold and securities purchased under resale agreements	200.0	194.6		194.6	
Securities held-to-maturity	1,504.0	1,466.6		1,466.6	
Loans and leases, net of allowance	15,529.3	15,926.6			15,926.6
Covered loans, net of allowance	843.6	893.6			893.6
FDIC indemnification asset	117.3	96.6			96.6
Investment in FHLB and FRB stock	78.0	78.0		78.0	
Financial Liabilities:					
Deposits	$ 23,651.8	$ 23,655.4	$	$ 22,779.3	$ 876.1
Other short-term borrowings	2.7	2.7			2.7
Long-term debt	706.5	769.0		693.9	75.1