PACWEST BANCORP
Form 10-Q
May 12, 2014

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2014

OR

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: 00-30747

PACWEST BANCORP

(Exact name of registrant as specified in its charter)

DELAWARE (State or other jurisdiction of incorporation or organization)	**33-0885320** (I.R.S. Employer Identification Number)
10250 Constellation Blvd., Suite 1640 **Los Angeles, California** (Address of principal executive offices)	**90067** (Zip Code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý 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 ý 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 definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ý	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). Yes o No ý

As of May 6, 2014, there were 101,910,929 shares of the registrant's common stock outstanding, excluding 40,000 shares of unvested restricted stock.

PACWEST BANCORP AND SUBSIDIARIES

MARCH 31, 2014 FORM 10-Q

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PART I FINANCIAL INFORMATION

ITEM 1. Condensed Consolidated Financial Statements (Unaudited)

PACWEST BANCORP AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Dollars in Thousands, Except Par Value and Share Data)

(Unaudited)

	March 31, 2014	December 31, 2013
ASSETS		
Cash and due from banks	$ 113,508	$ 96,424
Interest-earning deposits in financial institutions	228,579	50,998
Total cash and cash equivalents	342,087	147,422
Securities available-for-sale, at fair value ($37,594 and $37,904 covered by FDIC loss sharing at March 31, 2014 and December 31, 2013)	1,477,473	1,494,745
Federal Home Loan Bank stock, at cost	25,000	27,939
Total investment securities	1,502,473	1,522,684
Loans and leases, net of unearned income ($398,365 and $448,418 covered by FDIC loss sharing at March 31, 2014 and December 31, 2013)	4,161,067	4,312,352
Allowance for loan and lease losses ($20,930 and $21,793 for loans covered by FDIC loss sharing at March 31, 2014 and December 31, 2013)	(81,180)	(82,034)
Total loans and leases, net	4,079,887	4,230,318
Other real estate owned, net ($6,177 and $9,036 covered by FDIC loss sharing at March 31, 2014 and December 31, 2013)	46,870	51,837
Premises and equipment, net	29,908	32,435
FDIC loss sharing asset	34,628	45,524
Cash surrender value of life insurance	77,955	77,489
Goodwill	208,743	208,743
Core deposit and customer relationship intangibles, net	15,884	17,248
Other assets	179,418	199,663
Total assets	$ 6,517,853	$ 6,533,363

LIABILITIES		
Noninterest-bearing deposits	$ 2,391,609	$ 2,318,446
Interest-bearing deposits	2,977,799	2,962,541
Total deposits	5,369,408	5,280,987
Borrowings	5,748	113,726
Subordinated debentures	132,790	132,645
Discontinued operations	112,432	123,028
Accrued interest payable and other liabilities	63,773	73,884
Total liabilities	5,684,151	5,724,270
Commitments and contingencies		
STOCKHOLDERS' EQUITY		
Preferred stock, $0.01 par value; authorized 5,000,000 shares; none issued and outstanding		
Common stock, $0.01 par value; authorized 200,000,000 and 75,000,000 shares at March 31, 2014 and December 31, 2013, respectively; issued 46,532,624 and 46,526,124 shares, respectively (includes 1,087,436 and 1,216,524 shares of unvested restricted stock, respectively)	465	465
Additional paid-in capital	1,278,152	1,286,737
Accumulated deficit	(429,342)	(454,422)
Treasury stock, at cost; 755,044 and 703,290 shares at March 31, 2014 and December 31, 2013	(22,398)	(20,340)
Accumulated other comprehensive income	6,825	(3,347)
Total stockholders' equity	833,702	809,093
Total liabilities and stockholders' equity	$ 6,517,853	$ 6,533,363

See "Notes to Condensed Consolidated Financial Statements."

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PACWEST BANCORP AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS

(Dollars in Thousands, Except Per Share Data)

(Unaudited)

	Three Months Ended		
	March 31, 2014	December 31, 2013	March 31, 2013
Interest income:			
Loans and leases	$ 77,463	$ 73,352	$ 61,010
Investment securities	10,823	10,422	8,216
Deposits in financial institutions	74	82	43
Total interest income	88,360	83,856	69,269
Interest expense:			
Deposits	1,225	1,450	2,649
Borrowings	79	86	144
Subordinated debentures	1,041	1,062	783
Total interest expense	2,345	2,598	3,576
Net interest income	86,015	81,258	65,693
(Negative provision) provision for credit losses	(644)	(1,338)	3,137
Net interest income after negative provision for credit losses	86,659	82,596	62,556
Noninterest income:			
Service charges on deposit accounts	3,002	3,197	2,863
Other commissions and fees	1,932	2,125	1,933
Gain on sale of leases	106	683	225
Gain (loss) on sale of securities	4,752	(272)	409
Increase in cash surrender value of life insurance	466	448	433
FDIC loss sharing expense, net	(11,430)	(10,593)	(3,137)
Other income	5,863	486	114
Total noninterest income	4,691	(3,926)	2,840
Noninterest expense:			
Compensation	28,627	27,697	25,350
Accelerated vesting of restricted stock		12,420	
Occupancy	7,595	7,553	6,598

Data processing	2,540	2,216	2,233
Other professional services	2,286	2,314	2,097
Business development	934	992	736
Communications	737	860	613
Insurance and assessments	1,593	1,572	1,261
Non-covered other real estate owned, net	(246)	25	313
Covered other real estate owned, net	(1,615)	(594)	(813)
Intangible asset amortization	1,364	1,430	1,176
Acquisition and integration	2,200	4,253	692
Other expense	4,854	5,350	3,927
Total noninterest expense	50,869	66,088	44,183
Earnings from continuing operations before income taxes	40,481	12,582	21,213
Income tax expense	(14,576)	(9,135)	(7,719)
Net earnings from continuing operations	25,905	3,447	13,494
Loss from discontinued operations before income taxes	(1,413)	(578)	
Income tax benefit	588	240	
Net loss from discontinued operations	(825)	(338)	
Net earnings	$ 25,080	$ 3,109	$ 13,494
Basic earnings per share:			
Net earnings from continuing operations	$ 0.57	$ 0.07	$ 0.37
Net earnings	$ 0.55	$ 0.06	$ 0.37
Diluted earnings per share:			
Net earnings from continuing operations	$ 0.57	$ 0.07	$ 0.37
Net earnings	$ 0.55	$ 0.06	$ 0.37
Dividends declared per share	$ 0.25	$ 0.25	$ 0.25

See "Notes to Condensed Consolidated Financial Statements."

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PACWEST BANCORP AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In Thousands)

(Unaudited)

	Three Months Ended		
	March 31, 2014	**December 31, 2013**	**March 31, 2013**
Net earnings	$ 25,080	$ 3,109	$ 13,494
Other comprehensive income (loss) related to unrealized gains (losses) on securities available-for-sale:			
Unrealized holding gains (losses) arising during the period	22,291	(6,607)	(6,410)
Income tax benefit (expense) related to unrealized holding (losses) gains arising during the period	(9,363)	2,775	2,692
Reclassification adjustment for (gain) loss included in net earnings	(4,752)	272	(409)
Income tax (benefit) expense related to reclassification adjustment	1,996	(114)	172
Other comprehensive income (loss)	10,172	(3,674)	(3,955)
Comprehensive income (loss)	$ 35,252	$ (565)	$ 9,539

See "Notes to Condensed Consolidated Financial Statements."

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PACWEST BANCORP AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

(Dollars in Thousands, Except Share Data)

(Unaudited)

	Three Months Ended March 31, 2014						
	Common Stock						
	Shares	Par Value	Additional Paid-in Capital	Accumulated Deficit	Treasury Stock	Accumulated Other Comprehensive Income	Total
Balance, December 31, 2013	45,822,834	$ 465	$ 1,286,737	$ (454,422)	$ (20,340)	$ (3,347)	$ 809,093
Net earnings				25,080			25,080
Other comprehensive income net unrealized gain on securities available-for-sale, net of tax						10,172	10,172
Restricted stock awarded and earned stock compensation, net of shares forfeited	6,500		1,611				1,611
Restricted stock surrendered	(51,754)				(2,058)		(2,058)
Tax effect from vesting of restricted stock			1,110				1,110
Cash dividends paid ($0.25 per share)			(11,306)				(11,306)
Balance, March 31, 2014	45,777,580	$ 465	$ 1,278,152	$ (429,342)	$ (22,398)	$ 6,825	$ 833,702

See "Notes to Condensed Consolidated Financial Statements."

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PACWEST BANCORP AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In Thousands)

(Unaudited)

	Three Months Ended March 31, 2014	Three Months Ended March 31, 2013
Cash flows from operating activities:		
Net earnings	$ 25,080	$ 13,494
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	6,653	7,292
(Negative provision) provision for credit losses	(644)	3,137
Gain on sale of other real estate owned	(2,323)	(1,910)
Provision for losses on other real estate owned	94	1,185
Gain on sale of leases	(106)	(225)
Gain on sale of premises and equipment	(1,571)	
Gain on sale of securities	(4,752)	(409)
Earned stock compensation	1,611	1,764
Tax effect included in stockholders' equity of restricted stock vesting	(1,110)	(660)
Decrease in accrued and deferred income taxes, net	19,679	8,611
Decrease in FDIC loss sharing asset	10,896	1,635
Increase in other assets	(6,156)	(486)
Decrease in accrued interest payable and other liabilities	(20,107)	(7,601)
Net cash provided by operating activities	27,244	25,827
Cash flows from investing activities:		
Net decrease in loans and leases	149,440	113,099
Proceeds from sale of loans and leases	1,128	3,054
Securities available-for-sale:		
Proceeds from maturities and paydowns	33,860	100,980
Proceeds from sales	142,041	12,810
Purchases	(140,048)	(132,446)
Net redemptions of Federal Home Loan Bank stock	2,939	3,726
Proceeds from sales of other real estate owned	7,209	8,847
Purchases of premises and equipment, net	(1,115)	(742)
Proceeds from sales of premises and equipment	3,753	
Net cash provided by investing activities	199,207	109,328
Cash flows from financing activities:		
Net increase (decrease) in deposits:		
Noninterest-bearing	73,163	2,022
Interest-bearing	15,258	(157,913)
Net decrease in borrowings	(107,953)	(1,362)
Restricted stock surrendered	(2,058)	(2,182)
Tax effect included in stockholders' equity of restricted stock vesting	1,110	660

Cash dividends paid	(11,306)	(9,106)
Net cash used in financing activities	(31,786)	(167,881)
Net decrease in cash and cash equivalents	194,665	(32,726)
Cash and cash equivalents, beginning of period	147,422	164,404
Cash and cash equivalents, end of period	$ 342,087	$ 131,678
Supplemental disclosures of cash flow information:		
Cash paid for interest	$ 2,483	$ 4,063
Cash received for income taxes, net of payments	(5,693)	(760)
Loans transferred to other real estate owned	13	4,980

See "Notes to Condensed Consolidated Financial Statements."

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PACWEST BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

NOTE 1 BASIS OF PRESENTATION

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

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

We generate our revenue primarily from interest received on loans and leases and, to a lesser extent, from interest received on investment securities, and fees received in connection with deposit services, extending credit and other services offered, including foreign exchange services. Our major operating expenses are the interest paid by the Bank on deposits and borrowings, compensation and general operating expenses. The Bank relies on a foundation of locally generated and relationship-based deposits, with 73 branches located across 10 California counties. The Bank has a relatively low cost of funds due to a high percentage of noninterest-bearing and low cost deposits.

We have completed 26 acquisitions from May 2000 through March 31, 2014, including the acquisition of First California Financial Group, Inc. ("FCAL") on May 31, 2013. Since 2000, our acquisitions have been accounted for using the acquisition method of accounting and accordingly, the operating results of the acquired entities have been included in the condensed consolidated financial statements from their respective acquisition dates. See Note 3, *Acquisitions*, for more information about the FCAL acquisition, and Note 18, *Subsequent Events*, for information regarding the completion of the CapitalSource Inc. ("CapitalSource") merger on April 7, 2014.

Basis of Presentation

The accounting and reporting policies of the Company are in accordance with U.S. generally accepted accounting principles, which we may refer to as GAAP. All significant intercompany balances and transactions have been eliminated.

Our financial statements reflect all adjustments that are, in the opinion of management, necessary to present a fair statement of the results for the interim periods presented. Certain information and note disclosures normally included in consolidated financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to the rules and regulations of the Securities and

PACWEST BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

NOTE 1 BASIS OF PRESENTATION (Continued)

Exchange Commission. The interim operating results are not necessarily indicative of operating results for the full year.

Use of Estimates

Management of the Company has made a number of estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenue and expenses during the reporting period to prepare these condensed consolidated financial statements in conformity with GAAP. Actual results could differ from those estimates. Material estimates subject to change in the near term include, among other items, the allowance for credit losses, the carrying value of intangible assets, the carrying value of the FDIC loss sharing asset, the realization of deferred tax assets, and the fair value estimates of assets acquired and liabilities assumed in acquisitions.

Reclassifications

Certain prior period amounts have been reclassified to conform to the current period's presentation format. Starting with the June 30, 2013 quarter-end, loan tables present non-purchased credit impaired ("Non-PCI") and purchased credit impaired ("PCI") loan categories in addition to covered and non-covered loan information. Previously the loan tables only presented covered and non-covered loan categories.

NOTE 2 DISCONTINUED OPERATIONS

In connection with the acquisition of FCAL on May 31, 2013, we acquired Electronic Payment Services ("EPS"), a division of the Bank that is being discontinued. Accordingly, all income and expense related to EPS have been removed from continuing operations and are included in the condensed consolidated statements of earnings under the caption "Loss from discontinued operations." For the three months ended March 31, 2014, revenues (net interest income plus noninterest income) and pre-tax loss for the EPS division were $3,000 and $1.4 million, respectively. Liabilities of the EPS division, which consist primarily of noninterest-bearing deposits, are included in the condensed consolidated balance sheets under the caption "Discontinued operations." For segment reporting purposes, the EPS division is included in our Banking Segment.

NOTE 3 ACQUISITIONS

We completed the FCAL acquisition during the time period of January 1, 2013 to March 31, 2014, using the acquisition method of accounting, and accordingly, the operating results of FCAL have been included in our condensed consolidated financial statements from its May 31, 2013 date of acquisition.

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PACWEST BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

NOTE 3 ACQUISITIONS (Continued)

The following table presents the balance sheet of FCAL at estimated fair value as of its acquisition date:

	May 31, 2013 (In thousands)
Assets Acquired:	
Cash and due from banks	$ 6,124
Interest-earning deposits in financial institutions	266,889
Investment securities available-for-sale	4,444
FHLB stock	9,518
Loans and leases	1,049,613
Other real estate owned	13,772
Premises and equipment	15,322
FDIC loss sharing asset	17,241
Cash surrender value of life insurance	13,265
Goodwill	129,070
Core deposit and customer relationship intangibles	7,927
Other assets	47,671
Total assets acquired	$ 1,580,856
Liabilities Assumed:	
Noninterest-bearing deposits	$ 361,166
Interest-bearing deposits	739,713
Subordinated debentures	24,061
Discontinued operations	184,619
Accrued interest payable and other liabilities	19,729
Total liabilities assumed	$ 1,329,288
Total consideration paid	$ 251,568
Summary of consideration:	
PacWest common stock issued	$ 242,268
Cancellation of FCAL common stock owned by PacWest (at acquisition date fair value)	9,300

Total	$	251,568

First California Financial Group Acquisition

On May 31, 2013, we completed the acquisition of First California Financial Group, Inc., or FCAL. As part of the acquisition, First California Bank or FCB, a wholly-owned subsidiary of FCAL, merged with and into Pacific Western.

In the FCAL acquisition, each share of FCAL common stock was converted into the right to receive 0.2966 of a share of PacWest common stock. The exchange ratio was calculated based on the volume-weighted average share price of PacWest common stock for the 20 consecutive trading days

PACWEST BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

NOTE 3 ACQUISITIONS (Continued)

ending on the second full trading day prior to the receipt of the last of the regulatory approvals required under the merger agreement. PacWest issued an aggregate of approximately 8.4 million shares of PacWest common stock to FCAL stockholders. In addition, 1,094,000 shares of FCAL common stock previously owned by PacWest at a cost of $4.1 million were cancelled in the transaction. These shares were carried in our securities available-for-sale portfolio at their estimated market value with their unrealized gain of $5.2 million included in stockholders' equity at May 31, 2013. Under acquisition accounting, this unrealized gain was recognized in earnings. Based on the closing price of PacWest's common stock on May 31, 2013 of $28.83 per share, the aggregate consideration paid to FCAL common stockholders, including the 1,094,000 shares of FCAL common stock owned by us and cancelled in the merger, was $251.6 million.

The FCAL acquisition has been accounted for under the acquisition method of accounting. The assets and liabilities, both tangible and intangible, were recorded at their estimated fair values as of the May 31, 2013 acquisition date. The application of the acquisition method of accounting resulted in goodwill of $129.1 million. All of the recognized goodwill is expected to be non-deductible for tax purposes.

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

See Note 18, *Subsequent Events,* for information regarding the completion of the CapitalSource Inc. merger on April 7, 2014.

NOTE 4 GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill arises from the acquisition method of accounting for business combinations and represents the excess of the purchase price over the fair value of the net assets and other identifiable intangible assets acquired. Goodwill and other intangible assets deemed to have indefinite lives generated from purchase business combinations are not subject to amortization and are instead tested for impairment no less than annually. Impairment exists when the carrying value of goodwill exceeds its implied fair value. An impairment loss would be recognized in an amount equal to that excess and would be included in "Noninterest expense" in the condensed consolidated statement of earnings.

Our intangible assets with definite lives are core deposit intangibles, or CDI, and customer relationship intangibles, or CRI. These intangible assets are amortized over their respective estimated useful lives to their estimated residual values and reviewed for impairment at least quarterly. The amortization expense represents the estimated decline in the value of the underlying deposits or loan customers acquired. The weighted average amortization period remaining for our CDI and CRI was 2.6 years. The aggregate CDI and CRI amortization expense is expected to be $5.3 million for 2014. The estimated aggregate amortization expense related to these intangible assets for each of the next five years is $4.8 million for 2015, $3.0 million for 2016, $1.6 million for 2017, $1.3 million for 2018, and $954,000 for 2019.

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PACWEST BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

NOTE 4 GOODWILL AND OTHER INTANGIBLE ASSETS (Continued)

The following table presents the changes in the gross amounts of CDI and CRI and the related accumulated amortization for the periods indicated:

	Three Months Ended		
	March 31, 2014	December 31, 2013	March 31, 2013
	(In thousands)		
Gross Amount of CDI and CRI:			
Balance, beginning of period	$ 48,963	$ 48,963	$ 45,412
Balance, end of period	48,963	48,963	45,412
Accumulated Amortization:			
Balance, beginning of period	(31,715)	(30,285)	(30,689)
Amortization	(1,364)	(1,430)	(1,176)
Balance, end of period	(33,079)	(31,715)	(31,865)
Net CDI and CRI, end of period	$ 15,884	$ 17,248	$ 13,547

NOTE 5 INVESTMENT SECURITIES

Securities Available-for-Sale

The following tables present amortized cost, gross unrealized gains and losses, and carrying value of securities available-for-sale as of the dates indicated:

	March 31, 2014			
Security Type	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Carrying Value**
	(In thousands)			
Residential mortgage-backed securities:				
Government agency and government-sponsored enterprise pass through securities	$ 560,004	$ 16,204	$ (1,539)	$ 574,669
Government agency and government-sponsored enterprise collateralized mortgage obligations	272,832	762	(3,957)	269,637
Covered private label collateralized mortgage obligations	29,649	8,032	(87)	37,594
Municipal securities	455,437	5,599	(13,103)	447,933

Corporate debt securities	84,210	308	(307)	84,211
Government-sponsored enterprise debt securities	36,180	74	(200)	36,054
Other securities	27,393	37	(55)	27,375
Total securities available-for-sale	$ 1,465,705	$ 31,016	$ (19,248)	$ 1,477,473

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PACWEST BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

NOTE 5 INVESTMENT SECURITIES (Continued)

	December 31, 2013			
Security Type	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Carrying Value**
	(In thousands)			
Residential mortgage-backed securities:				
Government agency and government-sponsored enterprise pass through securities	$ 691,944	$ 18,012	$ (2,768)	$ 707,188
Government agency and government-sponsored enterprise collateralized mortgage obligations	197,069	388	(4,584)	192,873
Covered private label collateralized mortgage obligations	30,502	7,552	(150)	37,904
Municipal securities	459,182	1,749	(24,273)	436,658
Corporate debt securities	84,119	71	(1,483)	82,707
Government-sponsored enterprise debt securities	10,046		(174)	9,872
Other securities	27,654	2	(113)	27,543
Total securities available-for-sale	$ 1,500,516	$ 27,774	$ (33,545)	$ 1,494,745

The covered private label collateralized mortgage obligations ("CMO's") were acquired in the FDIC-assisted acquisition of Affinity Bank in August 2009 and are covered by an FDIC loss sharing agreement. The loss sharing provisions of this agreement expire in the third quarter of 2014 for non-single family covered assets such as these private label CMO's. Other securities consist primarily of asset-backed securities. See Note 11, *Fair Value Measurements*, for information on fair value measurements and methodology.

As of March 31, 2014, securities available-for-sale with a carrying value of $291.9 million were pledged as collateral for borrowings, public deposits and other purposes as required by various statutes and agreements.

During the three months ended March 31, 2014, we sold $137.3 million in government-sponsored enterprise ("GSE") pass through securities for which we realized a gross gain of $4.8 million. We sold these securities to take advantage of favorable market conditions for premium coupon seasoned GSE pass through securities, and redeployed the proceeds into single-maturity investments that are expected to perform better under current market conditions. During the three months ended March 31, 2013, we sold $12.4 million in corporate debt securities for which we realized a $409,000 gross gain. These securities were sold as part of our investment portfolio risk management activities to reduce price volatility and duration.

PACWEST BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

NOTE 5 INVESTMENT SECURITIES (Continued)

The following tables present, for those securities that were in a gross unrealized loss position, the carrying values and the gross unrealized losses on securities by length of time the securities were in an unrealized loss position as of the dates indicated:

	March 31, 2014					
	Less Than 12 Months		12 months or Longer		Total	
Security Type	Carrying Value	Gross Unrealized Losses	Carrying Value	Gross Unrealized Losses	Carrying Value	Gross Unrealized Losses
	(In thousands)					
Residential mortgage-backed securities:						
Government agency and government-sponsored enterprise pass through securities	$ 119,687	$ (1,381)	$ 673	$ (158)	$ 120,360	$ (1,539)
Government agency and government-sponsored enterprise collateralized mortgage obligations	218,387	(3,957)			218,387	(3,957)
Covered private label collateralized mortgage obligations	89	(1)	1,047	(86)	1,136	(87)
Municipal securities	175,910	(5,984)	98,152	(7,119)	274,062	(13,103)
Corporate debt securities	37,294	(307)			37,294	(307)
Government-sponsored enterprise debt securities	25,936	(200)			25,936	(200)
Other securities	16,550	(55)			16,550	(55)
Total	$ 593,853	$ (11,885)	$ 99,872	$ (7,363)	$ 693,725	$ (19,248)

	December 31, 2013					
	Less Than 12 Months		12 months or Longer		Total	
Security Type	Carrying Value	Gross Unrealized Losses	Carrying Value	Gross Unrealized Losses	Carrying Value	Gross Unrealized Losses
	(In thousands)					
Residential mortgage-backed securities:						
Government agency and government-sponsored enterprise pass through securities	$ 148,662	$ (2,767)	$ 32	$ (1)	$ 148,694	$ (2,768)
Government agency and government-sponsored enterprise collateralized mortgage obligations	179,938	(4,486)	4,383	(98)	184,321	(4,584)
Covered private label collateralized mortgage obligations	1,640	(60)	617	(90)	2,257	(150)
Municipal securities	337,208	(24,273)			337,208	(24,273)
Corporate debt securities	72,636	(1,483)			72,636	(1,483)
Government-sponsored enterprise debt securities	9,872	(174)			9,872	(174)
Other securities	23,969	(113)			23,969	(113)
Total	$ 773,925	$ (33,356)	$ 5,032	$ (189)	$ 778,957	$ (33,545)

PACWEST BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

NOTE 5 INVESTMENT SECURITIES (Continued)

We reviewed the securities that were in a continuous loss position less than 12 months and longer than 12 months at March 31, 2014, and concluded that their losses were a result of the level of market interest rates relative to the types of securities and pricing changes caused by shifting supply and demand dynamics and not a result of downgraded credit ratings or other indicators of deterioration of the underlying issuers' ability to repay. Accordingly, we determined that the securities were temporarily impaired and we did not recognize such impairment in the condensed consolidated statements of earnings. Additionally, we have no plans to sell these securities and believe that it is more likely than not we would not be required to sell these securities before recovery of their amortized cost.

The following table presents the contractual maturity distribution of our available-for-sale securities portfolio based on amortized cost and carrying value as of the date indicated:

	March 31, 2014	
Maturity	**Amortized Cost**	**Carrying Value**
	(In thousands)	
Due in one year or less	$ 3,585	$ 3,587
Due after one year through five years	24,390	24,614
Due after five years through ten years	266,745	265,949
Due after ten years	1,170,985	1,183,323
Total securities available-for-sale	$ 1,465,705	$ 1,477,473

Mortgage-backed securities have contractual terms to maturity, but require periodic payments to reduce principal. In addition, expected maturities may differ from contractual maturities because obligors and/or issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

The following table presents the composition of our interest income on investment securities:

	Three Months Ended		
Securities Interest by Type:	**March 31, 2014**	**December 31, 2013**	**March 31, 2013**
		(In thousands)	
Taxable interest	$ 6,920	$ 6,564	$ 5,563
Nontaxable interest	3,328	3,333	2,425
Dividend income	575	525	228
Total interest income on investment securities	$ 10,823	$ 10,422	$ 8,216

PACWEST BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

NOTE 5 INVESTMENT SECURITIES (Continued)

FHLB Stock

At March 31, 2014, the Company had a $25.0 million investment in Federal Home Loan Bank of San Francisco ("FHLB") stock carried at cost. During the first quarter of 2014, FHLB stock decreased $2.9 million due to redemptions by the FHLB. We evaluated the carrying value of our FHLB stock investment at March 31, 2014, and determined that it was not impaired. Our evaluation considered the long-term nature of the investment, the current financial and liquidity position of the FHLB, repurchase activity of excess stock by the FHLB at its carrying value, the return on the investment, and our intent and ability to hold this investment for a period of time sufficient to recover our recorded investment.

NOTE 6 LOANS AND LEASES

The Company's loan portfolio consists of (1) purchased credit-impaired ("PCI") loans and (2) non-purchased credit-impaired ("Non-PCI") loans. PCI loans represent acquired loans for which there was, at the acquisition date, evidence of credit deterioration since their origination and it was probable that we would be unable to collect all contractually required payments. Such loans are accounted for in accordance with ASC Subtopic 310-30, "*Loans and Debt Securities Acquired with Deteriorated Credit Quality*." Non-PCI loans are comprised of originated loans and acquired non-impaired loans for which there was no evidence of credit deterioration at their acquisition date and it was probable that we would be able to collect all contractually required payments. Originated loans are carried at the principal amount outstanding, net of unearned income. Unearned income is recognized as an adjustment to interest income over the contractual life of the loans using the effective interest method or taken into income when the related loans are paid off or sold. The purchase discount on acquired non-impaired loans is recognized as an adjustment to interest income over the contractual life of such loans using the effective interest method or taken into income when the related loans are paid off or sold.

We further present our loans by "covered" and "non-covered" loan categories. Covered loans represent loans covered by loss sharing agreements with the FDIC for which we will be reimbursed for a substantial portion of any future losses under the terms of the agreements. Covered loans also include a portion of the loans acquired in the FCAL acquisition as FCB had acquired two failed banks from the FDIC for which the loss sharing agreements with the FDIC remain in effect. Non-covered loans and leases represent loans and leases not covered by FDIC loss sharing agreements.

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PACWEST BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

NOTE 6 LOANS AND LEASES (Continued)

The following table summarizes the composition of our loan and lease portfolio as of the dates indicated:

	March 31, 2014			December 31, 2013		
	Non-PCI Loans and Leases	PCI Loans	Total	Non-PCI Loans and Leases	PCI Loans	Total
	(In thousands)					
Non-covered loans and leases	$ 3,745,849	$ 16,871	$ 3,762,720	$ 3,844,591	$ 20,326	$ 3,864,917
Covered loans	82,720	315,645	398,365	85,948	362,470	448,418
Total gross loans and leases	3,828,569	332,516	4,161,085	3,930,539	382,796	4,313,335
Unearned income	(18)		(18)	(983)		(983)
Total loans and leases, net of unearned income	3,828,551	332,516	4,161,067	3,929,556	382,796	4,312,352
Allowance for loan and lease losses:						
Non-covered loans and leases	(59,980)	(270)	(60,250)	(60,241)		(60,241)
Covered loans		(20,930)	(20,930)			