

UMPQUA HOLDINGS CORP
Form 10-K
February 15, 2013
Table Of Contents

United States

Securities and Exchange Commission

Washington, D.C. 20549

FORM 10-K

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended: December 31, 2012

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: 001-34624

Umpqua Holdings Corporation

(Exact Name of Registrant as Specified in Its Charter)

OREGON	93-1261319
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification Number)

One SW Columbia Street, Suite 1200 Portland, Oregon 97258

(Address of Principal Executive Offices)(Zip Code)

(503) 727-4100

(Registrant's Telephone Number, Including Area Code)

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

Title of each class	Name of each exchange on which registered
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NONE

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

Common Stock

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

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, 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.

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

The aggregate market value of the voting common stock held by non-affiliates of the registrant as of June 30, 2012, based on the closing price on that date of \$13.16 per share, and 110,488,100 shares held was \$1,454,023,396.

Indicate the number of shares outstanding for each of the issuer’s classes of common stock, as of the latest practical date:

The number of shares of the Registrant’s common stock (no par value) outstanding as of January 31, 2013 was 111,946,043.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the 2013 Annual Meeting of Shareholders of Umpqua Holdings Corporation are incorporated by reference in this Form 10-K in response to Part III, Items 10, 11, 12, 13 and 14.

Table Of Contents

UMPQUA HOLDINGS CORPORATION

FORM 10-K CROSS REFERENCE INDEX

<u>PART I</u>	3
<u>ITEM 1. BUSINESS</u>	3
<u>ITEM 1A. RISK FACTORS</u>	16
<u>ITEM 1B. UNRESOLVED STAFF COMMENTS</u>	23
<u>ITEM 2. PROPERTIES</u>	23
<u>ITEM 3. LEGAL PROCEEDINGS</u>	23
<u>ITEM 4. MINE SAFETY DISCLOSURES</u>	24
<u>PART II</u>	25
<u>ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES</u>	25
<u>ITEM 6. SELECTED FINANCIAL DATA</u>	28
<u>ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	30
<u>ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	30
<u>ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA</u>	72
<u>ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE</u>	150
<u>ITEM 9A. CONTROLS AND PROCEDURES</u>	151
<u>ITEM 9B. OTHER INFORMATION</u>	151
<u>PART III</u>	152
<u>ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE</u>	152
<u>ITEM 11. EXECUTIVE COMPENSATION</u>	152
<u>ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS</u>	152
<u>ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE</u>	152
<u>ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES</u>	152
<u>PART IV</u>	152
<u>ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES</u>	152
<u>SIGNATURES</u>	153
<u>EXHIBIT INDEX</u>	154

Table Of Contents

PART I

ITEM 1. BUSINESS.

This Annual Report on Form 10-K contains forward-looking statements, within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, which are intended to be covered by the safe harbor for “forward-looking statements” provided by the Private Securities Litigation Reform Act of 1995. These statements may include statements that expressly or implicitly predict future results, performance or events. Statements other than statements of historical fact are forward-looking statements. You can find many of these statements by looking for words such as “anticipates,” “expects,” “believes,” “estimates” and “intends” and words or phrases of similar meaning. We make forward-looking statements regarding projected sources of funds, availability of acquisition and growth opportunities, dividends, adequacy of our allowance for loan and lease losses and provision for loan and lease losses, our commercial real estate portfolio and subsequent chargeoffs. Forward-looking statements involve substantial risks and uncertainties, many of which are difficult to predict and are generally beyond our control. There are many factors that could cause actual results to differ materially from those contemplated by these forward-looking statements. Risks and uncertainties that could cause our financial performance to differ materially from our goals, plans, expectations and projections expressed in forward-looking statements include those set forth in our filings with the SEC, Item 1A of this Annual Report on Form 10-K, and the following:

- our ability to attract new deposits and loans and leases;
- demand for financial services in our market areas;
- competitive market pricing factors;
- deterioration in economic conditions that could result in increased loan and lease losses;
- risks associated with concentrations in real estate related loans;
- market interest rate volatility;
- compression of our net interest margin;
- stability of funding sources and continued availability of borrowings;
- changes in legal or regulatory requirements or the results of regulatory examinations that could restrict growth;
- our ability to recruit and retain key management and staff;
- availability of, and competition for, FDIC-assisted and other acquisition opportunities;
- risks associated with merger and acquisition integration;
- significant decline in the market value of the Company that could result in an impairment of goodwill;
- our ability to raise capital or incur debt on reasonable terms;

- regulatory limits on the Bank's ability to pay dividends to the Company;
- the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") and related rules and regulations on the Company's business operations and competitiveness, including the impact of executive compensation restrictions, which may affect the Company's ability to retain and recruit executives in competition with firms in other industries who do not operate under those restrictions; and
- the impact of the Dodd-Frank Act on the Company's interchange fee revenue, interest expense, FDIC deposit insurance assessments and regulatory compliance expenses, which includes a maximum permissible interchange fee that an issuer may receive for an electronic debit transaction, resulting in a decrease in interchange revenue on an average transaction.
- the impact of proposed "Basel III" capital rules that could require the Company to write down its trust preferred securities over an accelerated schedule.

For a more detailed discussion of some of the risk factors, see the section entitled "Risk Factors" below. We do not intend to update any factors, except as required by SEC rules, or to publicly announce revisions to any of our forward-looking statements. Any forward-looking statement speaks only as of the date that such statement was made. You should consider any forward looking statements in light of this explanation, and we caution you about relying on forward-looking statements.

Table Of Contents

Introduction

Umpqua Holdings Corporation (referred to in this report as “we,” “our,” “Umpqua,” and “the Company”), an Oregon corporation, was formed as a bank holding company in March 1999. At that time, we acquired 100% of the outstanding shares of South Umpqua Bank, an Oregon state-chartered bank formed in 1953. We became a financial holding company in March 2000 under the provisions of the Gramm-Leach-Bliley Act. Umpqua has two principal operating subsidiaries, Umpqua Bank (the “Bank”) and Umpqua Investments, Inc. (“Umpqua Investments”).

We file annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy statements and other information with the Securities and Exchange Commission (“SEC”). You may obtain these reports, and any amendments, from the SEC's website at www.sec.gov. You may obtain copies of these reports, and any amendments, through our website at www.umpquaholdingscorp.com. These reports are available through our website as soon as reasonably practicable after they are filed electronically with the SEC. All of our SEC filings since November 14, 2002 have been made available on our website within two days of filing with the SEC.

General Background

Headquartered in Roseburg, Oregon, Umpqua Bank is considered one of the most innovative community banks in the United States and has implemented a variety of retail marketing strategies to increase revenue and differentiate the company from its competition. The Bank combines a high touch customer experience with the sophisticated products and expertise of a commercial bank. The Bank provides a wide range of banking, wealth management, mortgage and other financial services to corporate, institutional and individual customers. Along with its subsidiaries, the Company is subject to the regulations of state and federal agencies and undergoes periodic examinations by these regulatory agencies.

Umpqua Investments is a registered broker-dealer and investment advisor with offices in Portland, Lake Oswego, and Medford, Oregon, and products and services offered through Umpqua Bank stores. The firm is one of the oldest investment companies in the Northwest and is actively engaged in the communities it serves. Umpqua Investments offers a full range of investment products and services including: stocks, fixed income securities (municipal, corporate, and government bonds, CDs, and money market instruments), mutual funds, annuities, options, retirement planning, money management services and life insurance.

Business Strategy

Umpqua Bank’s principal objective is to become the leading community-oriented financial services retailer throughout the Pacific Northwest and Northern California. We plan to continue the expansion of our market from Seattle to San Francisco, primarily along the I-5 corridor. We intend to continue to grow our assets and increase profitability and shareholder value by differentiating ourselves from competitors through the following strategies:

Capitalize On Innovative Product Delivery System. Our philosophy has been to develop an environment for the customer that makes the banking experience relevant and enjoyable. With this approach in mind, we have developed a unique store concept that offers “one-stop” shopping and includes distinct physical areas or boutiques, such as a “serious about service center,” an “investment opportunity center” and a “computer café,” which make the Bank's products and services more tangible and accessible. In 2006, we introduced our “Neighborhood Stores” and in 2007, we introduced the Umpqua “Innovation Lab.” In 2010, we introduced the next generation version of our Neighborhood Store in the Capitol Hill area of Seattle, Washington. We are continuing to remodel existing and acquired stores in metropolitan locations to further our retail vision and have a consistent brand experience.

Deliver Superior Quality Service. We insist on quality service as an integral part of our culture, from the Board of Directors to our new sales associates, and believe we are among the first banks to introduce a measurable quality service program. Under our “return on quality” program, the performance of each sales associate and store is evaluated monthly based on specific measurable factors such as the “sales effectiveness ratio” that totals the average number of banking products purchased by each new customer. The evaluations also encompass factors such as the number of new loan and deposit accounts generated in each store, reports by incognito “mystery shoppers” and customer surveys. Based on scores achieved, Umpqua’s “return on quality” program rewards both individual sales associates and store teams with financial incentives. Through such programs, we are able to measure the quality of service provided to our customers and maintain employee focus on quality customer service.

Establish Strong Brand Awareness. As a financial services retailer, we devote considerable resources to developing the “Umpqua Bank” brand. This is done through design strategy, marketing, merchandising, community based events, and delivery through our customer facing channels. From Bank branded bags of custom roasted coffee beans and chocolate coins with each transaction, to educational seminars and three Umpqua-branded ice cream trucks, Umpqua’s goal is to engage our customer with the brand in a whole new way. The unique look and feel of our stores and interactive displays help position us as an innovative, customer-friendly retailer of financial products and services. We build consumer preference for our products and services through strong brand awareness.

Table Of Contents

Use Technology to Expand Customer Base. Although our strategy continues to emphasize superior personal service, as consumer preferences evolve we continue to expand user-friendly, technology-based systems to attract customers who want to interact with their financial institution electronically. We offer technology-based services including remote deposit capture, online banking, bill pay and treasury services, mobile banking, voice response banking, automatic payroll deposit programs, advanced function ATMs, interactive product kiosks, and a robust internet web site. We believe the availability of both traditional bank services and electronic banking services enhances our ability to attract a broader range of customers and wrap our value proposition across all channels.

Increase Market Share in Existing Markets and Expand Into New Markets. As a result of our innovative retail product orientation, measurable quality service program and strong brand awareness, we believe that there is significant potential to increase business with current customers, to attract new customers in our existing markets and to enter new markets.

Pursue Strategic Acquisitions. A part of our strategy in this economic environment is to pursue the acquisition of banks within or in proximity to our geographic footprint that may be operating under capital constraints, regulatory pressure or other competitive disadvantages. We also consider the acquisition of certain failing banks that the FDIC makes available for bid, and that meet our strategic objectives. Failed bank transactions are attractive opportunities because we can acquire loans subject to a loss share agreement with the FDIC, or at a significant discount, that limits our downside risk on the purchased loan portfolio and, apart from our assumption of deposit liabilities, we have significant discretion as to the non-deposit liabilities that we assume. Assets purchased from the FDIC are marked to their fair value. We have completed four FDIC-assisted transactions since January 1, 2009.

Marketing and Sales

Our goal of increasing our share of financial services in our market areas is driven by a marketing and sales strategy with the following key components:

Media Advertising. Our comprehensive marketing campaigns aim to strengthen the Umpqua Bank brand and heighten public awareness about our innovative delivery of financial products and services. The Bank has been recognized nationally for its use of new media and unique approach. From programs like Umpqua's Discover Local Music Project and ice cream trucks, to campaigns like "Save Hard Spend Smart" and the "Lemonaire," Umpqua is utilizing nontraditional media channels and leveraging mass market media in new ways. In 2005 Umpqua dubbed the term "hand-shake marketing" to describe the Company's fresh approach to localized marketing.

Retail Store Concept. As a financial services provider, we believe that the store environment is critical to successfully market and sell products and services. Retailers traditionally have displayed merchandise within their stores in a manner designed to encourage customers to purchase their products. Purchases are made on the spur of the moment due to the products' availability and attractiveness. Umpqua Bank believes this same concept can be applied to financial institutions and accordingly displays financial services and products through tactile merchandising within our stores. Unlike many financial institutions whose strategy is to discourage customers from visiting their facilities in favor of ATMs or other forms of electronic banking, we encourage customers to visit our stores, where they are greeted by well-trained sales associates and encouraged to browse and to make "impulse purchases." Our "Next Generation" store model includes features like free wireless, free use of laptop computers, opening rooms with refrigerated beverages and innovative products packaging like MainStreet for businesses – a package that includes relationship pricing for deposit and loan products, and invitation to "Business Therapy" seminars. The stores host a variety of after-hours events, from poetry readings to seminars on how to build an art collection. To bring financial services to our customers in a cost-effective way, we introduced "Neighborhood Stores." We build these stores in

established neighborhoods and design them to be neighborhood hubs. These stand-alone full-service stores are smaller and emphasize advanced technology. To strengthen brand recognition, all Neighborhood Stores are similar in appearance. Umpqua's "Innovation Lab" is a one-of-a-kind location, showcasing emerging and existing technologies that foster community and redefine what consumers can expect from a banking experience. As a testing ground for new initiatives, the Lab will change regularly to feature new technology, products, services and community events.

Service Culture. Umpqua believes strongly that if we lead with a service culture, we will have more opportunity to sell our products and services and to create deeper customer relationships across all divisions, from retail to mortgage and commercial. Although a successful marketing program will attract customers to visit, a service environment and a well-trained sales team are critical to selling our products and services. We believe that our service culture has become well established throughout the organization due to our unique facility designs and ongoing training of our associates on all aspects of sales and service. We provide training at our in-house training facility, known as "The World's Greatest Bank University," to recognize and celebrate exceptional service, and pay commissions for the sale of the Bank's products and services. This service culture has helped transform us from a traditional community bank to a nationally recognized marketing company focused on selling financial products and services.

Table Of Contents

Products and Services

We offer a full array of financial products to meet the banking needs of our market area and target customers. To ensure the ongoing viability of our product offerings, we regularly examine the desirability and profitability of existing and potential new products. To make it easy for new prospective customers to bank with us and access our products, we offer a “Switch Kit,” which allows a customer to open a primary checking account with Umpqua Bank in less than ten minutes. Other avenues through which customers can access our products include our web site equipped with an e-switchkit which includes internet banking through “umpqua.online,” mobile banking, and our 24-hour telephone voice response system.

Deposit Products. We offer a traditional array of deposit products, including non-interest bearing checking accounts, interest bearing checking and savings accounts, money market accounts and certificates of deposit. These accounts earn interest at rates established by management based on competitive market factors and management's desire to increase certain types or maturities of deposit liabilities. Our approach is to tailor fit products and bundle those that meet the customer's needs. This approach is designed to add value for the customer, increase products per household and produce higher service fee income.

Private Bank. Umpqua Private Bank serves high net worth individuals with liquid investable assets by providing customized financial solutions and offerings. The private bank is designed to augment Umpqua's existing high-touch customer experience, and works collaboratively with the Bank's affiliate retail brokerage Umpqua Investments and with the independent investment management firm Ferguson Wellman Capital Management, to offer a comprehensive, integrated approach that meets clients' financial goals, including financial planning, trust services and investments. Umpqua entered into a strategic alliance with Ferguson Wellman in the fall of 2009 to further enhance our offerings to individuals, unions and corporate retirement plans, endowments and foundations.

Retail Brokerage Services. Umpqua Investments provides a full range of brokerage services including equity and fixed income products, mutual funds, annuities, options, retirement planning and money management services. Additionally, Umpqua Investments offers life insurance. At December 31, 2012, Umpqua Investments had 41 Series 7-licensed financial advisors serving clients at four stand-alone retail brokerage offices, one location located within a retirement facility, and “Investment Opportunity Centers” located in many Bank stores.

Commercial Loans and Commercial Real Estate Loans. We offer specialized loans for business and commercial customers, including accounts receivable and inventory financing, equipment loans, international trade, real estate construction loans and permanent financing and SBA program financing as well as capital markets and treasury management services. Additionally, we offer specially designed loan products for small businesses through our Small Business Lending Center, and have recently introduced a new business banking division to increase lending to small and mid-sized businesses. Ongoing credit management activities continue to focus on commercial real estate loans given this is a significant portion of our loan portfolio. We are also engaged in initiatives that continue to diversify the loan portfolio including a strong focus on commercial and industrial loans in addition to financing owner-occupied properties.

Residential Real Estate Loans. Real estate loans are available for construction, purchase and refinancing of residential owner-occupied and rental properties. Borrowers can choose from a variety of fixed and adjustable rate options and terms. We sell most residential real estate loans that we originate into the secondary market. Servicing is retained on the majority of these loans. We also support the Home Affordable Refinance Program and Home Affordable Modification Program.

Consumer Loans. We provide loans to individual borrowers for a variety of purposes, including secured and unsecured personal loans, home equity and personal lines of credit and motor vehicle loans.

Market Area and Competition

The geographic markets we serve are highly competitive for deposits, loans, leases and retail brokerage services. We compete with traditional banking institutions, as well as non-bank financial service providers, such as credit unions, brokerage firms and mortgage companies. In our primary market areas of Oregon, Western Washington, Northern California, and Nevada, major banks and large regional banks generally hold dominant market share positions. By virtue of their larger capital bases, these institutions have significantly larger lending limits than we do and generally have more expansive branch networks. Competition also includes other commercial banks that are community-focused.

As the industry becomes increasingly dependent on and oriented toward technology-driven delivery systems, permitting transactions to be conducted by telephone, computer and the internet, non-bank institutions are able to attract funds and provide lending and other financial services even without offices located in our primary service area. Some insurance companies and brokerage firms compete for deposits by offering rates that are higher than may be appropriate for the Bank in relation to its asset and liability management objectives. However, we offer a wide array of deposit products and believe we can compete effectively through rate-driven product promotions. We also compete with full service investment firms for non-bank financial products and services offered by Umpqua Investments.

Table Of Contents

Credit unions present a significant competitive challenge for our banking services and products. As credit unions currently enjoy an exemption from income tax, they are able to offer higher deposit rates and lower loan rates than we can on a comparable basis. Credit unions are also not currently subject to certain regulatory constraints, such as the Community Reinvestment Act, which, among other things, requires us to implement procedures to make and monitor loans throughout the communities we serve. Adhering to such regulatory requirements raises the costs associated with our lending activities, and reduces potential operating profits. Accordingly, we seek to compete by focusing on building customer relationships, providing superior service and offering a wide variety of commercial banking products that do not compete directly with products and services typically offered by the credit unions, such as commercial real estate loans, inventory and accounts receivable financing, and SBA program loans for qualified businesses.

Many of our stores are located in markets that have historically experienced growth below statewide averages. During the past several years, the States of Oregon, California, Washington, and Nevada have experienced economic difficulties. To the extent the fiscal condition of state and local governments does not improve, there could be an adverse effect on business conditions in the affected state that would negatively impact the prospects for the Bank's operations located there.

The following table presents the Bank's market share percentage for total deposits as of June 30, 2012, in each county where we have operations. The table also indicates the ranking by deposit size in each market. All information in the table was obtained from SNL Financial of Charlottesville, Virginia, which compiles deposit data published by the FDIC as of June 30, 2012 and updates the information for any bank mergers and acquisitions completed subsequent to the reporting date.

Table Of Contents

Oregon

County	Market Share	Market Rank	Number of Stores
Benton	6.4%	7	1
Clackamas	4.0%	7	5
Coos	39.0%	1	5
Curry	23.6%	2	1
Deschutes	4.8%	8	5
Douglas	62.4%	1	9
Jackson	16.1%	1	9
Josephine	16.7%	2	5
Lane	17.0%	1	9
Lincoln	11.7%	5	2
Linn	11.8%	5	3
Marion	8.6%	5	3
Multnomah	3.0%	6	16
Washington	4.1%	7	5

California

County	Market Share	Market Rank	Number of Stores
Amador	5.4%	7	1
Butte	3.2%	10	2
Calaveras	24.4%	2	4
Colusa	39.1%	1	2
Contra Costa	0.2%	23	2
El Dorado	7.4%	4	5
Glenn	31.1%	2	2
Humboldt	24.9%	1	7
Lake	16.4%	3	2
Marin	1.9%	12	3
Mendocino	3.3%	7	1
Napa	12.0%	3	7
Placer	7.0%	3	9
Sacramento	1.0%	17	6
San Francisco	0.0%	42	1
San Joaquin	0.6%	17	1
Shasta	2.3%	9	1
Solano	3.5%	9	4
Sonoma	0.5%	17	3

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Stanislaus	0.8%	15	2
Sutter	15.0%	2	2
Tehama	16.7%	1	2
Trinity	26.3%	2	1
Tuolumne	17.2%	3	5
Yolo	2.6%	12	1
Yuba	26.2%	1	2

8

Table Of Contents

Washington

County	Market Share	Market Rank	Number of Stores
Clark	7.8%	7	5
King	0.6%	17	15
Pierce	3.6%	8	11
Snohomish	0.7%	21	1

Nevada

County	Market Share	Market Rank	Number of Stores
Washoe	0.4%	8	4

Lending and Credit Functions

The Bank makes both secured and unsecured loans to individuals and businesses. At December 31, 2012, commercial real estate, commercial, residential, and consumer and other represented approximately 63%, 26%, 10%, and 1%, respectively, of the total non-covered loan and lease portfolio.

Inter-agency guidelines adopted by federal bank regulators mandate that financial institutions establish real estate lending policies with maximum allowable real estate loan-to-value limits, subject to an allowable amount of non-conforming loans as a percentage of capital. We have adopted as loan policy loan-to-value limits that range from 5% to 10% less than the federal guidelines for each category; however, policy exceptions are permitted for real estate loan customers with strong financial credentials.

Allowance for Loan and Lease Losses (“ALLL”) Methodology

The Bank performs regular credit reviews of the loan and lease portfolio to determine the credit quality and adherence to underwriting standards. When loans and leases are originated, they are assigned a risk rating that is reassessed periodically during the term of the loan through the credit review process. The Company’s risk rating methodology assigns risk ratings ranging from 1 to 10, where a higher rating represents higher risk. The 10 risk rating categories are a primary factor in determining an appropriate amount for the allowance for loan and lease losses. The Bank has a management ALLL Committee, which is responsible for, among other things, regularly reviewing the ALLL methodology, including loss factors, and ensuring that it is designed and applied in accordance with generally accepted accounting principles. The ALLL Committee reviews and approves loans and leases recommended for impaired status. The ALLL Committee also approves removing loans and leases from impaired status. The Bank’s Audit and Compliance Committee provides board oversight of the ALLL process and reviews and approves the ALLL

methodology on a quarterly basis.

Each risk rating is assessed an inherent credit loss factor that determines the amount of the allowance for loan and lease losses provided for that group of loans and leases with similar risk rating. Credit loss factors may vary by region based on management's belief that there may ultimately be different credit loss rates experienced in each region.

Regular credit reviews of the portfolio also identify loans that are considered potentially impaired. Potentially impaired loans are referred to the ALLL Committee which reviews and approves designated loans as impaired. A loan is considered impaired when based on current information and events, we determine that we will probably not be able to collect all amounts due according to the loan contract, including scheduled interest payments. When we identify a loan as impaired, we measure the impairment using discounted cash flows, except when the sole remaining source of the repayment for the loan is the liquidation of the collateral. In these cases, we use the current fair value of the collateral, less selling costs, instead of discounted cash flows. If we determine that the value of the impaired loan is less than the recorded investment in the loan, we either recognize an impairment reserve as a specific component to be provided for in the allowance for loan and lease losses or charge-off the impaired balance on collateral dependent loans if it is determined that such amount represents a confirmed loss. The combination of the risk rating-based allowance component and the impairment reserve allowance component lead to an allocated allowance for loan and lease losses.

The Bank may also maintain an unallocated allowance amount to provide for other credit losses inherent in a loan and lease portfolio that may not have been contemplated in the credit loss factors. This unallocated amount generally comprises less than 10% of the allowance, but may be maintained at higher levels during times of deteriorating economic conditions characterized by falling real estate values. The unallocated amount is reviewed periodically based on trends in credit losses, the results of credit reviews and overall economic trends. As of December 31, 2012, there was no unallocated allowance amount.

Table Of Contents

Management believes that the ALLL was adequate as of December 31, 2012. There is, however, no assurance that future loan losses will not exceed the levels provided for in the ALLL and could possibly result in additional charges to the provision for loan and lease losses. In addition, bank regulatory authorities, as part of their periodic examination of the Bank, may require additional charges to the provision for loan and lease losses in future periods if warranted as a result of their review. Approximately 79% of our total loan portfolio is secured by real estate, and a significant decline in real estate market values may require an increase in the ALLL. The U.S. recession, the housing market downturn, and declining real estate values in our markets have negatively impacted aspects of our residential development, commercial real estate, commercial construction and commercial loan portfolios. A renewed deterioration or a prolonged delay in economic recovery in our markets may adversely affect our loan portfolio and may lead to additional charges to the provision for loan and lease losses.

Employees

As of December 31, 2012, we had a total of 2,376 full-time equivalent employees. None of the employees are subject to a collective bargaining agreement and management believes its relations with employees to be good. Umpqua Bank was named #55 on Fortune magazine's 2013 list of "100 Best Companies to Work For", #69 on the 2012 list, #25 on the 2011 list, and #23 on the 2010 list. Information regarding employment agreements with our executive officers is contained in Item 11 below, which item is incorporated by reference to our proxy statement for the 2013 annual meeting of shareholders.

Government Policies

The operations of our subsidiaries are affected by state and federal legislative changes and by policies of various regulatory authorities. These policies include, for example, statutory maximum legal lending rates, domestic monetary policies of the Board of Governors of the Federal Reserve System, United States fiscal policy, and capital adequacy and liquidity constraints imposed by federal and state regulatory agencies.

Supervision and Regulation

General. We are extensively regulated under federal and state law. These laws and regulations are generally intended to protect depositors and customers, not shareholders. To the extent that the following information describes statutory or regulatory provisions, it is qualified in its entirety by reference to the particular statute or regulation. Any change in applicable laws or regulations may have a material effect on our business and prospects. Our operations may be affected by legislative changes and by the policies of various regulatory authorities. We cannot accurately predict the nature or the extent of the effects on our business and earnings that fiscal or monetary policies, or new federal or state legislation may have in the future. Umpqua is subject to the disclosure and regulatory requirements of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, both as administered by the Securities and Exchange Commission. As a listed company on NASDAQ, Umpqua is subject to NASDAQ rules for listed companies.

Holding Company Regulation. We are a registered financial holding company under the Gramm-Leach-Bliley Act of 1999 (the "GLB Act"), and are subject to the supervision of, and regulation by, the Board of Governors of the Federal Reserve System (the "Federal Reserve"). As a financial holding company, we are examined by and file reports with the Federal Reserve. The Federal Reserve expects a bank holding company to serve as a source of financial and managerial strength to its subsidiary bank and, under appropriate circumstances, to commit resources to support the subsidiary bank.

Financial holding companies are bank holding companies that satisfy certain criteria and are permitted to engage in activities that traditional bank holding companies are not. The qualifications and permitted activities of financial holdings companies are described below under “Regulatory Structure of the Financial Services Industry.”

Federal and State Bank Regulation. Umpqua Bank, as a state chartered bank with deposits insured by the FDIC, is primarily subject to the supervision and regulation of the Oregon Department of Consumer and Business Services Division of Finance and Corporate Securities, the Washington Department of Financial Institutions, the California Department of Financial Institutions, the Nevada Division of Financial Institutions, the FDIC and the Consumer Financial Protection Bureau (CFPB). These agencies may prohibit the Bank from engaging in what they believe constitute unsafe or unsound banking practices. Our primary state regulator (the State of Oregon) regularly examines the Bank or participates in joint examinations with the FDIC.

The Community Reinvestment Act (“CRA”) requires that, in connection with examinations of financial institutions within its jurisdiction, the FDIC evaluate the record of the financial institutions in meeting the credit needs of their local communities, including low- and moderate-income neighborhoods, consistent with the safe and sound operation of those institutions. These factors are also considered in evaluating mergers, acquisitions and applications to open a branch or new facility. A less than “Satisfactory” rating would result in the suspension of any growth of the Bank through acquisitions or opening de novo branches until the rating is improved. As of the most recent CRA examination in April 2010, the Bank's CRA rating was “Satisfactory.”

Table Of Contents

Banks are also subject to certain restrictions imposed by the Federal Reserve Act on extensions of credit to executive officers, directors, principal shareholders or any related interest of such persons. Extensions of credit must be made on substantially the same terms, including interest rates and collateral as, and follow credit underwriting procedures that are not less stringent than, those prevailing at the time for comparable transactions with persons not affiliated with the bank, and must not involve more than the normal risk of repayment or present other unfavorable features. Banks are also subject to certain lending limits and restrictions on overdrafts to such persons. A violation of these restrictions may result in the assessment of substantial civil monetary penalties on the affected bank or any officer, director, employee, agent or other person participating in the conduct of the affairs of that bank, the imposition of a cease and desist order, and other regulatory sanctions.

The Federal Reserve Act and related Regulation W limit the amount of certain loan and investment transactions between the Bank and its affiliates, require certain levels of collateral for such loans, and limit the amount of advances to third parties that may be collateralized by the securities of Umpqua or its subsidiaries. Regulation W requires that certain transactions between the Bank and its affiliates be on terms substantially the same, or at least as favorable to the Bank, as those prevailing at the time for comparable transactions with or involving nonaffiliated companies or, in the absence of comparable transactions, on terms and under circumstances, including credit standards, that in good faith would be offered to or would apply to nonaffiliated companies. Umpqua and its subsidiaries have adopted an Affiliate Transactions Policy and have entered into various affiliate agreements in compliance with Regulation W.

The Federal Reserve and the FDIC have adopted non-capital safety and soundness standards for institutions. These standards cover internal controls, information and internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation, fees and benefits, and standards for asset quality, earnings and stock valuation. An institution that fails to meet these standards must develop a plan acceptable to the agency, specifying the steps that it will take to meet the standards. Failure to submit or implement such a plan may subject the institution to regulatory sanctions. We believe that the Bank is in compliance with these standards.

Federal Deposit Insurance. Substantially all deposits with Umpqua Bank are insured up to applicable limits by the Deposit Insurance Fund (“DIF”) of the FDIC and are subject to deposit insurance assessments to maintain the DIF.

In October 2010, the FDIC adopted a new DIF restoration plan to ensure that the fund reserve ratio reaches 1.35% by September 30, 2020, as required by the Dodd-Frank Act. At least semi-annually, the FDIC will update its loss and income projections for the DIF and, if needed, increase or decrease assessment rates.

On February 7, 2011, the FDIC adopted a final rule modifying the risk-based assessment system from a domestic deposit base to a scorecard based assessment system, effective April 1, 2011. Effective as of April 1, 2011, the Bank was categorized as a large institution as the Bank has more than \$10 billion in assets. The initial base assessment rates range from five to 35 basis points. After potential adjustments related to unsecured debt and brokered deposit balances, the final total assessment rates range from 2.5 to 45 basis points. Initial base assessment rates for large institutions ranged from five to 35 basis points. The Bank’s assessment rate for 2012 fell at the low end of this range. Further increases in the assessment rate could have a material adverse effect on our earnings, depending upon the amount of the increase.

In 2006, the Reform Act increased the deposit insurance limit for certain retirement plan deposit accounts from \$100,000 to \$250,000. The basic insurance limit for other deposits, including individuals, joint account holders, businesses, government entities, and trusts, remained at \$100,000. The Reform Act also provided for the merger of the two deposit insurance funds administered by the FDIC, the Bank Insurance Fund (“BIF”) and the Savings Association Insurance Fund (“SAIF”), into the DIF. On October 3, 2008, the EESA temporarily raised the basic limit on

federal deposit insurance coverage from \$100,000 to \$250,000 per depositor. The basic deposit insurance limit would have returned to \$100,000 after December 31, 2009. On May 20, 2009, the Helping Families Save Their Homes Act extended the temporary increase in the standard maximum deposit insurance amount to \$250,000 per depositor through December 31, 2013. The standard maximum deposit insurance amount would return to \$100,000 on January 1, 2014. The Dodd-Frank Act permanently raises the current standard maximum federal deposit insurance amount from \$100,000 to \$250,000 per qualified account.

Table Of Contents

In November 2008, the FDIC approved the final ruling establishing the Transaction Account Guarantee Program (“TAGP”) as part of the Temporary Liquidity Guarantee Program (“TLGP”). Under this program, effective immediately and through December 31, 2009, all non-interest bearing transaction accounts became fully guaranteed by the FDIC for the entire amount in the account. This unlimited coverage also extended to NOW (interest bearing deposit accounts) earning an interest rate no greater than 0.50% and all IOLTAs (lawyers’ trust accounts). Coverage under the TAGP, funded through insurance premiums paid by participating financial institutions, was in addition to and separate from the additional coverage announced under EESA. In August 2009, the FDIC extended the TAGP portion of the TLGP through June 30, 2010. In June 2010, the FDIC extended the TAGP portion of the TLGP for an additional six months, from July 1, 2010 to December 31, 2010. The rule required that interest rates on qualifying NOW accounts offered by banks participating in the program be reduced to 0.25% from 0.50%. The rule provided for an additional extension of the program, without further rulemaking, for a period of time not to exceed December 31, 2011. Umpqua elected to participate in the TAGP through the extended period. In July 2010, the Dodd-Frank Act was enacted, which provides for unlimited deposit insurance for noninterest bearing transactions accounts (excluding NOW, but including IOLTAs) beginning December 31, 2010 for a period of two years. The TAGP expired as of December 31, 2012 and the FDIC will no longer provide separate, unlimited deposit insurance under that program.

The FDIC may terminate the deposit insurance of any insured depository institution if it determines that the institution has engaged in or is engaging in unsafe and unsound banking practices, is in an unsafe or unsound condition or has violated any applicable law, regulation or order or any condition imposed in writing by, or pursuant to, any written agreement with the FDIC. The termination of deposit insurance for the Bank could have a material adverse effect on our financial condition and results of operations due to the fact that the Bank’s liquidity position would likely be affected by deposit withdrawal activity.

Dividends. Under the Oregon Bank Act and the Federal Deposit Insurance Corporation Improvement Act of 1991, the Bank is subject to restrictions on the payment of cash dividends to its parent company. A bank may not pay cash dividends if that payment would reduce the amount of its capital below that necessary to meet minimum applicable regulatory capital requirements. In addition, under the Oregon Bank Act, the amount of the dividend paid by the Bank may not be greater than net unreserved retained earnings, after first deducting to the extent not already charged against earnings or reflected in a reserve, all bad debts, which are debts on which interest is unpaid and past due at least six months unless the debt is fully secured and in the process of collection; all other assets charged-off as required by Oregon bank regulators or a state or federal examiner; and all accrued expenses, interest and taxes of the Bank. In addition, state and federal regulatory authorities are authorized to prohibit banks and holding companies from paying dividends that would constitute an unsafe or unsound banking practice. The Federal Reserve has issued a policy statement on the payment of cash dividends by bank holding companies, which expresses the Federal Reserve’s view that a bank holding company should pay cash dividends only to the extent that its net income for the past year is sufficient to cover both the cash dividends and a rate of earnings retention that is consistent with the holding company’s capital needs, asset quality and overall financial condition.

Capital Adequacy. The federal and state bank regulatory agencies use capital adequacy guidelines in their examination and regulation of holding companies and banks. If capital falls below the minimum levels established by these guidelines, a holding company or a bank may be denied approval to acquire or establish additional banks or non-bank businesses or to open new facilities.

The FDIC and Federal Reserve have adopted risk-based capital guidelines for holding companies and banks. The risk-based capital guidelines are designed to make regulatory capital requirements more sensitive to differences in risk profile among holding companies and banks, to account for off-balance sheet exposure and to minimize disincentives for holding liquid assets. Assets and off-balance sheet items are assigned to broad risk categories, each with

appropriate weights. The resulting capital ratios represent capital as a percentage of total risk-weighted assets and off-balance sheet items. The capital adequacy guidelines limit the degree to which a holding company or bank may leverage its equity capital.

Federal regulations establish minimum requirements for the capital adequacy of depository institutions, such as the Bank. Banks with capital ratios below the required minimums are subject to certain administrative actions, including prompt corrective action, the termination of deposit insurance upon notice and hearing, or a temporary suspension of insurance without a hearing.

The Federal Deposit Insurance Corporation Improvement Act of 1991 (“FDICIA”) requires federal banking regulators to take “prompt corrective action” with respect to a capital-deficient institution, including requiring a capital restoration plan and restricting certain growth activities of the institution. Umpqua could be required to guarantee any such capital restoration plan required of the Bank if the Bank became undercapitalized. Pursuant to FDICIA, regulations were adopted defining five capital levels: well capitalized, adequately capitalized, undercapitalized, severely undercapitalized and critically undercapitalized. Under the regulations, the Bank is considered “well capitalized” as of December 31, 2012.

Federal and State Regulation of Broker-Dealers. Umpqua Investments, Inc. is a fully disclosed introducing broker-dealer clearing through First Clearing LLC. Umpqua Investments is regulated by the Financial Industry Regulatory Authority (“FINRA”) and has deposits insured through the Securities Investors Protection Corp (“SIPC”) as well as third party insurers. FINRA performs regular examinations of the firm that include reviews of policies, procedures, recordkeeping, trade practices, and customer protection as well as other inquiries.

Table Of Contents

SIPC protects client securities and cash up to \$500,000, including \$100,000 for cash with additional coverage provided through First Clearing for the remaining net equity balance in a brokerage account, if any. This coverage does not include losses in investment accounts.

Broker-Dealer and Related Regulatory Supervision. Umpqua Investments is a member of, and is subject to the regulatory supervision of, FINRA. Areas subject to this regulatory review include compliance with trading rules, financial reporting, investment suitability for clients, and compliance with stock exchange rules and regulations.

Effects of Government Monetary Policy. Our earnings and growth are affected not only by general economic conditions, but also by the fiscal and monetary policies of the federal government, particularly the Federal Reserve. The Federal Reserve implements national monetary policy for such purposes as curbing inflation and combating recession, through its open market operations in U.S. Government securities, control of the discount rate applicable to borrowings from the Federal Reserve, and establishment of reserve requirements against certain deposits. These activities influence growth of bank loans, investments and deposits, and also affect interest rates charged on loans or paid on deposits. The nature and impact of future changes in monetary policies and their impact on us cannot be predicted with certainty.

Regulatory Structure of the Financial Services Industry. Federal laws and regulations governing banking and financial services underwent significant changes in recent years and are subject to significant changes in the future. From time to time, legislation is introduced in the United States Congress that contains proposals for altering the structure, regulation, and competitive relationships of the nation's financial institutions. If enacted into law, these proposals could increase or decrease the cost of doing business, limit or expand permissible activities, or affect the competitive balance among banks, savings associations, and other financial institutions. Whether or in what form any such legislation may be adopted or the extent to which our business might be affected thereby cannot be predicted.

The GLB Act, enacted in November 1999, repealed sections of the Banking Act of 1933, commonly referred to as the Glass-Steagall Act, that prohibited banks from engaging in securities activities, and prohibited securities firms from engaging in banking. The GLB Act created a new form of holding company, known as a financial holding company, that is permitted to acquire subsidiaries that are variously engaged in banking, securities underwriting and dealing, and insurance underwriting.

A bank holding company, if it meets specified requirements, may elect to become a financial holding company by filing a declaration with the Federal Reserve, and may thereafter provide its customers with a broader spectrum of products and services than a traditional bank holding company is permitted to do. A financial holding company may, through a subsidiary, engage in any activity that is deemed to be financial in nature and activities that are incidental or complementary to activities that are financial in nature. These activities include traditional banking services and activities previously permitted to bank holding companies under Federal Reserve regulations, but also include underwriting and dealing in securities, providing investment advisory services, underwriting and selling insurance, merchant banking (holding a portfolio of commercial businesses, regardless of the nature of the business, for investment), and arranging or facilitating financial transactions for third parties.

To qualify as a financial holding company, the bank holding company must be deemed to be well-capitalized and well-managed, as those terms are used by the Federal Reserve. In addition, each subsidiary bank of a bank holding company must also be well-capitalized and well-managed and be rated at least "satisfactory" under the Community Reinvestment Act. A bank holding company that does not qualify, or has not chosen, to become a financial holding company must limit its activities to traditional banking activities and those non-banking activities the Federal Reserve has deemed to be permissible because they are closely related to the business of banking.

The GLB Act also includes provisions to protect consumer privacy by prohibiting financial services providers, whether or not affiliated with a bank, from disclosing non-public personal, financial information to unaffiliated parties without the consent of the customer, and by requiring annual disclosure of the provider's privacy policy.

Legislation enacted by Congress in 1995 permits interstate banking and branching, which allows banks to expand nationwide through acquisition, consolidation or merger. Under this law, an adequately capitalized bank holding company may acquire banks in any state or merge banks across state lines if permitted by state law. Further, banks may establish and operate branches in any state subject to the restrictions of applicable state law. Under Oregon law, an out-of-state bank or bank holding company may merge with or acquire an Oregon state chartered bank or bank holding company if the Oregon bank, or in the case of a bank holding company, the subsidiary bank, has been in existence for a minimum of three years, and the law of the state in which the acquiring bank is located permits such merger. The Bank now has the ability to open additional de novo branches in the states of Oregon, California, Washington, and Nevada.

Table Of Contents

Section 613 of the Dodd-Frank Act eliminates interstate branching restrictions that were implemented as part of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, and removes many restrictions on de novo interstate branching by national and state-chartered banks. The FDIC and the OCC now have authority to approve applications by insured state nonmember banks and national banks, respectively, to establish de novo branches in states other than the bank's home state if "the law of the State in which the branch is located, or is to be located, would permit establishment of the branch, if the bank were a State bank chartered by such State." The enactment of this section may significantly increase interstate banking by community banks in western states, where barriers to entry were previously high.

Anti-Terrorism Legislation. The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act ("USA Patriot Act"), enacted in 2001:

- prohibits banks from providing correspondent accounts directly to foreign shell banks;
- imposes due diligence requirements on banks opening or holding accounts for foreign financial institutions or wealthy foreign individuals;
- requires financial institutions to establish an anti-money-laundering ("AML") compliance program; and
- generally eliminates civil liability for persons who file suspicious activity reports.

The USA Patriot Act also increases governmental powers to investigate terrorism, including expanded government access to account records. The Department of the Treasury is empowered to administer and make rules to implement the Act, which to some degree, affects our record-keeping and reporting expenses. Should the Bank's AML compliance program be deemed insufficient by federal regulators, we would not be able to grow through acquiring other institutions or opening de novo branches.

Sarbanes-Oxley Act of 2002. The Sarbanes-Oxley Act of 2002 addresses public company corporate governance, auditing, accounting, executive compensation and enhanced and timely disclosure of corporate information.

The Sarbanes-Oxley Act represents significant federal involvement in matters traditionally left to state regulatory systems, such as the regulation of the accounting profession, and regulation of the relationship between a Board of Directors and management and between a Board of Directors and its committees.

The Sarbanes-Oxley Act provides for, among other things:

- prohibition on personal loans by Umpqua to its directors and executive officers except loans made by the Bank in accordance with federal banking regulations;

- independence requirements for Board audit committee members and our auditors;
- certification of Exchange Act reports by the chief executive officer, chief financial officer and principal accounting officer;
- disclosure of off-balance sheet transactions;
- expedited reporting of stock transactions by insiders; and
- increased criminal penalties for violations of securities laws.

The Sarbanes-Oxley Act also requires:

- management to establish, maintain and evaluate disclosure controls and procedures;
- management to report on its annual assessment of the effectiveness of internal controls over financial reporting;
- our external auditor to attest to the effectiveness of internal controls over financial reporting.

The SEC has adopted regulations to implement various provisions of the Sarbanes-Oxley Act, including disclosures in periodic filings pursuant to the Exchange Act. Also, in response to the Sarbanes-Oxley Act, NASDAQ adopted new standards for listed companies. In 2004, the Sarbanes-Oxley Act substantially increased our reporting and compliance expenses.

Emergency Economic Stabilization Act of 2008 (EESA). This act granted broad powers to the U.S. Treasury, the FDIC, and the Federal Reserve to stabilize the financial markets under the following programs:

- the Capital Purchase Program allocated \$250 billion to Treasury to purchase senior preferred shares and warrants to purchase

Table Of Contents

commons stock from approved financial institutions;

- the Troubled Asset Purchase Program allocated \$250 billion to Treasury to purchase troubled assets from financial institutions, with Treasury to also receive securities issued by participating institutions;

- the Temporary Liquidity Guaranty Program (“TLGP”) authorized the FDIC to insure newly issued senior unsecured debt and insure the total balance in non-interest bearing transactional deposit accounts of those institutions who elect to participate;

- the Commercial Paper and Money Market Investor Funding Facilities authorized the Federal Reserve Bank of New York to purchase rated commercial paper from U.S. companies and to purchase money market instruments from U.S. money market mutual funds.

The Dodd-Frank Wall Street Reform and Consumer Protection Act. On July 21, 2010, President Obama signed the Dodd-Frank Act, which is a sweeping overhaul of financial industry regulation. In general, the Act:

- Creates a systemic-risk council of top regulators, the Financial Stability Oversight Council (FSOC), whose purpose is to identify risks and respond to emerging threats to the financial stability of the U.S. arising from large, interconnected bank holding companies or nonbank financial companies;
- Gives the FDIC authority to unwind large failing financial firms. Treasury would supply funds to cover the up-front costs of winding down the failed firm, but the government would have to put a "repayment plan" in place. Regulators would recoup any losses incurred from the wind-down afterwards by assessing fees on financial firms with more than \$50 billion in assets;
- Directs the FDIC to base deposit-insurance assessments on assets minus tangible capital instead of on domestic deposits and requires the FDIC to increase premium rates to raise the Deposit Insurance Fund's (DIF) minimum reserve ratio from 1.15% to 1.35% by September 30, 2020. Banks, like Umpqua, with consolidated assets greater than \$10 billion would pay the increased premiums;
- Extended the FDIC's Transaction Account Guarantee (TAG) program to December 31, 2012. There was no “opt-out” from the extension;
- Permanently increases FDIC deposit-insurance coverage to \$250,000, retroactive to January 1, 2008. The Act eliminates the 1.5% cap on the DIF reserve ratio and automatic dividends when the ratio exceeds 1.35%. Under the

agreement, the FDIC would have discretion on whether to provide dividends to DIF members;

- Authorizes banks to pay interest on business checking accounts, which is likely to significantly increase our interest expense;

- Creates a new Consumer Financial Protection Bureau (CFPB), housed under the Federal Reserve and led by a director appointed by the President and confirmed by the Senate. All existing consumer laws and regulations will be transferred to this agency and each existing regulatory agency will contribute their respective consumer regulatory and exam staffs to the CFPB;

- Grants to CFPB the authority to write consumer protection rules for banks and nonbank financial firms offering consumer financial services or products and to ensure that consumers are protected from “unfair, deceptive, or abusive” acts or practices. The CFPB also has authority to examine and enforce regulations for banks, like Umpqua, with greater than \$10 billion in assets;

- Authorizes the CFPB to require banks to compile and provide reports relating to its consumer lending, marketing and other consumer business activities and to make that information available to the public if it is “in the public interest”;

- Directs the Federal Reserve to set interchange fees for debit card transactions charged by banks with more than \$10 billion in assets. It must establish what it determines are reasonable fees by factoring in their transaction costs compared to those for checks;

- Requires loan originators to retain 5% of any loan sold and securitized, unless it is a “qualified residential mortgage”, which includes standard 30 and 15 year fixed rate loans. It also specifically exempts from risk retention FHA, VA, Farmer Mac and Rural Housing Service loans;

- Excludes the proceeds of trust preferred securities from Tier 1 capital except for trust preferred securities issued before May 19, 2010 by bank holding companies, like the Company, with less than \$15 billion in assets at December 31, 2009;

- Adopts various mortgage lending and predatory lending provisions;

Table Of Contents

- Requires federal regulators jointly to prescribe regulations mandating that financial institutions with more than \$1 billion in assets to disclose to their regulators their incentive compensation plans to permit the regulators to determine whether the plans provide executive officers, employees, directors or principal shareholders with excessive compensation, fees or benefits, or could lead to material financial loss to the institution;
- Imposes a number of requirements related to executive compensation that apply to all public companies, such as prohibition of broker discretionary voting in connection with a shareholder vote on executive compensation; mandatory shareholder “say on pay” (every one to three years) and “say on golden parachutes”; and clawback of incentive compensation from current or former executive officers following any accounting restatement;
- Establishes a modified version of the “Volcker Rule” and generally prohibits banks from engaging in proprietary trading or holding or obtaining an interest in a hedge fund or private equity fund, to the extent that it would exceed 3% of its Tier 1 capital. A bank's interest in any single hedge fund or private equity fund may not exceed 3% of the assets of that fund.

Joint Agency Guidance on Incentive Compensation. On June 21, 2010, federal banking regulators issued final joint agency guidance on Sound Incentive Compensation Policies. This guidance applies to executive and non-executive incentive compensation plans administered by banks. The guidance says that incentive compensation programs must:

- Provide employees incentives that appropriately balance risk and reward.
- Be compatible with effective controls and risk- management;
- Be supported by strong corporate governance, including active and effective oversight by the board;

The Federal Reserve reviews, as part of the regular, risk-focused examination process, the incentive compensation arrangements of the Company and other banking organizations. The findings of the supervisory initiatives are included in reports of examination and any deficiencies will be incorporated into the Company's supervisory ratings, which can affect the Company's ability to make acquisitions and take other actions.

ITEM 1A. RISK FACTORS.

In addition to the other information set forth in this report, you should carefully consider the factors discussed below. These factors could materially adversely affect our business, financial condition, liquidity, results of operations and capital position, and could cause our actual results to differ materially from our historical results or the results contemplated by the forward-looking statements contained in this report.

Difficult market conditions have adversely affected and may continue to have an adverse effect on our industry.

Since 2007, dramatic declines in the housing market, with falling home prices and increasing foreclosures and unemployment and under-employment have negatively impacted the credit performance of mortgage loans and resulted in significant write-downs of asset values by financial institutions, including government-sponsored entities as well as major commercial and investment banks. These write-downs have caused many financial institutions to seek additional capital, to merge with larger and stronger institutions and, in some cases, to fail. The protracted poor economy has led to an increased level of commercial and consumer delinquencies, lack of consumer confidence, increased market volatility and widespread reduction of business activity generally. We have experienced only moderate improvement in these conditions in the recent past and we don't expect significant improvement in the economy in the near future. There is a risk that economic conditions will deteriorate. A worsening of these conditions would likely exacerbate the adverse effects of these difficult market conditions on us and others in the financial institutions industry. In particular, we may face the following risks in connection with these events:

- We face increased regulation of our industry, including as a result of the Dodd-Frank Act. Compliance with such regulation will increase our costs, reduce existing sources of revenue and may limit our ability to pursue business opportunities.
- Our ability to assess the creditworthiness of our customers may be impaired if the models and approaches we use to select, manage, and underwrite our customers become less predictive of future performance.
- The process we use to estimate losses inherent in our loan portfolio requires difficult, subjective, and complex judgments, including forecasts of economic conditions and how these economic predictions might impair the ability of our borrowers to repay their loans, which process may no longer be capable of accurate estimation and may, in turn, impact its reliability.
- There may be downward pressure on our stock price.
- We may face increased competition due to intensified consolidation of the financial services industry.

If current levels of market disruption and volatility continue or worsen, there can be no assurance that we will not experience an adverse effect, which may be material, on our ability to access capital and on our business, financial condition and results of operations.

Table Of Contents

The majority of our assets are loans, which if not repaid would result in losses to the Bank.

The Bank, like other lenders, is subject to credit risk, which is the risk of losing principal or interest due to borrowers' failure to repay loans in accordance with their terms. Underwriting and documentation controls cannot mitigate all credit risk. A downturn in the economy or the real estate market in our market areas or a rapid increase in interest rates could have a negative effect on collateral values and borrowers' ability to repay. To the extent loans are not paid timely by borrowers, the loans are placed on non-accrual status, thereby reducing interest income. Further, under these circumstances, an additional provision for loan and lease losses or unfunded commitments may be required. See Management's Discussion and Analysis of Financial Condition and Results of Operations—"Allowance for Loan and Lease Losses and Reserve for Unfunded Commitments", "Provision for Loan and Lease Losses" and "Asset Quality and Non-Performing Assets".

A large percentage of our loan portfolio is secured by real estate, in particular commercial real estate. Deterioration in the real estate market or other segments of our loan portfolio would lead to additional losses, which could have a material adverse effect on our business, financial condition and results of operations.

As of December 31, 2012, approximately 79% of our total loan portfolio is secured by real estate, the majority of which is commercial real estate. As a result of increased levels of commercial and consumer delinquencies and declining real estate values, since 2007 we have experienced elevated levels of net charge-offs and allowances for loan and lease reserves. Increases in commercial and consumer delinquency levels or continued declines in real estate market values would require increased net charge-offs and increases in the allowance for loan and lease losses, which could have a material adverse effect on our business, financial condition and results of operations and prospects.

Deterioration in the real estate market could result in loans that we have restructured to become delinquent and classified as non-accrual loans.

At December 31, 2012, impaired loans of \$70.6 million were classified as performing restructured loans. We restructured the loans in response to borrower financial difficulty, and generally provided for a temporary modification of loan repayment terms. Loans are reported as restructured when we grant concessions to a borrower experiencing financial difficulties that we would not otherwise consider. Examples of such concessions include forgiveness of principal or accrued interest, extending the maturity dates or providing a lower interest rate than would be normally available for a transaction of similar risk. In exchange for these concessions, at the time of restructure, we require additional collateral to bring the loan to value to at most 100%. A further decline in the economic conditions in our general market areas or other factors could adversely impact borrowers with restructured loans and cause borrowers to become delinquent or otherwise default or call into question their ability to repay full interest and principal in accordance with the restructured terms, which would result in the restructured loan being reclassified as non-accrual.

The effects of the economic recession have been particularly severe in our primary market areas in the Pacific Northwest, Northern California, and Nevada.

Substantially all of our loans are to businesses and individuals in Northern California, Oregon, Washington, and Nevada. The Pacific Northwest has one of the nation's highest unemployment rates and major employers in Oregon and Washington have implemented substantial employee layoffs or scaled back growth plans. Severe declines in housing prices and property values have been particularly acute in our primary market areas. The States of California, Oregon, Washington, and Nevada continue to face fiscal challenges, the long-term effects of which on each State's economy cannot be predicted. A further deterioration in the economic conditions or a prolonged delay in economic

recovery in our primary market areas could result in the following consequences, any of which could materially and adversely affect our business: loan delinquencies may increase; problem assets and foreclosures may increase putting further price pressures on valuations generally; demand for our products and services may decrease; low cost or noninterest bearing deposits may decrease; and collateral for loans made by us, especially real estate, may decline in value, in turn reducing customers' borrowing power, and reducing the value of assets and collateral associated with our existing loans.

The benefits of our FDIC loss-sharing agreements may be reduced or eliminated.

In connection with Umpqua Bank's assumption of the banking operations of Evergreen Bank, Rainier Pacific Bank, and Nevada Security Bank, the Bank and the FDIC entered into Whole Bank Purchase and Assumption Agreements with Loss-Share. Our decisions regarding the fair value of assets acquired, including the FDIC loss-sharing assets, could be inaccurate which could materially and adversely affect our business, financial condition, results of operations, and future prospects. Management makes various assumptions and judgments about the collectability of the acquired loans, including the creditworthiness of borrowers and the value of the real estate and other assets serving as collateral for the repayment of secured loans. In FDIC-assisted acquisitions that include loss-sharing agreements, we record a loss-sharing asset that reflects our estimate of the timing and amount of future losses that are anticipated to occur in and used to value the acquired loan portfolio. In determining the size of the loss-sharing asset, we analyze the loan portfolio based on historical loss experience, volume and classification of loans, volume and trends in delinquencies and nonaccruals, local economic conditions, and other pertinent information.

Table Of Contents

If our assumptions relating to the timing or amount of expected losses are incorrect, there could be a negative impact on our operating results. Increases in the amount of future losses in response to different economic conditions or adverse developments in the acquired loan portfolio may result in increased credit loss provisions. Changes in our estimate of the timing of those losses, specifically if those losses are to occur beyond the applicable loss-sharing periods, may result in impairments of the FDIC indemnification asset.

Our ability to obtain reimbursement under the loss-sharing agreements on covered assets depends on our compliance with the terms of the loss-sharing agreements.

Management must certify to the FDIC on a quarterly basis our compliance with the terms of the FDIC loss-sharing agreements as a prerequisite to obtaining reimbursement from the FDIC for realized losses on covered assets. The required terms of the agreements are extensive and failure to comply with any of the guidelines could result in a specific asset or group of assets permanently losing their loss-sharing coverage. Additionally, management may decide to forgo loss-share coverage on certain assets to allow greater flexibility over the management of certain assets. As of December 31, 2012, \$487.5 million, or 4.1%, of the Company's assets were covered by the aforementioned FDIC loss-sharing agreements.

Under the terms of the FDIC loss-sharing agreements, the assignment or transfer of a loss-sharing agreement to another entity generally requires the written consent of the FDIC. No assurances can be given that we will manage the covered assets in such a way as to maintain loss-share coverage on all such assets.

Acquisition opportunities may not become available and increased competition may make it more difficult for us to acquire banks in traditional M&A transactions or to successfully bid on failed bank transactions.

Our near-term business strategy includes pursuing the acquisition of banks within or in proximity to our geographic footprint that may be operating under capital constraints, regulatory pressure or other competitive disadvantages as well as analyzing and bidding on failing banks that the FDIC plans to place in receivership. Traditional merger and acquisition transactions have been infrequent in the past few years, but we expect that the volume may be increasing as banks work through their problem loan portfolios. However, many target banks may be valued at a discount to their book value, making transactions difficult to conclude. In addition, the FDIC may not place banks that meet our strategic objectives into receivership and the bidding process for failing banks has become very competitive. We may not be able to match or beat the bids of other acquirers unless we bid aggressively by increasing the premium paid on assumed deposits or reducing the discount bid on assets purchased, which could make the acquisition less beneficial to the financial performance of the Bank.

A rapid change in interest rates, or maintenance of rates at historically high or low levels for an extended period, could make it difficult to maintain our current interest income spread and could result in reduced earnings.

Our earnings are largely derived from net interest income, which is interest income and fees earned on loans and investments, less interest paid on deposits and other borrowings. Interest rates are highly sensitive to many factors that are beyond the control of our management, including general economic conditions and the policies of various governmental and regulatory authorities. As interest rates change, net interest income is affected. With fixed rate assets (such as fixed rate loans and most investment securities) and liabilities (such as certificates of deposit), the effect on net interest income depends on the cash flows associated with the maturity of the asset or liability. Asset/liability management policies may not be successfully implemented and from time to time our risk position is not balanced. An unanticipated rapid decrease or increase in interest rates could have an adverse effect on the spreads between the interest rates earned on assets and the rates of interest paid on liabilities, and therefore on the level of net

interest income. For instance, any rapid increase in interest rates in the future could result in interest expense increasing faster than interest income because of fixed rate loans and longer-term investments. Historically low rates for an extended period of time result in reduced returns from the investment and loan portfolios. Further, substantially higher interest rates generally reduce loan demand and may result in slower loan growth than previously experienced. See Management's Discussion and Analysis of Financial Condition and Results of Operations—"Quantitative and Qualitative Disclosures about Market Risk".

Interest rate volatility and credit risk adjusted rate spreads may impact our financial assets and liabilities measured at fair value, particularly the fair value of our junior subordinated debentures.

The widening of the credit risk adjusted rate spreads on potential new issuances of junior subordinated debentures above our contractual spreads and reductions in three month LIBOR rates have contributed to the cumulative positive fair value adjustment in our junior subordinated debentures carried at fair value. Tightening of these credit risk adjusted rate spreads and interest rate volatility may result in recognizing negative fair value adjustments charged to earnings in the future.

The Dodd-Frank Act and other recent legislative and regulatory initiatives contain numerous provisions and requirements that could detrimentally affect the Company's business.

Table Of Contents

The Dodd-Frank Act and related regulations subject us and other financial institutions to additional restrictions, oversight, reporting obligations and costs, which could have an adverse impact on our business, financial condition, results of operations or the price of our common stock. In addition, this increased regulation of the financial services industry restricts the ability of firms within the industry to conduct business consistent with historical practices, including aspects such as compensation, interest rates, new and inconsistent consumer protection regulations and mortgage regulation, among others. Congress or state legislatures could also adopt laws reducing the amount that borrowers are otherwise contractually required to pay under existing loan contracts, require lenders to extend or restructure certain loans or limit foreclosure and collection remedies. Federal and state regulatory agencies also frequently adopt changes to their regulations or change the manner in which existing regulations are applied.

We cannot predict the substance or impact of pending or future legislation or regulation, or the application thereof. Compliance with such current and potential regulation and scrutiny will significantly increase our costs, impede the efficiency of our internal business processes, may require us to increase our regulatory capital and may limit our ability to pursue business opportunities in an efficient manner. In response, we may be required to or choose to raise additional capital, which could have a dilutive effect on the existing holders of our common stock and adversely affect the market price of our common stock.

We and our subsidiaries are subject to extensive regulation under federal and state laws. These laws and regulations are primarily intended to protect customers, depositors and the deposit insurance fund, rather than shareholders. The Bank is an Oregon state-chartered commercial bank whose primary regulator is the Oregon Division of Finance and Corporate Securities. The Bank is also subject to the supervision by and the regulations of the Washington Department of Financial Institutions, the California Department of Financial Institutions, the Nevada Division of Financial Institutions, the Federal Deposit Insurance Corporation (“FDIC”), which insures bank deposits and the Consumer Financial Protection Bureau. Umpqua Investments is subject to extensive regulation by the Securities and Exchange Commission (“SEC”) and the Financial Industry Regulatory Authority. Umpqua is subject to regulation and supervision by the Board of Governors of the Federal Reserve System, the SEC and NASDAQ. Federal and state regulations may place banks and brokerage firms at a competitive disadvantage compared to less regulated competitors such as finance companies, credit unions, mortgage banking companies and leasing companies. There is also the possibility that laws could be enacted that would prohibit a company from controlling both an FDIC-insured bank and a broker dealer, or restrict their activities if under common ownership. If we receive less than satisfactory results on regulatory examinations, we could be restricted from making acquisitions, adding new stores, developing new lines of business or otherwise continuing our growth strategy for a period of time. Future changes in federal and state banking and brokerage regulations could adversely affect our operating results and ability to continue to compete effectively.

We may be required to raise additional capital in the future, but that capital may not be available when it is needed, or it may only be available on unacceptable terms, which could adversely affect our financial condition and results of operations.

We are required by federal and state regulatory authorities to maintain adequate levels of capital to support our operations or to support future FDIC-assisted acquisitions. Our ability to raise additional capital, if needed, will depend on conditions in the capital markets at that time, which are outside our control, and on our financial performance. Accordingly, we may not be able to raise additional capital, if needed, on terms acceptable to us. If we cannot raise additional capital when needed, our ability to further expand our operations and pursue our growth strategy could be materially impaired. We and Umpqua Bank are currently well capitalized under applicable regulatory guidelines. However, our business could be negatively affected if we or Umpqua Bank failed to remain well capitalized. For example, because Umpqua Bank is well capitalized and we otherwise qualify as a financial

holding company, we are permitted to engage in a broader range of activities than are permitted to a bank holding company. Loss of financial holding company status could require that we cease these broader activities. The banking regulators are authorized (and sometimes required) to impose a wide range of requirements, conditions, and restrictions on banks, thrifts, and bank holding companies that fail to maintain adequate capital levels. Further, proposed rules to incorporate Basel III capital requirements may become applicable to us beginning January 1, 2013.

Table Of Contents

Proposed rules will require increased capital, disqualify TRUPS as Tier 1 Capital and accelerate the accretion of a fair value discount.

In June 2012, federal banking regulators jointly proposed rules that would update the agencies' general risk based and leverage capital requirements to incorporate "Basel III" capital requirements and implement section 171 of the Dodd Frank Act. The proposed rules would be phased in over the next 10 years, beginning January 1, 2013. Among other things, the proposed rules would require that we maintain a common equity Tier 1 capital ratio of 4.5%, a Tier 1 capital ratio of 6%, a total capital ratio of 8% and a leverage ratio of 4%. In addition, we would have to maintain an additional capital conservation buffer of 2.5% of total risk weighted assets or be subject to limitations on dividends and other capital distributions, as well as limiting discretionary bonus payments to executive officers. Under the proposed rules, trust preferred securities/junior subordinated debentures (TRUPS) would be phased out of Tier 1 capital at a rate of 10% per year over a 10 year period. TRUPS now constitute approximately 18% of our Tier 1 capital. In addition, we would be required to accelerate the accretion of an approximate \$49 million fair value discount in our TRUPS portfolio over a more accelerated time period than anticipated prior to the proposed rules being issued. These proposals may require us to raise more common capital or other capital that qualifies as Tier 1 capital. The application of more stringent capital requirements could, among other things, result in lower returns on invested capital and result in regulatory actions if we were to be unable to comply with such requirements. However, based on the current components and levels of our capital and assets, we believe that we would be in compliance with the requirements in the proposed rules if they were currently in effect. There is no assurance that the Basel III-related proposals will be adopted in their current form, what changes may be made prior to adoption, or when the final rules will be effective.

Conditions in the financial markets may limit our access to additional funding to meet our liquidity needs.

Liquidity is essential to our business. An inability to raise funds through deposits, borrowings, the sale or pledging as collateral of loans and other assets could have a substantial negative effect on our liquidity. Our access to funding sources in amounts adequate to finance our activities could be impaired by factors that affect us specifically or the financial services industry in general. An adverse regulatory action against us could detrimentally impact our access to liquidity sources. Our ability to borrow could also be impaired by factors that are nonspecific to us, such as severe disruption of the financial markets or negative news and expectations about the prospects for the financial services industry as a whole as evidenced by turmoil in the domestic and worldwide credit markets.

Our wholesale funding sources may prove insufficient to support our future growth or an unexpected reduction in deposits.

We must maintain sufficient funds to respond to the needs of depositors and borrowers. As a part of our liquidity management, we use a number of funding sources in addition to core deposit growth and repayments and maturities of loans and investments. If we grow more rapidly than any increase in our deposit balances, we are likely to become more dependent on these sources, which include Federal Home Loan Bank advances, proceeds from the sale of loans and liquidity resources at the holding company. Our financial flexibility will be severely constrained if we are unable to maintain our access to funding or if adequate financing is not available to accommodate future growth at acceptable interest rates. If we are required to rely more heavily on more expensive funding sources to support future growth, our revenues may not increase proportionately to cover our costs, and our profitability would be adversely affected.

As a bank holding company that conducts substantially all of our operations through Umpqua Bank, our banking subsidiary, our ability to pay dividends, repurchase our shares or to repay our indebtedness depends upon liquid assets held by the holding company and the results of operations of our subsidiaries.

Umpqua Holdings Corporation is a separate and distinct legal entity from our subsidiaries and it receives substantially all of its revenue from dividends paid from Umpqua Bank. There are legal limitations on the extent to which the Bank may extend credit, pay dividends or otherwise supply funds to, or engage in transactions with, us. Our inability to receive dividends from the Bank could adversely affect our business, financial condition, results of operations and prospects.

Our net income depends primarily upon Umpqua Bank's net interest income, which is the income that remains after deducting from total income generated by earning assets the expense attributable to the acquisition of the funds required to support earning assets (primarily interest paid on deposits). The amount of interest income is dependent on many factors including the volume of earning assets, the general level of interest rates, the dynamics of changes in interest rates and the levels of nonperforming loans. All of those factors affect the Bank's ability to pay dividends to the holding company.

Table Of Contents

Various statutory provisions restrict the amount of dividends the Bank can pay to us without regulatory approval. The Bank may not pay cash dividends if that payment could reduce the amount of its capital below that necessary to meet the “adequately capitalized” level in accordance with regulatory capital requirements. It is also possible that, depending upon the financial condition of the Bank and other factors, regulatory authorities could conclude that payment of dividends or other payments, including payments to us, is an unsafe or unsound practice and impose restrictions or prohibit such payments. Under Oregon law, the Bank may not pay dividends in excess of unreserved retained earnings, deducting there from, to the extent not already charged against earnings or reflected in a reserve, the following: (1) all bad debts, which are debts on which interest is past due and unpaid for at least six months, unless the debt is fully secured and in the process of collection; (2) all other assets charged-off as required by Oregon bank regulators or a state or federal examiner; and (3) all accrued expenses, interest and taxes of the institution. The Federal Reserve has issued a policy statement on the payment of cash dividends by bank holding companies, which expresses the Federal Reserve’s view that a bank holding company should pay cash dividends only to the extent that its net income for the past year is sufficient to cover both the cash dividends and a rate of earnings retention that is consistent with the holding company’s capital needs, asset quality and overall financial condition.

A significant decline in the company’s market value could result in an impairment of goodwill.

In past years, the Company’s common stock had traded at a price below its book value, including goodwill and other intangible assets. The valuation of goodwill is estimated using discounted cash flows of forecasted earnings, estimated sales price based on recent observable market transactions and market capitalization based on current stock price. If impairment was deemed to exist, a write down of goodwill would occur with a charge to earnings.

We have a gross deferred tax asset position of \$106.0 million at December 31, 2012, and we are required to assess the recoverability of this asset on an ongoing basis.

Deferred tax assets are evaluated on a quarterly basis to determine if they are expected to be recoverable in the future. Our evaluation considers positive and negative evidence to assess whether it is more likely than not that a portion of the asset will not be realized. The risk of a valuation allowance increases if continuing operating losses are incurred. Future negative operating performance or other negative evidence may result in a valuation allowance being recorded against some or all of this amount. A valuation allowance on our deferred tax asset could have a material adverse impact on our capital and results of operations.

We are pursuing an aggressive growth strategy that is expected to include mergers and acquisitions, which could create integration risks.

Umpqua is among the fastest-growing community financial services organizations in the United States. Since 2000, we have completed the acquisition and integration of 11 other financial institutions. There is no assurance that future acquisitions will be successfully integrated. We have announced our intent to pursue FDIC-assisted acquisition opportunities, traditional M&A transactions, and to open new stores in Oregon, Washington and California to continue our growth strategy. If we pursue our growth strategy too aggressively, or if factors beyond management’s control divert attention away from our integration plans, we might not be able to realize some or all of the anticipated benefits. Moreover, we are dependent on the efforts of key personnel to achieve the synergies associated with our acquisitions. The loss of one or more of our key persons could have a material adverse effect upon our ability to achieve the anticipated benefits.

The financial services industry is highly competitive with respect to deposits, loans and products.

We face pricing competition for loans and deposits. We also face competition with respect to customer convenience, product lines, accessibility of service and service capabilities. Our most direct competition comes from other banks, brokerages, mortgage companies and savings institutions. We also face competition from credit unions, government-sponsored enterprises, mutual fund companies, insurance companies and other non-bank businesses. This significant competition in attracting and retaining deposits and making loans as well as in providing other financial services throughout our market area may impact future earnings and growth. Our success depends, in part, on the ability to adapt products and services to evolving industry standards. There is increasing pressure to provide products and services at lower prices. This can reduce net interest income and non-interest income from fee-based products and services. In addition, new technology-driven products and services are often introduced and adopted, which could require us to make substantial capital expenditures to modify or adapt existing products and services or develop new products and services. We may not be successful in introducing new products and services or those new products may not achieve market acceptance. We could lose business, be forced to price products and services on less advantageous terms to retain or attract clients, or be subject to cost increases. As a result, our business, financial condition or results of operations may be adversely affected.

Table Of Contents

Involvement in non-bank business creates risks associated with the securities industry.

Umpqua Investments' retail brokerage operations present special risks not borne by community banks that focus exclusively on community banking. For example, the brokerage industry is subject to fluctuations in the stock market that may have a significant adverse impact on transaction fees, customer activity and investment portfolio gains and losses. Likewise, additional or modified regulations may adversely affect Umpqua Investments' operations. Umpqua Investments is also dependent on a small number of established brokers, whose departure could result in the loss of a significant number of customer accounts. A significant decline in fees and commissions or trading losses suffered in the investment portfolio could adversely affect Umpqua Investments' income and potentially require the contribution of additional capital to support its operations. Umpqua Investments is subject to claim arbitration risk arising from customers who claim their investments were not suitable or that their portfolios were too actively traded. These risks increase when the market, as a whole, declines. The risks associated with retail brokerage may not be supported by the income generated by those operations. See Management's Discussion and Analysis of Financial Condition and Results of Operations—"Non-interest Income".

The value of the securities in our investment securities portfolio may be negatively affected by continued disruptions in securities markets.

The market for some of the investment securities held in our portfolio has become extremely volatile over the past three years. Volatile market conditions or deteriorating financial performance of the issuer or obligor may detrimentally affect the value of these securities. There can be no assurance that the declines in market value associated with these disruptions will not result in other-than-temporary or permanent impairments of these assets, which would lead to accounting charges that could have a material adverse effect on our net income and capital levels.

The volatility of our mortgage banking business can adversely affect earnings if our mitigating strategies are not successful.

Changes in interest rates greatly affect the mortgage banking business. One of the principal risks in this area is prepayment of mortgages and the consequent detrimental effect on the value of mortgage servicing rights ("MSR"). We may employ hedging strategies to mitigate this risk but if the hedging decisions and strategies are not successful, our net income could be adversely affected. See Management's Discussion and Analysis of Financial Condition and Results of Operations—"Mortgage Servicing Rights".

Our business is highly reliant on technology and our ability to manage the operational risks associated with technology.

Our business involves storing and processing sensitive consumer and business customer data. A cyber security breach may result in theft of such data or disruption of our transaction processing systems. We depend on internal systems and outsourced technology to support these data storage and processing operations. Our inability to use or access these information systems at critical points in time could unfavorably impact the timeliness and efficiency of our business operations. A material breach of customer data security may negatively impact our business reputation and cause a loss of customers, result in increased expense to contain the event and/or require that we provide credit monitoring services for affected customers, result in regulatory fines and sanctions and may result in class action litigation. Cyber security risk management programs are expensive to maintain and will not protect the Company from all risks associated with maintaining the security of customer data and the Company's proprietary data from external and internal intrusions, disaster recovery and failures in the controls used by our vendors. In addition, Congress and the legislatures of states in which we operate regularly consider legislation that would impose more stringent data privacy

requirements.

Our business is highly reliant on third party vendors and our ability to manage the operational risks associated with outsourcing those services.

We rely on third parties to provide services that are integral to our operations. These vendors provide services that support our operations, including the storage and processing of sensitive consumer and business customer data, as well as our sales efforts. A cyber security breach of a vendor's system may result in theft of our data or disruption of business processes. A material breach of customer data security at a service provider's site may negatively impact our business reputation and cause a loss of customers; result in increased expense to contain the event and/or require that we provide credit monitoring services for affected customers, result in regulatory fines and sanctions and may result in litigation. In most cases, we will remain primarily liable to our customers for losses arising from a breach of a vendor's data security system. We rely on our outsourced service providers to implement and maintain prudent cyber security controls. We have procedures in place to assess a vendor's cyber security controls prior to establishing a contractual relationship and to periodically review assessments of those control systems; however, these procedures are not infallible and a vendor's system can be breached despite the procedures we employ. We have alliances with other companies that assist in our sales efforts. In our wealth management business, we have an alliance with Ferguson Wellman, a registered investment advisor to whom we refer customers for investment advice and asset management services. We cannot be sure that we will be able to maintain these relationships on favorable terms. In addition, some of our data processing services are provided by companies associated with our competitors. The loss of these vendor relationships could disrupt the services we provide to our customers and cause us to incur significant expense in connection with replacing these services.

Store construction can disrupt banking activities and may not be completed on time or within budget, which could result in reduced

Table Of Contents

earnings.

The Bank has, over the past several years, been transformed from a traditional community bank into a community-oriented financial services retailer. We have announced plans to build new stores in Oregon, Washington and California as part of our de novo branching strategy. This includes our strategy of building “Neighborhood Stores.” We also continue to remodel acquired bank branches to resemble retail stores that include distinct physical areas or boutiques such as a “serious about service center,” an “investment opportunity center” and a “computer cafe.” Store construction involves significant expense and risks associated with locating store sites and delays in obtaining permits and completing construction. Remodeling involves significant expense, disrupts banking activities during the remodeling period, and presents a new look and feel to the banking services and products being offered. Financial constraints may delay remodeling projects. Customers may not react favorably to the construction-related activities or the remodeled look and feel. There are risks that construction or remodeling costs will exceed forecasted budgets and that there may be delays in completing the projects, which could cause disruption in those markets.

Damage to our brand and reputation could significantly harm our business and prospects.

Our brand and reputation are important assets. Our relationship with many of our customers is predicated upon our reputation as a high quality provider of financial services that adheres to the highest standards of ethics, service quality and regulatory compliance. We believe that our brand has been, and continues to be, well received in our industry, with current and potential customers, investors and employees. Our ability to attract and retain customers, investors and employees depends upon external perceptions of us. Damage to our reputation among existing and potential customers, investors and employees could cause significant harm to our business and prospects and may arise from numerous sources, including litigation or regulatory actions, failing to deliver minimum standards of service and quality, lending practices, inadequate protection of customer information, sales and marketing efforts, compliance failures, unethical behavior and the misconduct of employees. Adverse developments with respect to our industry may also, by association, negatively impact our reputation or result in greater regulatory or legislative scrutiny or litigation against us.

ITEM 1B. UNRESOLVED STAFF COMMENTS.

None.

ITEM 2. PROPERTIES.

The executive offices of Umpqua and Umpqua Investments are located at One SW Columbia Street in Portland, Oregon in office space that is leased. The Bank owns its main office located in Roseburg, Oregon. At December 31, 2012, the Bank conducted Community Banking activities or operated Commercial Banking Centers at 200 locations, in Northern California, Oregon and Washington along the I-5 corridor; in the San Francisco Bay area, Inland Foothills, Napa and Coastal regions in California; in Bend and along the Coast of Oregon; in greater Seattle and Bellevue, Washington, and in Reno, Nevada, of which 64 are owned and 136 are leased under various agreements. As of December 31, 2012, the Bank also operated 18 facilities for the purpose of administrative and other functions, such

as back-office support, of which five are owned and 13 are leased. All facilities are in a good state of repair and appropriately designed for use as banking or administrative office facilities. As of December 31, 2012, Umpqua Investments leased four stand-alone offices from unrelated third parties, one stand-alone office from the Bank, and also leased space in nine Bank stores under lease agreements that are based on market rates.

Additional information with respect to owned premises and lease commitments is included in Notes 8 and 20, respectively, of the Notes to Consolidated Financial Statements in Item 8 below.

ITEM 3. LEGAL PROCEEDINGS.

On December 29, 2011, in the United States District Court for the Northern District of California-San Francisco Division (case no. 11-6700), Amber Hawthorne filed a class action lawsuit against Umpqua Bank on behalf of herself and a national class, including a sub-class of California residents seeking in excess of \$5 million, plus punitive damages, alleging that Umpqua Bank engaged in unfair and deceptive practices by posting debit items in a high to low order to maximize overdraft fees, automatically enrolling customers in debit Overdraft Protection (“ODP”) programs before the Regulation E revisions, failing to adequately disclose posting order, manipulating posting to maximize ODP fees and failing to advise customers how to minimize fees. Plaintiff alleges claims for breach of contract, breach of the covenant of good faith and fair dealing, unconscionability, conversion, unjust enrichment, and a violation of California Business & Professions Code 17200 (for the California subclass). The claims are in the initial stage of investigation but Umpqua believes that the claims are not supportable and are overstated and the Company intends to vigorously defend the case.

Due to the nature of our business, we are involved in legal proceedings that arise in the ordinary course of our business. While the outcome of these matters is currently not determinable, we do not expect that the ultimate costs to resolve these matters will have a material adverse effect on our consolidated financial position, results of operations, or cash flows.

See Note 20 (Legal Proceedings) for a discussion of the Company’s involvement in litigation pertaining to Visa, Inc.

Table Of Contents

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

24

Table Of Contents

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

(a) Our common stock is traded on The NASDAQ Global Select Market under the symbol "UMPQ." As of December 31, 2012, there were 200,000,000 common shares authorized for issuance. The following table presents the high and low sales prices of our common stock for each period, based on inter-dealer prices that do not include retail mark-ups, mark-downs or commissions, and cash dividends declared for each period:

Quarter Ended	High	Low	Cash Dividend Per Share
December 31, 2012	\$ 13.03	\$ 11.17	\$ 0.09
September 30, 2012	\$ 13.88	\$ 11.84	\$ 0.09
June 30, 2012	\$ 13.72	\$ 11.84	\$ 0.09
March 31, 2012	\$ 13.86	\$ 11.72	\$ 0.07
December 31, 2011	\$ 12.83	\$ 8.35	\$ 0.07
September 30, 2011	\$ 12.07	\$ 8.10	\$ 0.07
June 30, 2011	\$ 12.10	\$ 10.83	\$ 0.05
March 31, 2011	\$ 12.81	\$ 10.40	\$ 0.05

As of December 31, 2012, our common stock was held by approximately 4,529 shareholders of record, a number that does not include beneficial owners who hold shares in "street name", or shareholders from previously acquired companies that have not exchanged their stock. At December 31, 2012, a total of 1.9 million stock options, 763,000 shares of restricted stock and 130,000 restricted stock units were outstanding. Additional information about stock options, restricted stock and restricted stock units is included in Note 22 of the Notes to Consolidated Financial Statements in Item 8 below and in Item 12 below.

The payment of future cash dividends is at the discretion of our Board and subject to a number of factors, including results of operations, general business conditions, growth, financial condition and other factors deemed relevant by the Board of Directors. Further, our ability to pay future cash dividends is subject to certain regulatory requirements and restrictions discussed in the Supervision and Regulation section in Item 1 above.

During 2012, Umpqua's Board of Directors approved a quarterly cash dividend of \$0.07 per common share for the first quarter and \$0.09 per common share for the second, third and fourth quarters. These dividends were made pursuant to our existing dividend policy and in consideration of, among other things, earnings, regulatory capital levels, the overall payout ratio and expected asset growth. We expect that the dividend rate will be reassessed on a quarterly basis by the Board of Directors in accordance with the dividend policy.

We have a dividend reinvestment plan that permits shareholder participants to purchase shares at the then-current market price in lieu of the receipt of cash dividends. Shares issued in connection with the dividend reinvestment plan are purchased in open market transactions.

Equity Compensation Plan Information

The following table sets forth information about equity compensation plans that provide for the award of securities or the grant of options to purchase securities to employees and directors of Umpqua, its subsidiaries and its predecessors by merger that were in effect at December 31, 2012.

25

Table Of Contents

(shares in thousands)

Plan category	Equity Compensation Plan Information		
	(A)	(B)	(C)
	Number of securities to be issued upon exercise of outstanding options warrants and rights	Weighted average exercise price of outstanding options, warrants and rights (4)	Number of securities remaining available for future issuance under equity compensation plans excluding securities reflected in column (A)
Equity compensation plans approved by security holders			
2003 Stock Incentive Plan (1)	1,739	\$ 15.19	1,066
2007 Long Term Incentive Plan (2)	130	-	768
Other (3)	149	\$ 17.40	-
Total	2,018	\$ 15.37	1,834
Equity compensation plans not approved by security holders	-	-	-
Total	2,018	\$ 15.37	- 1,834

(1) At Umpqua's 2010 Annual Meeting, shareholders approved an amendment to the 2003 Stock Incentive Plan to make an additional two million shares of stock available for issuance through awards of incentive stock options, nonqualified stock options or restricted stock grants, provided awards of stock options and restricted stock grants under the 2003 Stock Incentive Plan, when added to options outstanding under all other plans, are limited to a maximum 10% of the outstanding shares on a fully diluted basis. The Plan's termination date was extended to June 30, 2015.

(2) At Umpqua's 2007 Annual Meeting, shareholders approved a 2007 Long Term Incentive Plan. The plan authorized the issuance of one million shares of stock through awards of performance-based restricted stock unit grants to executive officers. Target grants of 20,000 and maximum grants of 25,000 were approved to be issued in 2012 and target grants of 60,000 and maximum grants of 105,000 were approved to be issued in 2011 under this plan. During 2010, 16,000 units vested and were released and 94,000 units forfeited upon the retirement of an executive. During 2011, 63,300 units vested and were released and 47,475 units forfeited. During 2012, no units vested and were released and 113,750 units forfeited. As of December 31, 2012, 130,000 restricted stock units are expected to vest if the current estimate of performance-based targets is satisfied, and would result in 767,650 securities available for future issuance.

(3) Includes other Umpqua stock plans and stock plans assumed through previous mergers.

(4) Weighted average exercise price is based solely on securities with an exercise price.

(b) Not applicable.

(c) The following table provides information about repurchases of common stock by the Company during the quarter ended December 31, 2012:

Period	Total number of Common Shares Purchased (1)	Average Price Paid per Common Share	Total Number of Shares Purchased as Part of Publicly Announced Plan (2)	Maximum Number of Remaining Shares that May be Purchased at Period End under the Plan
10/1/12 - 10/31/12	215	\$ 12.69	-	12,244,829
11/1/12 - 11/30/12	37,358	\$ 12.39	-	12,244,829
12/1/12 - 12/31/12	-	\$ -	133,373	12,111,456
Total for quarter	37,573	\$ 12.39	133,373	

(1) Shares repurchased by the Company during the quarter consist of cancellation of 639 restricted shares to pay withholding taxes. There were 36,934 shares tendered in connection with option exercises and 133,373 shares were repurchased pursuant to the Company's publicly announced corporate stock repurchase plan described in (2) below.

Table Of Contents

(2) The Company's share repurchase plan, which was first approved by the Board and announced in August 2003, was amended on September 29, 2011 to increase the number of common shares available for repurchase under the plan to 15 million shares. The repurchase program will run through June 2013. As of December 31, 2012, a total of 12.1 million shares remained available for repurchase. The Company repurchased 512,280 shares in 2012 and 2.5 million shares under the repurchase plan in 2011 and no shares under the repurchase plan in 2010. The timing and amount of future repurchases will depend upon the market price for our common stock, securities laws restricting repurchases, asset growth, earnings, and our capital plan.

During the year ended December 31, 2012, there were 37,720 shares tendered in connection with option exercises. During the year ended December 31, 2011, there were 8,135 shares tendered in connection with option exercises. Restricted shares cancelled to pay withholding taxes totaled 45,873 and 23,158 shares during the years ended December 31, 2012 and 2011, respectively. There were no restricted stock units cancelled to pay withholding taxes during the year ended December 31, 2012. Restricted stock units cancelled to pay withholding taxes totaled 22,439 during the year ended December 31, 2011.

Stock Performance Graph

The following chart, which is furnished not filed, compares the yearly percentage changes in the cumulative shareholder return on our common stock during the five fiscal years ended December 31, 2012, with (i) the Total Return Index for NASDAQ Bank Stocks (ii) the Total Return Index for The Nasdaq Stock Market (U.S. Companies) and (iii) the Standard and Poor's 500. This comparison assumes \$100.00 was invested on December 31, 2007, in our common stock and the comparison indices, and assumes the reinvestment of all cash dividends prior to any tax effect and retention of all stock dividends. Price information from December 31, 2007 to December 31, 2012, was obtained by using the NASDAQ closing prices as of the last trading day of each year.

	Period Ending					
	12/31/2007	12/31/2008	12/31/2009	12/31/2010	12/31/2011	12/31/2012
Umpqua Holdings Corporation	\$ 100.00	\$ 98.49	\$ 93.10	\$ 85.95	\$ 89.49	\$ 87.45
Nasdaq Bank Stocks	\$ 100.00	\$ 78.46	\$ 65.67	\$ 74.97	\$ 67.10	\$ 79.64
Nasdaq U.S.	\$ 100.00	\$ 60.02	\$ 87.24	\$ 103.08	\$ 102.26	\$ 120.42
S&P 500	\$ 100.00	\$ 63.00	\$ 79.68	\$ 91.68	\$ 93.61	\$ 108.59

ITEM 6. SELECTED FINANCIAL DATA.

Umpqua Holdings Corporation

27

Table Of Contents

Annual Financial Trends

(In thousands, except per share data)

	2012	2011	2010	2009	2008
Interest income	\$ 456,085	\$ 501,753	\$ 488,596	\$ 423,732	\$ 442,546
Interest expense	48,849	73,301	93,812	103,024	152,239
Net interest income	407,236	428,452	394,784	320,708	290,307
Provision for non-covered loan and lease losses	21,796	46,220	113,668	209,124	107,678
Provision for covered loan and lease losses	7,405	16,141	5,151	-	-
Non-interest income	136,829	84,118	75,904	73,516	107,118
Non-interest expense	357,314	338,611	311,063	267,178	215,588
Goodwill impairment	-	-	-	111,952	982
Merger related expenses	2,338	360	6,675	273	-
Income (loss) before provision for (benefit from) income taxes	155,212	111,238	34,131	(194,303)	73,177
Provision for (benefit from) income taxes	53,321	36,742	5,805	(40,937)	22,133
Net income (loss)	101,891	74,496	28,326	(153,366)	51,044
Preferred stock dividends	-	-	12,192	12,866	1,620
Dividends and undistributed earnings allocated to participating securities	682	356	67	30	154
Net earnings (loss) available to common shareholders	\$ 101,209	\$ 74,140	\$ 16,067	\$ (166,262)	\$ 49,270

YEAR END

Assets	\$ 11,795,443	\$ 11,562,858	\$ 11,668,710	\$ 9,381,372	\$ 8,597,550
Earning assets	10,465,505	10,263,923	10,374,131	8,344,203	7,491,498
Non-covered loans and leases (1)	6,681,080	5,888,098	5,658,987	5,999,267	6,131,374
Covered loans and leases	477,078	622,451	785,898	-	-
Deposits	9,379,275	9,236,690	9,433,805	7,440,434	6,588,935
Term debt	253,605	255,676	262,760	76,274	206,531
Junior subordinated debentures, at fair value	85,081	82,905	80,688	85,666	92,520
Junior subordinated debentures, at amortized cost	110,985	102,544	102,866	103,188	103,655
Common shareholders' equity	1,724,039	1,672,413	1,642,574	1,362,182	1,284,830

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Total shareholders' equity	1,724,039	1,672,413	1,642,574	1,566,517	1,487,008
Common shares outstanding	111,890	112,165	114,537	86,786	60,146

AVERAGE

Assets	\$ 11,499,499	\$ 11,600,435	\$ 10,830,486	\$ 8,975,178	\$ 8,342,005
Earning assets	10,252,167	10,332,242	9,567,341	7,925,014	7,215,001
Non-covered loans and leases (1)	6,153,116	5,723,771	5,783,452	6,103,666	6,118,540
Covered loans and leases	554,078	707,026	681,569	-	-
Deposits	9,124,619	9,301,978	8,607,980	7,010,739	6,459,576
Term debt	254,601	257,496	261,170	129,814	194,312
Junior subordinated debentures	187,139	184,115	184,134	190,491	226,349
Common shareholders' equity	1,701,403	1,671,893	1,589,393	1,315,953	1,254,730
Total shareholders' equity	1,701,403	1,671,893	1,657,544	1,519,119	1,281,220
Basic common shares outstanding	111,935	114,220	107,922	70,399	60,084
Diluted common shares outstanding	112,151	114,409	108,153	70,399	60,424

PER COMMON SHARE
DATA

Basic earnings (loss)	\$ 0.90	\$ 0.65	\$ 0.15	\$ (2.36)	\$ 0.82
Diluted earnings (loss)	0.90	0.65	0.15	(2.36)	0.82
Book value	15.41	14.91	14.34	15.70	21.36
Tangible book value ⁽²⁾	9.28	8.87	8.39	8.33	8.76
Cash dividends declared	0.34	0.24	0.20	0.20	0.62

Table Of Contents

(dollars in thousands)

	2012	2011	2010	2009	2008
PERFORMANCE RATIOS					
Return on average assets ⁽³⁾	0.88%	0.64%	0.15%	-1.85%	0.59%
Return on average common shareholders' equity ⁽⁴⁾	5.95%	4.43%	1.01%	-12.63%	3.93%
Return on average tangible common shareholders' equity ⁽⁵⁾	9.87%	7.47%	1.76%	-26.91%	9.99%
Efficiency ratio ^{(6), (7)}	65.54%	65.58%	66.90%	95.34%	54.08%
Average common shareholders' equity to average assets	14.80%	14.41%	14.68%	14.66%	15.04%
Leverage ratio ⁽⁸⁾	11.44%	10.91%	10.56%	12.79%	12.38%
Net interest margin (fully tax equivalent) ⁽⁹⁾	4.02%	4.19%	4.17%	4.09%	4.07%
Non-interest revenue to total net revenue ⁽¹⁰⁾	25.15%	16.41%	16.13%	18.65%	26.95%
Dividend payout ratio ⁽¹¹⁾	37.78%	36.92%	133.33%	-8.47%	75.61%
ASSET QUALITY					
Non-covered, non-performing loans	\$ 70,968	\$ 91,383	\$ 145,248	\$ 199,027	\$ 133,366
Non-covered, non-performing assets	88,106	125,558	178,039	223,593	161,264
Allowance for non-covered loan and lease losses	85,391	92,968	101,921	107,657	95,865
Net non-covered charge-offs	29,373	55,173	119,404	197,332	96,717
Non-covered, non-performing loans to non-covered loans and leases	1.06%	1.55%	2.57%	3.32%	2.18%
Non-covered, non-performing assets to total assets	0.75%	1.09%	1.53%	2.38%	1.88%
Allowance for non-covered loan and lease losses to total non-covered loans and leases	1.28%	1.58%	1.80%	1.79%	1.56%
Allowance for non-covered credit losses to non-covered loans and leases	1.30%	1.59%	1.82%	1.81%	1.58%
Net charge-offs to average non-covered loans and leases	0.48%	0.96%	2.06%	3.23%	1.58%

- (1) Excludes loans held for sale
- (2) Average common shareholders' equity less average intangible assets (excluding MSR) divided by shares outstanding at the end of the year. See Management's Discussion and Analysis of Financial Condition and Results of Operations—"Results of Operations – Overview" for the reconciliation of non-GAAP financial measures, in Item 7 of this report.
- (3) Net earnings (loss) available to common shareholders divided by average assets.
- (4) Net earnings (loss) available to common shareholders divided by average common shareholders' equity.
- (5) Net earnings (loss) available to common shareholders divided by average common shareholders' equity less average intangible assets. See Management's Discussion and Analysis of Financial Condition and Results of Operations—"Results of Operations – Overview" for the reconciliation of non-GAAP financial measures, in Item 7 of this report.
- (6) Non-interest expense divided by the sum of net interest income (fully tax equivalent) and non-interest income.
- (7) The efficiency ratio calculation includes goodwill impairment charges of \$112.0 million and \$1.0 million in 2009 and 2008, respectively. Goodwill impairment losses are a non-cash expense that have no direct effect on the Company's or the Bank's liquidity or capital ratios.
- (8) Tier 1 capital divided by leverage assets. Leverage assets are defined as quarterly average total assets, net of goodwill, intangibles and certain other items as required by the Federal Reserve.
- (9) Net interest margin (fully tax equivalent) is calculated by dividing net interest income (fully tax equivalent) by average interest earnings assets.
- (10) Non-interest revenue divided by the sum of non-interest revenue and net interest income
- (11) Dividends declared per common share divided by basic earnings per common share.

Table Of Contents

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward looking statements and risk factors

See the discussion of forward-looking statements and risk factors in Part I Item 1 and Item 1A of this report.

Executive Overview

Significant items for the year ended December 31, 2012 were as follows:

Financial Performance

- Net earnings available to common shareholders per diluted common share were \$0.90 for the year ended December 31, 2012, as compared to net earnings available to common shareholders per diluted common share of \$0.65 for the year ended December 31, 2011. Operating earnings per diluted common share, defined as earnings available to common shareholders before net gains or losses on junior subordinated debentures carried at fair value, net of tax, bargain purchase gains, net of tax, merger related expenses, net of tax, and goodwill impairment, divided by the same diluted share total used in determining diluted earnings per common share, were \$0.93 for the year ended December 31, 2012, as compared to operating income per diluted common share of \$0.66 for the year ended December 31, 2011. Operating income per diluted share is considered a “non-GAAP” financial measure. More information regarding this measurement and reconciliation to the comparable GAAP measurement is provided under the heading Results of Operations - Overview below.
- Net interest margin, on a tax equivalent basis, decreased to 4.02% for the year ended December 31, 2012, compared to 4.19% for the year ended December 31, 2011. The decrease in net interest margin resulted from the decline in non-covered loan yields, the decrease in average covered loan balances and the decline in investment yields, partially offset by a decrease in average interest bearing cash, the increase in average non-covered loans outstanding, an increase in loan disposal gains from the covered loan portfolio, a decrease in interest bearing liabilities and the decrease in the cost of interest bearing deposits. Excluding the impact of loan disposal gains from the covered loan portfolio and interest and fee reversals on non-accrual loans, our adjusted net interest margin was 3.86% for the year ended December 31, 2012, as compared to adjusted net interest margin of 3.95% for the year ended December 31, 2011. Adjusted net interest margin is considered a “non-GAAP” financial measure. More information regarding this measurement and reconciliation to the comparable GAAP measurement is provided under the heading Results of Operations - Overview below.
- Mortgage banking revenue was \$84.2 million for 2012, compared to \$26.6 million for 2011. Closed mortgage volume increased 121% in the current year-to-date over the prior year same period due to an ongoing increased purchase and refinancing activity relating to historically low interest rates.
- Total gross non-covered loans and leases were \$6.7 billion as of December 31, 2012, an increase of \$793.0 million, or 13.5%, as compared to December 31, 2011. This increase is principally attributable to new loan production and draws on commercial lines of credit.

- Total deposits were \$9.4 billion as of December 31, 2012, an increase of \$142.6 million, or 1.5%, as compared to December 31, 2011. Non-interest bearing deposits increased \$365.8 million, or 19.1%, and low cost savings accounts increased \$88.8 million, or 23.0%, as compared to December 31, 2011.
- Total consolidated assets were \$11.8 billion as of December 31, 2012, representing a slight increase from the \$11.6 billion at December 31, 2011.

Credit Quality

- Non-covered, non-performing assets decreased to \$88.1 million, or 0.75% of total assets, as of December 31, 2012, as compared to \$125.6 million, or 1.09% of total assets, as of December 31, 2011. Non-covered, non-performing loans decreased to \$71.0 million, or 1.06% of total non-covered loans, as of December 31, 2012, as compared to \$91.4 million, or 1.55% of total non-covered loans as of December 31, 2011. Non-accrual loans have been written-down to their estimated net realizable values.
- Net charge-offs on non-covered loans were \$29.4 million for the year ended December 31, 2012, or 0.48% of average non-covered loans and leases, as compared to net charge-offs of \$55.2 million, or 0.96% of average non-covered loans and leases, for the year ended December 31, 2011.
- The provision for non-covered loan and lease losses was \$21.8 million for 2012, as compared to \$46.2 million recognized for 2011. This resulted from continued improvement and stabilization of credit quality, continued decline in non-performing loans, and decline in net charge-offs.

Table Of Contents

Capital and Growth Initiatives

- Total risk based capital decreased to 16.5% as of December 31, 2012, compared to 17.2% as of December 31, 2011, as a result of increased risk-weighted assets primarily due to non-covered loan growth and the acquisition of Circle Bancorp.
- Declared cash dividends of \$0.34 per common share for 2012 compared to \$0.24 per common share for 2011. In determining the amount of dividends to be paid, we consider capital preservation, expected asset growth, projected earnings and our overall dividend pay-out ratio.
- Completed acquisition of Circle Bancorp in 2012, resulting in the addition of six new stores in the greater Bay area of Northern California.
- Opened two new Home Lending offices and a two new Commercial Banking Centers in the greater Bay area of Northern California.

SUMMARY OF CRITICAL ACCOUNTING POLICIES

The SEC defines “critical accounting policies” as those that require application of management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and may change in future periods. Our significant accounting policies are described in Note 1 in the Notes to Consolidated Financial Statements in Item 8 of this report. Not all of these significant accounting policies require management to make difficult, subjective or complex judgments or estimates. Management believes that the following policies would be considered critical under the SEC's definition.

Allowance for Loan and Lease Losses and Reserve for Unfunded Commitments

The Bank performs regular credit reviews of the loan and lease portfolio to determine the credit quality and adherence to underwriting standards. When loans and leases are originated, they are assigned a risk rating that is reassessed periodically during the term of the loan through the credit review process. Consumer and residential loan portfolios are reviewed monthly for their performance as a pool of loans, since no single loan is individually significant or judged by its risk rating, size or potential risk of loss. In contrast, the monitoring process for the commercial and commercial real estate portfolios includes periodic reviews of individual loans with risk ratings assigned to each loan and performance judged on a loan by loan basis. The Company's risk rating methodology assigns risk ratings ranging from 1 to 10, where a higher rating represents higher risk. The 10 risk rating categories are a primary factor in determining an appropriate amount for the allowance for loan and lease losses. The Bank has a management Allowance for Loan and Lease Losses (“ALLL”) Committee, which is responsible for, among other things, regularly reviewing the ALLL methodology, including loss factors, and ensuring that it is designed and applied in accordance with generally accepted accounting principles. The ALLL Committee reviews and approves loans and leases

recommended for impaired status. The ALLL Committee also approves removing loans and leases from impaired status. The Bank's Audit and Compliance Committee provides board oversight of the ALLL process and reviews and approves the ALLL methodology on a quarterly basis.

Each risk rating is assessed an inherent credit loss factor that determines the amount of the allowance for loan and lease losses provided for that group of loans and leases with similar risk rating. Credit loss factors may vary by region based on management's belief that there may ultimately be different credit loss rates experienced in each region. Regular credit reviews of the portfolio also identify loans that are considered potentially impaired. Potentially impaired loans are referred to the ALLL Committee which reviews and approves designated loans as impaired. A loan is considered impaired when based on current information and events, we determine that we will probably not be able to collect all amounts due according to the loan contract, including scheduled interest payments. When we identify a loan as impaired, we measure the impairment using discounted cash flows, except when the sole remaining source of the repayment for the loan is the liquidation of the collateral for collateral dependent loans. A loan is considered collateral dependent if repayment of the loan is expected to be provided solely by the underlying collateral and there are no other available and reliable sources of repayment. In these cases, we use the current fair value of the collateral, less selling costs, instead of discounted cash flows. If we determine that the value of the impaired loan is less than the recorded investment in the loan, we either recognize an impairment reserve as a specific component to be provided for in the allowance for loan and lease losses or charge-off the impaired balance on collateral dependent loans if it is determined that such amount represents a confirmed loss. The combination of the risk rating-based allowance component and the impairment reserve allowance component lead to an allocated allowance for loan and lease losses.

The Bank may also maintain an unallocated allowance amount to provide for other credit losses inherent in a loan and lease portfolio that may not have been contemplated in the credit loss factors. This unallocated amount generally comprises less than 10% of the allowance, but may be maintained at higher levels during times of economic conditions characterized by falling real estate values. The unallocated amount is reviewed periodically based on trends in credit losses, the results of credit reviews and overall economic trends. As of December 31, 2012, there was no unallocated allowance amount.

Table Of Contents

The reserve for unfunded commitments (“RUC”) is established to absorb inherent losses associated with our commitment to lend funds, such as with a letter or line of credit. The adequacy of the ALLL and RUC are monitored on a regular basis and are based on management's evaluation of numerous factors. These factors include the quality of the current loan portfolio; the trend in the loan portfolio's risk ratings; current economic conditions; loan concentrations; loan growth rates; past-due and non-performing trends; evaluation of specific loss estimates for all significant problem loans; historical charge-off and recovery experience; and other pertinent information.

Management believes that the ALLL was adequate as of December 31, 2012. There is, however, no assurance that future loan losses will not exceed the levels provided for in the ALLL and could possibly result in additional charges to the provision for loan and lease losses. In addition, bank regulatory authorities, as part of their periodic examination of the Bank, may require additional charges to the provision for loan and lease losses in future periods if warranted as a result of their review. Approximately 79% of our loan portfolio is secured by real estate, and a significant decline in real estate market values may require an increase in the allowance for loan and lease losses.

Covered Loans and FDIC Indemnification Asset

Loans acquired in an FDIC-assisted acquisition that are subject to a loss-share agreement are referred to as “covered loans” and reported separately in our statements of financial condition. Acquired loans were aggregated into pools based on individually evaluated common risk characteristics and aggregate expected cash flows were estimated for each pool. A pool is accounted for as a single asset with a single interest rate, cumulative loss rate and cash flow expectation. The cash flows expected to be received over the life of the pool were estimated by management with the assistance of a third party valuation specialist. These cash flows were input into a FASB ASC 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality (“ASC 310-30”), compliant accounting loan system which calculates the carrying values of the pools and underlying loans, book yields, effective interest income and impairment, if any, based on actual and projected events. Default rates, loss severity, and prepayment speeds assumptions are periodically reassessed and updated within the accounting model to update our expectation of future cash flows. The excess of the cash flows expected to be collected over a pool's carrying value is considered to be the accretable yield and is recognized as interest income over the estimated life of the loan or pool using the effective yield method. The accretable yield may change due to changes in the timing and amounts of expected cash flows. Changes in the accretable yield are disclosed quarterly.

The Company has elected to account for amounts receivable under the loss-share agreement as an indemnification asset in accordance with FASB ASC 805, Business Combinations (“ASC 805”). The FDIC indemnification asset is initially recorded at fair value, based on the discounted value of expected future cash flows under the loss-share agreement. The difference between the carrying value and the undiscounted cash flows the Company expects to collect from the FDIC will be accreted or amortized into non-interest income over the life of the FDIC indemnification asset, which is maintained at the loan pool level.

Mortgage Servicing Rights (“MSR”)

In accordance with FASB ASC 860, Transfers and Servicing (“ASC 860”), the Company determines its classes of servicing assets based on the asset type being serviced along with the methods used to manage the risk inherent in the servicing assets, which includes the market inputs used to value the servicing assets. The Company elected to measure its residential mortgage servicing assets at fair value and to report changes in fair value through earnings. Fair value adjustments encompass market-driven valuation changes and the runoff in value that occurs from the passage of time, which are separately reported. Under the fair value method, the MSR is carried in the balance sheet at fair value and the changes in fair value are reported in earnings under the caption mortgage banking revenue in the period in which

the change occurs.

Retained mortgage servicing rights are measured at fair value as of the date of sale. We use quoted market prices when available. Subsequent fair value measurements are determined using a discounted cash flow model. In order to determine the fair value of the MSR, the present value of expected future cash flows is estimated. Assumptions used include market discount rates, anticipated prepayment speeds, delinquency and foreclosure rates, and ancillary fee income. This model is periodically validated by an independent external model validation group. The model assumptions and the MSR fair value estimates are also compared to observable trades of similar portfolios as well as to MSR broker valuations and industry surveys, as available.

The expected life of the loan can vary from management's estimates due to prepayments by borrowers, especially when rates fall. Prepayments in excess of management's estimates would negatively impact the recorded value of the mortgage servicing rights. The value of the mortgage servicing rights is also dependent upon the discount rate used in the model, which we base on current market rates. Management reviews this rate on an ongoing basis based on current market rates. A significant increase in the discount rate would reduce the value of mortgage servicing rights. Additional information is included in Note 10 of the Notes to Consolidated Financial Statements.

32

Table Of Contents

Valuation of Goodwill and Intangible Assets

At December 31, 2012, we had \$685.3 million in goodwill and other intangible assets as a result of business combinations. Goodwill and other intangible assets with indefinite lives are not amortized but instead are periodically tested for impairment. Management performs an impairment analysis for the intangible assets with indefinite lives on an annual basis as of December 31. Additionally, goodwill and other intangible assets with indefinite lives are evaluated on an interim basis when events or circumstance indicate impairment potentially exists. The impairment analysis requires management to make subjective judgments. Events and factors that may significantly affect the estimates include, among others, competitive forces, customer behaviors and attrition, changes in revenue growth trends, cost structures, technology, changes in discount rates and specific industry and market conditions. There can be no assurance that changes in circumstances, estimates or assumption may result in additional impairment of all, or some portion of, goodwill.

The Company performed its annual goodwill impairment analysis of the Community Banking reporting segment as of December 31, 2012. In the first step of the goodwill impairment test the Company determined that the fair value of the Community Banking reporting unit exceeded its carrying amount. The impairment analysis requires management to make subjective judgments. Events and factors that may significantly affect the estimates include, among others, competitive forces, customer behaviors and attrition, changes in revenue growth trends, cost structures, technology, changes in discount rates and specific industry and market conditions. There can be no assurance that changes in circumstances, estimates or assumption will not result in additional impairment of all, or some portion of, goodwill. Additional information is included in Note 9 of the Notes to Consolidated Financial Statements.

Stock-based Compensation

In accordance with FASB ASC 718, Stock Compensation, we recognize expense in the income statement for the grant-date fair value of stock options and other equity-based forms of compensation issued to employees over the employees' requisite service period (generally the vesting period). The requisite service period may be subject to performance conditions. The fair value of each grant is estimated as of the grant date using the Black-Scholes option-pricing model or a Monte Carlo simulation pricing model. Management assumptions utilized at the time of grant impact the fair value of the option calculated under the pricing model, and ultimately, the expense that will be recognized over the life of the option. Additional information is included in Note 1 of the Notes to Consolidated Financial Statements.

Fair Value

FASB ASC 820, Fair Value Measurements and Disclosures, establishes a hierarchical disclosure framework associated with the level of pricing observability utilized in measuring financial instruments at fair value. The degree of judgment utilized in measuring the fair value of financial instruments generally correlates to the level of pricing observability. Financial instruments with readily available active quoted prices or for which fair value can be measured from actively quoted prices generally will have a higher degree of pricing observability and a lesser degree of judgment utilized in measuring fair value. Conversely, financial instruments rarely traded or not quoted will generally have little or no pricing observability and a higher degree of judgment utilized in measuring fair value. Pricing observability is impacted by a number of factors, including the type of financial instrument, whether the financial instrument is new to the market and not yet established and the characteristics specific to the transaction. See Note 24 of the Notes to Consolidated Financial Statements for additional information about the level of pricing transparency associated with financial instruments carried at fair value.

RECENT ACCOUNTING PRONOUNCEMENTS

In April 2011, the FASB issued ASU No. 2011-02, A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring. The Update provides additional guidance relating to when creditors should classify loan modifications as troubled debt restructurings. The ASU also ends the deferral issued in January 2010 of the disclosures about troubled debt restructurings required by ASU No. 2010-20. The provisions of ASU No. 2011-02 and the disclosure requirements of ASU No. 2010-20 are effective for the Company's interim reporting period ending September 30, 2011. The guidance applies retrospectively to restructurings occurring on or after January 1, 2011. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

In April 2011, the FASB issued ASU No. 2011-03, Reconsideration of Effective Control for Repurchase Agreements. The Update amends existing guidance to remove from the assessment of effective control, the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee and, as well, the collateral maintenance implementation guidance related to that criterion. ASU No. 2011-03 is effective for the Company's reporting period beginning on or after December 15, 2011. The guidance applies prospectively to transactions or modification of existing transactions that occur on or after the effective date and early adoption is not permitted. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

Table Of Contents

In April 2011, the FASB issued ASU No. 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. The Update amends existing guidance regarding the highest and best use and valuation premise by clarifying these concepts are only applicable to measuring the fair value of nonfinancial assets. The Update also clarifies that the fair value measurement of financial assets and financial liabilities which have offsetting market risks or counterparty credit risks that are managed on a portfolio basis, when several criteria are met, can be measured at the net risk position. Additional disclosures about Level 3 fair value measurements are required including a quantitative disclosure of the unobservable inputs and assumptions used in the measurement, a description of the valuation process in place, and discussion of the sensitivity of fair value changes in unobservable inputs and interrelationships about those inputs as well disclosure of the level of the fair value of items that are not measured at fair value in the financial statements but disclosure of fair value is required. The provisions of ASU No. 2011-04 are effective for the Company's reporting period beginning after December 15, 2011 and are applied prospectively. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

In June 2011, the FASB issued ASU No. 2011-05, Presentation of Comprehensive Income. The Update amends current guidance to allow a company the option of presenting the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The provisions do not change the items that must be reported in other comprehensive income or when an item of other comprehensive must to reclassified to net income. The amendments do not change the option for a company to present components of other comprehensive income either net of related tax effects or before related tax effects, with one amount shown for the aggregate income tax expense (benefit) related to the total of other comprehensive income items. The amendments do not affect how earnings per share is calculated or presented. The provisions of ASU No. 2011-05 are effective for the Company's reporting period beginning after December 15, 2011 and are applied retrospectively. Early adoption was permitted and there are no required transition disclosures. In December 2011, the FASB issued ASU No. 2011-12, Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05. The ASU defers indefinitely the requirement to present reclassification adjustments and the effect of those reclassification adjustments on the face of the financial statements where net income is presented, by component of net income, and on the face of the financial statements where other comprehensive income is presented, by component of other comprehensive income. The adoption of the ASUs did not have a material impact on the Company's consolidated financial statements.

In September 2011, the FASB issued ASU No. 2011-08, Testing Goodwill for Impairment. With the Update, a company testing goodwill for impairment now has the option of performing a qualitative assessment before calculating the fair value of the reporting unit (the first step of goodwill impairment test). If, on the basis of qualitative factors, the fair value of the reporting unit is more likely than not greater than the carrying amount, a quantitative calculation would not be needed. Additionally, new examples of events and circumstances that an entity should consider in performing its qualitative assessment about whether to proceed to the first step of the goodwill impairment have been made to the guidance and replace the previous guidance for triggering events for interim impairment assessment. The amendments are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

In December 2011, the FASB issued ASU No. 2012-11, Disclosures about Offsetting Assets and Liabilities. The Update requires an entity to offset, and present as a single net amount, a recognized eligible asset and a recognized eligible liability when it has an unconditional and legally enforceable right of setoff and intends either to settle the asset and liability on a net basis or to realize the asset and settle the liability simultaneously. The ASU requires an

entity to disclose information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position. The amendments are effective for annual and interim reporting periods beginning on or after January 1, 2013. The Company is currently in the process of evaluating the ASU but does not expect it will have a material impact on the Company's consolidated financial statements.

In July 2012, the FASB issued ASU No. 2012-02, Testing Indefinite-Lived Intangible Assets for Impairment. With the Update, a company testing indefinite-lived intangibles for impairment now has the option to assess qualitative factors to determine whether the existence of events and circumstances indicates that it is more likely than not that the indefinite-lived intangible asset is impaired. If, after assessing the totality of events and circumstances, an entity concludes that it is not more likely than not that the indefinite-lived intangible asset is impaired, then the entity is not required to take further action. However, if an entity concludes otherwise, then it is required to determine the fair value of the indefinite-lived intangible asset and perform the quantitative impairment test by comparing the fair value with the carrying amount in accordance with current guidance. An entity also has the option to bypass the qualitative assessment for any indefinite-lived intangible asset in any period and proceed directly to performing the quantitative impairment test. An entity will be able to resume performing the qualitative assessment in any subsequent period. The amendments are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after September 15, 2012. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

Table Of Contents

In October 2012, the FASB issued ASU No. 2012-06, Subsequent Accounting for an Indemnification Asset Recognized at the Acquisition Date as a Result of a Government-Assisted Acquisition of a Financial Institution. The Update clarifies that when an entity recognizes an indemnification asset as a result of a government-assisted acquisition of a financial institution and, subsequently, a change in the cash flows expected to be collected on the indemnification asset occurs as a result of a change in cash flows expected to be collected on the assets subject to indemnification, the reporting entity should subsequently account for the change in the measurement of the indemnification asset on the same basis as the change in the assets subject to indemnification. Any amortization of changes in value should be limited to the contractual term of the indemnification agreement. The amendments are effective for annual and interim reporting periods beginning on or after December 15, 2012. The adoption of this ASU will not have a material impact on the Company's consolidated financial statements.

In January 2013, the FASB issued ASU No. 2013-01, Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities. The Update clarifies that ASU. 2011-11 applies only to derivatives, including bifurcated embedded derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions that are either offset or subject to an enforceable master netting arrangement or similar agreement. Entities with other types of financial assets and financial liabilities subject to a master netting arrangement or similar agreement are no longer subject to the disclosure requirements in ASU. 2011-11. The amendments are effective for annual and interim reporting periods beginning on or after January 1, 2013. The Company is currently in the process of evaluating the ASU but does not expect it will have a material impact on the Company's consolidated financial statements.

In February 2013, the FASB issued ASU No. 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. The Update requires an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component and to present either on the face of the statement where net income is presented, or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income, but only if the amount reclassified is required to be reclassified to net income in its entirety in the same reporting period. The amendments are effective for annual and interim reporting periods beginning on or after December 15, 2012. The Company is currently in the process of evaluating the ASU but does not expect it will have a material impact on the Company's consolidated financial statements.

RESULTS OF OPERATIONS—OVERVIEW

For the year ended December 31, 2012, net earnings available to common shareholders was \$101.2 million, or \$0.90 per diluted common share, as compared to net earnings available to common shareholders of \$74.1 million, or \$0.65 per diluted common share for the year ended December 31, 2011. The increase in net earnings available to common shareholders in 2012 is principally attributable to increased non-interest income and decreased provision for loan losses, partially offset by decreased net interest income and increased non-interest expense.

For the year ended December 31, 2011, net earnings available to common shareholders was \$74.1 million, or \$0.65 per diluted common share, as compared to net earnings available to common shareholders of \$16.1 million, or \$0.15 per diluted common share for the year ended December 31, 2010. The increase in net earnings available to common shareholders in 2011 is principally attributable to increased net interest income, increased non-interest income, and decreased provision for loan losses, partially offset by increased non-interest expense.

Umpqua recognizes gains or losses on our junior subordinated debentures carried at fair value resulting from the estimated market credit risk adjusted spread and changes in interest rates that do not directly correlate with the Company's operating performance. Also, Umpqua incurs significant expenses related to the completion and integration of mergers and acquisitions. Additionally, we may recognize goodwill impairment losses that have no direct effect on the Company's or the Bank's cash balances, liquidity, or regulatory capital ratios. Lastly, Umpqua may recognize one-time bargain purchase gains on certain FDIC-assisted acquisitions that are not reflective of Umpqua's on-going earnings power. Accordingly, management believes that our operating results are best measured on a comparative basis excluding the impact of gains or losses on junior subordinated debentures measured at fair value, net of tax, merger-related expenses, net of tax, and other charges related to business combinations such as goodwill impairment charges or bargain purchase gains, net of tax. We define operating earnings as earnings available to common shareholders before gains or losses on junior subordinated debentures carried at fair value, net of tax, bargain purchase gains on acquisitions, net of tax, merger related expenses, net of tax, and goodwill impairment, and we calculate operating earnings per diluted share by dividing operating earnings by the same diluted share total used in determining diluted earnings per common share (see Note 25 of the Notes to Consolidated Financial Statements in Item 8 below). Operating earnings and operating earnings per diluted share are considered "non-GAAP" financial measures. Although we believe the presentation of non-GAAP financial measures provides a better indication of our operating performance, readers of this report are urged to review the GAAP results as presented in the Financial Statements and Supplementary Data in Item 8 below.

The following table provides the reconciliation of earnings available to common shareholders (GAAP) to operating earnings (non-GAAP), and earnings per diluted common share (GAAP) to operating earnings per diluted share (non-GAAP) for years ended December 31, 2012, 2011 and 2010:

Table Of Contents

Reconciliation of Net Earnings Available to Common Shareholders to Operating Earnings

Years Ended December 31,

(in thousands, except per share data)

	2012	2011	2010
Net earnings available to common shareholders	\$ 101,209	\$ 74,140	\$ 16,067
Adjustments:			
Net loss (gain) on junior subordinated debentures carried at fair value, net of tax (1)	1,322	1,318	(2,988)
Bargain purchase gain on acquisitions, net of tax (1)	-	-	(3,862)
Merger-related expenses, net of tax	1,403	216	4,005
Operating earnings	\$ 103,934	\$ 75,674	\$ 13,222
Per diluted share:			
Net earnings available to common shareholders	\$ 0.90	\$ 0.65	\$ 0.15
Adjustments:			
Net loss on junior subordinated debentures carried at fair value, net of tax	0.01	0.01	(0.03)
Bargain purchase gain on acquisitions, net of tax	-	-	(0.04)
Merger-related expenses, net of tax	0.02	-	0.04
Operating earnings	\$ 0.93	\$ 0.66	\$ 0.12

(1) Adjusted for income tax effect of pro forma operating earnings of 40%.

Management believes adjusted net interest income and adjusted net interest margin are useful financial measures because they enable investors to evaluate the underlying growth or compression in these values excluding interest income adjustments related to credit quality. Management uses these measures to evaluate adjusted net interest income operating results exclusive of credit costs, in order to monitor our effectiveness in growing higher interest yielding assets and managing our cost of interest bearing liabilities over time. Adjusted net interest income is calculated as net interest income, adjusting tax exempt interest income to its taxable equivalent, adding back interest and fee reversals related to new non-accrual loans during the period, and deducting the interest income gains recognized from loan disposition activities within covered loan pools. Adjusted net interest margin is calculated by dividing adjusted net interest income by a period's average interest earning assets. Adjusted net interest income and adjusted net interest margin are considered "non-GAAP" financial measures. Although we believe the presentation of non-GAAP financial measures provides a better indication of our operating performance, readers of this report are urged to review the GAAP results as presented in the Financial Statements and Supplementary Data in Item 8 below.

The following table presents a reconciliation of net interest income to adjusted net interest income and net interest margin to adjusted net interest margin for the years ended December 31, 2012, 2011, and 2010:

Reconciliation of Net Interest Income to Adjusted Net Interest Income and Net Interest Margin to Adjusted Net Interest Margin

Years Ended December 31,

(dollars in thousands)

	2012	2011	2010
Net interest income - tax equivalent basis (1)	\$ 411,886	\$ 432,748	\$ 399,054
Adjustments:			
Interest and fee reversals on non-accrual loans	1,498	1,751	3,529
Covered loan disposal gains	(17,829)	(26,327)	(26,945)
Adjusted net interest income - tax equivalent basis (1)	\$ 395,555	\$ 408,172	\$ 375,638
Average interest earning assets	\$ 10,252,167	\$ 10,332,242	\$ 9,567,341
Net interest margin - consolidated (1)	4.02%	4.19%	4.17%
Adjusted net interest margin - consolidated (1)	3.86%	3.95%	3.92%

(1) Tax-exempt income has been adjusted to a tax equivalent basis at a 35% tax rate. The amount of such adjustment was an addition to recorded income of \$4.7 million, \$4.3 million, and \$4.3 million for the years ended 2012, 2011, and 2010, respectively.

Table Of Contents

The following table presents the returns on average assets, average common shareholders' equity and average tangible common shareholders' equity for the years ended December 31, 2012, 2011, and 2010. For each of the periods presented, the table includes the calculated ratios based on reported net earnings available to common shareholders and operating income as shown in the table above. Our return on average common shareholders' equity is negatively impacted as the result of capital required to support goodwill. To the extent this performance metric is used to compare our performance with other financial institutions that do not have merger and acquisition-related intangible assets, we believe it beneficial to also consider the return on average tangible common shareholders' equity. The return on average tangible common shareholders' equity is calculated by dividing net earnings available to common shareholders by average shareholders' common equity less average goodwill and intangible assets, net (excluding MSRs). The return on average tangible common shareholders' equity is considered a non-GAAP financial measure and should be viewed in conjunction with the return on average common shareholders' equity.

Return on Average Assets, Common Shareholders' Equity and Tangible Common Shareholders' Equity

For the Years Ended December 31,

(dollars in thousands)

	2012	2011	2010
Returns on average assets:			
Net earnings available to common shareholders	0.88%	0.64%	0.15%
Operating earnings	0.90%	0.65%	0.12%
Returns on average common shareholders' equity:			
Net earnings available to common shareholders	5.95%	4.43%	1.01%
Operating earnings	6.11%	4.53%	0.83%
Returns on average tangible common shareholders' equity:			
Net earnings available to common shareholders	9.87%	7.47%	1.76%
Operating earnings	10.14%	7.63%	1.45%
Calculation of average common tangible shareholders' equity:			
Average common shareholders' equity	\$ 1,701,403	\$ 1,671,893	\$ 1,589,393
Less: average goodwill and other intangible assets, net	(676,354)	(679,588)	(674,597)
Average tangible common shareholders' equity	\$ 1,025,049	\$ 992,305	\$ 914,796

Additionally, management believes tangible common equity and the tangible common equity ratio are meaningful measures of capital adequacy. Umpqua believes the exclusion of certain intangible assets in the computation of tangible common equity and tangible common equity ratio provides a meaningful base for period-to-period and company-to-company comparisons, which management believes will assist investors in analyzing the operating results

and capital of the Company. Tangible common equity is calculated as total shareholders' equity less preferred stock and less goodwill and other intangible assets, net (excluding MSRs). In addition, tangible assets are total assets less goodwill and other intangible assets, net (excluding MSRs). The tangible common equity ratio is calculated as tangible common shareholders' equity divided by tangible assets. The tangible common equity and tangible common equity ratio is considered a non-GAAP financial measure and should be viewed in conjunction with the total shareholders' equity and the total shareholders' equity ratio.

The following table provides a reconciliation of ending shareholders' equity (GAAP) to ending tangible common equity (non-GAAP), and ending assets (GAAP) to ending tangible assets (non-GAAP) as of December 31, 2012 and December 31, 2011:

Table Of Contents

Reconciliations of Total Shareholders' Equity to Tangible Common Shareholders' Equity and Total Assets to Tangible Assets

(dollars in thousands)	December 31, 2012	December 31, 2011
Total shareholders' equity	\$ 1,724,039	\$ 1,672,413
Subtract:		
Goodwill and other intangible assets, net	685,331	677,224
Tangible common shareholders' equity	\$ 1,038,708	\$ 995,189
Total assets	\$ 11,795,443	\$ 11,562,858
Subtract:		
Goodwill and other intangible assets, net	685,331	677,224
Tangible assets	\$ 11,110,112	\$ 10,885,634
Tangible common equity ratio	9.35%	9.14%

Non-GAAP financial measures have inherent limitations, are not required to be uniformly applied, and are not audited. Although we believe these non-GAAP financial measure are frequently used by stakeholders in the evaluation of a company, they have limitations as analytical tools, and should not be considered in isolation or as a substitute for analyses of results as reported under GAAP.

NET INTEREST INCOME

Net interest income is the largest source of our operating income. Net interest income for 2012 was \$407.2 million, a decrease of \$21.2 million or 5.0% compared to the same period in 2011. The decrease in net interest income in 2012 as compared to 2011 is attributable to a decrease in outstanding average interest-earning assets, primarily covered loans, investment securities and interest bearing cash, and a decrease in net interest margin, partially offset by an increase in non-covered loans and leases and a decrease in interest-bearing liabilities.

Net interest income for 2011 was \$428.5 million, an increase of \$33.7 million, or 9% over 2010. The increase in net interest income in 2011 as compared to 2010 is attributable to growth in outstanding average interest-earning assets, primarily average covered loans and average investment securities, increased covered loan yields, decreased cost of deposits and investing excess interest earning cash into the investment portfolio, partially offset by a decline in average non-covered loans outstanding, lower non-covered loan yields, lower investment yields, and increased average interest bearing deposit balances.

The net interest margin (net interest income as a percentage of average interest earnings assets) on a fully tax equivalent basis was 4.02% for 2012, a decrease of 17 basis points as compared to the same period in 2011. The decrease in net interest margin primarily resulted from a decline in non-covered loan yields, decrease in average covered loans outstanding, a decrease in loan disposal gains from the covered loan portfolio, and a decline in

investment yields, partially offset by a decrease in average interest bearing cash, an increase in average non-covered loans outstanding, a decrease in the cost of interest-bearing deposits, and a decrease in average interest-bearing liabilities.

Loan disposal related activities within the covered loan portfolio, either through loans being paid off in full or transferred to other real estate owned ("OREO"), result in gains within covered loan interest income to the extent assets received in satisfaction of debt (such as cash or the net realizable value of OREO received) exceeds the allocated carrying value of the loan disposed of from the pool. Loan disposal activities contributed \$17.8 million of interest income for 2012, compared to \$26.3 million of interest income for 2011 and \$26.9 million for 2010. While dispositions of covered loans positively impact net interest margin, we recognize a corresponding decrease to the change in FDIC indemnification asset at the incremental loss-sharing rate within other non-interest income.

Net interest income for 2012 was negatively impacted by \$1.5 million reversal of interest and fee income on non-covered, non-accrual loans, as compared to \$1.8 million for 2011 and \$3.5 million for 2010.

Excluding the impact of covered loan disposal gains and interest and fee income reversals on non-covered, non-accrual loans, tax equivalent net interest margin would have been 3.86%, 3.95%, and 3.92% for 2012, 2011, and 2010 respectively.

Partially offsetting the decrease in net interest margin in 2012 as compared to 2011 is the continued reduction in the cost of interest-bearing liabilities, specifically interest-bearing deposits. The total cost of interest-bearing deposits for 2012 was 0.44%, representing a decrease of 30 basis points compared to 2011.

Table Of Contents

The net interest margin on a fully tax-equivalent basis was 4.19% for 2011, an increase of two basis points as compared to the same period in 2010. The increase in net interest margin primarily resulted from an increase in average covered loans and investment balances, a decrease in interest bearing cash, and a decrease in our interest expense to earning assets of 27 basis points due to declining costs of interest bearing deposits, partially offset by a decrease in average non-covered loan balances, and decline in investment yields.

Our net interest income is affected by changes in the amount and mix of interest-earning assets and interest-bearing liabilities, as well as changes in the yields earned on interest-earning assets and rates paid on deposits and borrowed funds. The following tables present average balance sheet information, together with interest income and yields on average interest-earning assets, and interest expense and rates paid on average interest-bearing liabilities for years ended December 31, 2012, 2011 and 2010:

Average Rates and Balances

(dollars in thousands)

	2012			2011			2010	
	Average Balance	Interest Income or Expense	Average Yields or Rates	Average Balance	Interest Income or Expense	Average Yields or Rates	Average Balance	
INTEREST-EARNING ASSETS:								
Non-covered loans and leases (1)	\$ 6,331,519	\$ 313,294	4.95%	\$ 5,794,106	\$ 319,702	5.52%	\$ 5,828,637	\$ 33
Covered loans and leases, net	554,078	73,518	13.27%	707,026	86,011	12.17%	681,569	73
Taxable securities	2,743,672	59,161	2.16%	2,968,501	85,797	2.89%	1,946,222	67
Non-taxable securities (2)	258,816	13,834	5.34%	224,085	12,949	5.78%	227,589	13
Temporary investments and interest bearing deposits	364,082	928	0.25%	638,524	1,590	0.25%	883,324	23
Total interest earning assets	10,252,167	460,735	4.49%	10,332,242	506,049	4.90%	9,567,341	49
Allowance for non-covered loan and lease losses	(86,656)			(96,748)			(102,016)	
Other assets	1,333,988			1,364,941			1,365,161	
Total assets	\$ 11,499,499			\$ 11,600,435			\$ 10,830,486	

INTEREST-BEARING LIABILITIES:

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Interest bearing checking and savings accounts	\$ 4,987,873	\$ 9,463	0.19%	\$ 4,765,091	\$ 20,647	0.43%	\$ 4,203,109	\$ 3
Time deposits	2,102,711	21,670	1.03%	2,754,533	35,096	1.27%	2,875,706	4
Securities sold under agreements to repurchase and federal funds purchased	142,363	288	0.20%	113,129	539	0.48%	54,696	5
Term debt	254,601	9,279	3.64%	257,496	9,255	3.59%	261,170	9
Junior subordinated debentures	187,139	8,149	4.35%	184,115	7,764	4.22%	184,134	7
Total interest-bearing liabilities	7,674,687	48,849	0.64%	8,074,364	73,301	0.91%	7,578,815	9
Non-interest-bearing deposits	2,034,035			1,782,354			1,529,165	
Other liabilities	89,373			71,824			64,962	
Total liabilities	9,798,095			9,928,542			9,172,942	
Preferred equity	-			-			68,151	
Common equity	1,701,403			1,671,893			1,589,393	
Total shareholders' equity	1,701,403			1,671,893			1,657,544	
Total liabilities and shareholders' equity	\$ 11,499,498			\$ 11,600,435			\$ 10,830,486	
NET INTEREST INCOME		\$ 411,886			\$ 432,748			\$ 3
NET INTEREST SPREAD			3.85%			3.99%		
AVERAGE YIELD ON EARNING ASSETS (1), (2)			4.49%			4.90%		
INTEREST EXPENSE TO EARNING ASSETS			0.47%			0.71%		
NET INTEREST INCOME TO EARNING ASSETS OR NET INTEREST MARGIN (1), (2)			4.02%			4.19%		

(1) Non-covered non-accrual loans, leases, and mortgage loans held for sale are included in the average balance.

(2) Tax-exempt income has been adjusted to a tax equivalent basis at a 35% tax rate. The amount of such adjustment was an addition to recorded income of approximately \$4.7 million, \$4.3 million, and \$4.3 million for the years ended 2012, 2011, and 2010, respectively.

The following table sets forth a summary of the changes in tax equivalent net interest income due to changes in average asset and liability balances (volume) and changes in average rates (rate) for 2012 compared to 2011 and 2011 compared to 2010. Changes in tax equivalent interest income and expense, which are not attributable specifically to either volume or rate, are allocated proportionately between both variances.

Table Of Contents

Rate/Volume Analysis

(in thousands)

	2012 compared to 2011			2011 compared to 2010		
	Increase (decrease) in interest income and expense due to changes in			Increase (decrease) in interest income and expense due to changes in		
	Volume	Rate	Total	Volume	Rate	Total
INTEREST-EARNING ASSETS:						
Non-covered loans and leases	\$ 28,204	\$ (34,612)	\$ (6,408)	\$ (1,983)	\$ (14,635)	\$ (16,618)
Covered loans and leases	(19,795)	7,302	(12,493)	2,836	9,363	12,199
Taxable securities	(6,119)	(20,517)	(26,636)	30,950	(12,555)	18,395
Non-taxable securities ⁽¹⁾	1,905	(1,020)	885	(203)	43	(160)
Temporary investments and interest bearing deposits						