

COLUMBIA BANKING SYSTEM INC

Form 10-K

February 29, 2016

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, 2015 or

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

Commission File Number 0-20288

COLUMBIA BANKING SYSTEM, INC.

(Exact name of registrant as specified in its charter)

Washington

(State or other jurisdiction of incorporation or organization)

1301 "A" Street

Tacoma, Washington 98402

(Address of principal executive offices) (Zip code)

Registrant's Telephone Number, Including Area Code: (253) 305-1900

91-1422237

(I.R.S. Employer

Identification Number)

Securities Registered Pursuant to Section 12(b) of the Act:

Common Stock, No Par Value

(Title of class)

Securities Registered Pursuant to Section 12(g) of the Act: None

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

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

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (17 C.F.R. 229.405) 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, or a non-accelerated filer, or a smaller reporting company. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act (check one):

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

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The aggregate market value of Common Stock held by non-affiliates of the registrant at June 30, 2015 was \$1,856,086,644 based on the closing sale price of the Common Stock on that date.

The number of shares of registrant's Common Stock outstanding at January 31, 2016 was 57,744,431.

**DOCUMENTS INCORPORATED BY REFERENCE:**

Portions of the Registrant's definitive 2016 Annual Meeting Proxy Statement.

Part III

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COLUMBIA BANKING SYSTEM, INC.  
 FORM 10-K ANNUAL REPORT  
 DECEMBER 31, 2015

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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This annual report on Form 10-K may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include, but are not limited to, statements about our plans, objectives, expectations and intentions that are not historical facts, and statements identified by words such as “expects,” “anticipates,” “intends,” “plans,” “believes,” “should,” “projects,” “seeks,” “estimates” or the negative version of these words or other comparable words or phrases of a future or forward-looking nature. These forward-looking statements are based on current beliefs and expectations of management and are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control. In addition, these forward-looking statements are subject to assumptions with respect to future business strategies and decisions that are subject to change. In addition to the factors set forth in the sections titled “Risk Factors,” “Business” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in this Form 10-K, the following factors, among others, could cause actual results to differ materially from the anticipated results expressed or implied by the forward-looking statements:

- local and national economic conditions could be less favorable than expected or could have a more direct and pronounced effect on us than expected and adversely affect our ability to continue internal growth and maintain the quality of our earning assets;
- the local housing/real estate markets where we operate and make loans could face challenges;
- the risks presented by the economy, which could adversely affect credit quality, collateral values, including real estate collateral, investment values, liquidity and loan originations and loan portfolio delinquency rates;
- the efficiencies and enhanced financial and operating performance we expect to realize from investments in personnel, acquisitions and infrastructure may not be realized;
- the ability to complete future acquisitions and to successfully integrate acquired entities;
- interest rate changes could significantly reduce net interest income and negatively affect funding sources;
- projected business increases following strategic expansion or opening of new branches could be lower than expected;
- changes in the scope and cost of Federal Deposit Insurance Corporation (“FDIC”) insurance and other coverages;
- the impact of acquired loans on our earnings;
- changes in accounting principles, policies, and guidelines applicable to bank holding companies and banking;
- changes in laws and regulations affecting our businesses, including changes in the enforcement and interpretation of such laws and regulations by applicable governmental and regulatory agencies;
- competition among financial institutions could increase significantly;
- continued consolidation in the Pacific Northwest financial services industry resulting in the creation of larger financial institutions that may have greater resources could change the competitive landscape;
- the goodwill we have recorded in connection with acquisitions could become impaired, which may have an adverse impact on our earnings and capital;
- the reputation of the financial services industry could deteriorate, which could adversely affect our ability to access markets for funding and to acquire and retain customers;
- our ability to identify and address cyber-security risks, including security breaches, “denial of service attacks,” “hacking” and identity theft;
- any material failure or interruption of our information and communications systems or inability to keep pace with technological changes;
- our ability to effectively manage credit risk, interest rate risk, market risk, operational risk, legal risk, liquidity risk and regulatory and compliance risk;
- the effect of geopolitical instability, including wars, conflicts and terrorist attacks;
- our profitability measures could be adversely affected if we are unable to effectively manage our capital;
- natural disasters, including earthquakes, tsunamis, flooding, fires and other unexpected events; and
- the effects of any damage to our reputation resulting from developments related to any of the items identified above.

You should take into account that forward-looking statements speak only as of the date of this report. Given the described uncertainties and risks, we cannot guarantee our future performance or results of operations and you should not place undue reliance on these forward-looking statements. We undertake no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required under federal securities laws.

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PART I

ITEM 1. BUSINESS

General

Columbia Banking System, Inc. (referred to in this report as “we,” “our,” “the Company”, and “Columbia”) is a registered bank holding company whose wholly owned banking subsidiary is Columbia State Bank (“Columbia Bank” or “the Bank”). Headquartered in Tacoma, Washington, we provide a full range of banking services to small and medium-sized businesses, professionals and individuals throughout Washington, Oregon and Idaho. As part of the acquisition of West Coast Bancorp (“West Coast”) in 2013, the Company also acquired West Coast Trust Company, Inc. (“West Coast Trust”), an Oregon trust company that provides agency, fiduciary and other related trust services with offices in Portland and Salem, Oregon. Effective January 1, 2016, Columbia Bank’s trust department was consolidated into West Coast Trust, and West Coast Trust was renamed Columbia Trust Company.

Columbia Bank was established in 1993 to take advantage of commercial banking business opportunities in our principal market area. The opportunities to capture commercial banking market share were due to increased consolidations of banks, primarily through acquisitions by out-of-state bank holding companies, which created dislocation of customers.

At December 31, 2015, Columbia Bank had locations throughout Washington, Oregon and Idaho. The vast majority of Columbia Bank’s loans, loan commitments and core deposits are within its service areas. Columbia Bank is a Washington state-chartered commercial bank, the deposits of which are insured in whole or in part by the FDIC. Columbia Bank is subject to regulation by the FDIC, the Washington State Department of Financial Institutions Division of Banks, the Oregon Department of Consumer and Business Services Division of Finance and Corporate Securities, and the Idaho Department of Finance. Although Columbia Bank is not a member of the Federal Reserve System, the Board of Governors of the Federal Reserve System (“Federal Reserve”) has certain supervisory authority over the Company, which can also affect Columbia Bank.

Business Overview

Our goal is to continue to be a leading Pacific Northwest regional community banking company while consistently increasing shareholder value. We continue to build on our reputation for excellent customer service in order to be recognized as the bank of choice for retail customers and small to medium-sized businesses in all markets we serve. We have established a network of 149 branches in Washington, Oregon and Idaho as of December 31, 2015 from which we intend to grow market share. We operate 74 branches in 21 counties in the state of Washington, 59 branches in 16 counties in Oregon and 16 branches in 10 counties in Idaho.

Our branch system funds our lending activities and allows for increased contact with customers, better serving both retail and business depositors. We believe this approach enables us to expand lending activities while attracting a stable core deposit base and enhancing utilization of our full range of products and services. To support our strategy of market penetration and increased profitability, while continuing our personalized banking approach, we have invested in experienced banking and administrative personnel and have incurred related costs in the creation of our branch network. Our branch system and other delivery channels are continually evaluated as an important component of ongoing efforts to improve efficiencies without compromising customer service.

Business Strategy

Our business strategy is to provide our customers with the financial sophistication and product depth of a regional banking company while retaining the appeal and service level of a community bank. We continually evaluate our existing business processes while focusing on maintaining asset quality and a diversified loan and deposit portfolio. We continue to build our strong core deposit base, expanding total revenue and controlling expenses in an effort to gain operational efficiencies and increase our return on average equity. As a result of our strong commitment to highly personalized, relationship-oriented customer service, our varied products, our strategic branch locations and the long-standing community presence of our managers, banking officers and branch personnel, we believe we are well positioned to attract and retain new customers and to increase our market share of loans, deposits, investments, and other financial services. We are committed to increasing market share in the communities we serve by continuing to leverage our existing branch network, adding new branches in key locations and considering business combinations

that are consistent with our expansion strategy throughout the Pacific Northwest. We have grown our franchise over the past decade through a combination of acquisitions and organic growth.

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Products & Services

We place the highest priority on customer service and assist our customers in making informed decisions when selecting from the products and services we offer. We continuously review our product and service offerings to ensure that we provide our customers with the tools to meet their financial needs. A more complete listing of all the services and products available to our customers can be found on our website: [www.columbiabank.com](http://www.columbiabank.com). Some of the core products and services we offer include:

Personal Banking

- Checking and Saving Accounts
- Consumer Lending
- Electronic Bill Pay
- Mobile Banking
- Online Banking
- Residential Lending
- VISA® Card Services

Business Banking

- Agricultural Lending
- Checking and Saving Accounts
- Commercial & Industrial Lending
- International Banking
- Merchant Card Services
- Mobile Banking
- Municipal Lending
- Online Banking
- Real Estate and Real Estate

Construction Lending

- Remote Deposit Capture
- SBA Lending
- Small Business Services
- Treasury Management
- VISA® Card Services

Wealth Management

- Investment Services through CB
- Financial Services
- Private Banking
  - Professional Banking
  - Trust Services

Personal Banking: We offer our personal banking customers an assortment of account products including noninterest and interest-bearing checking, savings, money market and certificate of deposit accounts. Overdraft protection is also available with direct links to the customer’s checking account. Personal banking customers are also provided with a variety of borrowing products including fixed and variable rate home equity loans and lines of credit, home mortgages for purchases and refinances, personal loans, and other consumer loans. Eligible personal banking customers with checking accounts are provided a Visa® Debit Card which can be used both to make purchases and as an ATM card. A variety of Visa® Credit Cards are also available to eligible personal banking customers.

Online Banking

Columbia Bank’s Premier Personal Online Banking provides simple navigation, access to important information and frequently used features, as well as the foundation for a best-in-class mobile banking solution. Our online banking service, Columbia Online™, provides our personal banking customers with the ability to safely and securely conduct their banking business 24 hours a day, 7 days a week.



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**Business Banking:** A variety of checking, savings, interest bearing money market and certificate of deposit accounts are offered to business banking customers to satisfy all their banking needs. In addition to these core banking products, we provide a breadth of services to support the complete financial needs of small and middle market businesses including Cash Management, Commercial Lending, International Banking, Merchant Card Services, Business VISA<sup>®</sup> Debit and Credit Cards and Wealth Management.

### Treasury Management

Columbia Bank's diversified Cash Management Programs are tailored to meet specific banking needs of each individual business. We combine technology with integrated operations and local expertise for safe, powerful, flexible solutions. Columbia customers, of all sizes, choose from a full range of transaction and Cash Management tools to gain more control over and make more from their money. Services include Commercial Online Banking, Positive Pay fraud protection, Automated Clearing House (ACH) payments, and Remote Deposit Capture.

Our Cash Management professionals work with businesses to find the best combination of services to meet their needs. This customized, modular approach ensures their business banking operations are cost-effective now, with flexibility for future growth.

### Commercial Lending

We offer a variety of loan products tailored to meet the various needs of business banking customers. Commercial loan products include accounts receivable and inventory financing as well as Small Business Administration ("SBA") financing. We also offer commercial real estate loan products for construction and development or permanent financing. Real estate lending activities have been focused on construction and permanent loans for both owner occupants and investor oriented real estate properties. Commercial banking has been directed toward meeting the credit and related deposit needs of various sized businesses and professional practice organizations operating in our primary market areas.

### International Banking

Columbia Bank's international services division offers a range of financial services to help our business customers explore global markets and conduct international trade smoothly and expeditiously. We are proud to provide small and mid-size businesses with the same caliber of expertise and personalized service that national banks usually limit to large businesses. Our experience with foreign currency exchange, letters of credit, foreign collections and trade finance services can help companies open the door to new markets and suppliers overseas.

### Merchant Card Services

Business clients that use Columbia's Merchant Card Services have the ability to accept Visa<sup>®</sup>, MasterCard<sup>®</sup>, American Express<sup>®</sup> and Discover<sup>®</sup> sales drafts for deposit directly into their business checking account. Merchants are provided with a comprehensive accounting system tailored to their needs, which includes month-to-date credit card deposit information on a transaction statement. Internet access is available, allowing business customers to review merchant statements and authorized, captured, cleared and settled transactions. Columbia offers state-of-the-art point of sale solutions to suit our customers' needs for card acceptance, including terminals, mobile platforms, virtual terminals and on-line applications.

### Business VISA<sup>®</sup> Debit and Credit Cards

Our business banking customers are offered a selection of Visa<sup>®</sup> Cards including the Business Debit Card that works like a check wherever Visa<sup>®</sup> is accepted. We partner with Elan Financial Services to offer a variety of Visa<sup>®</sup> Credit Cards that come with important business features including award-winning expense management tools, free employee cards and added security benefits. A specialty community card for nonprofit organizations and municipalities is also available.

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Wealth Management: We offer tailored solutions to high net-worth individuals, families and professional businesses in the areas of private banking, professional banking, financial services and trust and estate services.

CB Financial Services

Located at Columbia State Bank, CB Financial Services<sup>(1)</sup>, offers a comprehensive array of financial solutions that focuses on wealth management by delivering personalized service and experience through dedicated financial advisors serving various geographical areas.

Comprehensive solutions include:

Individual and Business Retirement Solutions: 401(k) plans, SEPs, IRAs, SIMPLE, Profit Sharing, Non-Qualified Deferred Compensation Plans, Money Pension Plans, Exit Planning Strategies.

Insurance Solutions: Long-Term Care, Disability, Life Insurance (Key Man Life Insurance, Buy-Sell Agreements).

Wealth Management: Professional Asset Management, Strategic Asset Allocation, Fixed Income (Bond) Investing (Municipal, Corporate, Government), Exchange Traded Funds (ETFs), Annuities, Mutual Funds, Equities.

Financial Planning: Asset Allocation, Net Worth Analysis, Estate Planning & Preservation<sup>(2)</sup>, Education Funding, Wealth Transfer.

Private Banking

Columbia Private Banking offers affluent clientele and their businesses complex financial solutions, such as deposit and cash management services, credit services, and wealth management strategies. Each private banker coordinates a relationship team of experienced financial professionals to meet the unique needs of each discerning customer.

Professional Banking

Columbia Professional Bankers are uniquely qualified to help medical and dental professionals acquire, build and grow their practice. We offer tailored banking and investment solutions delivered by experienced bankers with the industry knowledge necessary to meet their business's unique needs. No matter what the needs are now or in the years to come, we guide professionals through all their financial options to make their banking as easy and personal as possible.

Trust and Investment Services

We offer a wide range of high quality fiduciary, investment and administrative trust services, coupled with local, personalized attention to the unique requirements of each trust. Services include Personal Trusts, Special Needs (Supplemental) Trusts, Estate Settlement Services, Investment Agency and Charitable Management Services.

Our highly skilled and experienced professionals are fully dedicated to providing the information, diligence and care to help our customers achieve their financial goals and plan for a better future.

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Securities and insurance products are offered through Cetera Investment Services LLC (doing insurance business in California as CFGIS Insurance Agency), member FINRA/SIPC. Advisory services are offered through Cetera Investment Advisers LLC. Neither firm is affiliated with the financial institution where investment services are offered.

\* Investment products are Not FDIC insured \* No bank guarantee \* Not a deposit \* Not insured by any federal government agency \* May lose value.

(2) For a comprehensive review of your personal situation, always consult a tax or legal advisor. Neither Cetera, nor any of its representatives may give legal or tax advice.

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### Competition

Our industry remains highly competitive despite a slow recovery from the recent economic crisis. Several other financial institutions with greater resources compete for banking business in our market areas. These competitors have the ability to make larger loans, finance extensive advertising and promotion campaigns, access international financial markets and allocate their investment assets to regions of highest yield and demand. In addition to competition from other banking institutions, we continue to compete with non-banking companies such as credit unions, brokerage houses and other financial services companies. We compete for deposits, loans, and other financial services by offering our customers similar breadth of products as our larger competitors while delivering a more personalized service level with faster transaction turnaround time.

### Employees

As of December 31, 2015 the Company employed 1,868 full-time equivalent employees. We value our employees and pride ourselves on providing a professional work environment accompanied by comprehensive pay and benefit programs. We are committed to providing flexible and value-added benefits to our employees through a “Total Compensation Philosophy” which incorporates all compensation and benefits. Our continued commitment to employees was demonstrated by Columbia Bank being honored as one of the Puget Sound Business Journal’s “Washington’s Best Workplaces” for the ninth consecutive year.

### Available Information

We file annual reports on Form 10-K, quarterly reports on Form 10-Q, periodic reports on Form 8-K, proxy statements and other information with the United States Securities and Exchange Commission (the “SEC”). The public may obtain copies of these reports and any amendments at the SEC’s Internet site, [www.sec.gov](http://www.sec.gov).

Additionally, reports filed with the SEC can be obtained through our website at [www.columbiabank.com](http://www.columbiabank.com). These reports are made available through our website as soon as reasonably practicable after they are filed electronically with the SEC. Information contained on our website is not incorporated by reference into this report.

### Supervision and Regulation

The following discussion provides an overview of certain elements of the extensive regulatory framework applicable to the Company and Columbia State Bank, which operates under the name Columbia Bank in Washington, Oregon and Idaho. This regulatory framework is primarily designed for the protection of depositors, customers, federal deposit insurance funds and the banking system as a whole, rather than specifically for the protection of shareholders. Due to the breadth and growth of this regulatory framework, our costs of compliance continue to increase in order to monitor and satisfy these requirements.

To the extent that this section describes statutory and regulatory provisions, it is qualified by reference to those provisions. These statutes and regulations, as well as related policies, are subject to change by Congress, state legislatures and federal and state regulators. Changes in statutes, regulations or regulatory policies applicable to us, including the interpretation or implementation thereof, could have a material effect on our business or operations. In light of the financial crisis, numerous changes to the statutes, regulations or regulatory policies applicable to us have been made or proposed. The full extent to which these changes will impact our business is not yet known. However, our continued efforts to monitor and comply with new regulatory requirements add to the complexity and cost of our business.

### Federal and State Bank Holding Company Regulation

**General.** The Company is a bank holding company as defined in the Bank Holding Company Act of 1956, as amended (the “BHCA”), and is therefore subject to regulation, supervision and examination by the Federal Reserve. In general, the BHCA limits the business of bank holding companies to owning or controlling banks and engaging in other activities closely related to banking. The Company must file reports with and provide the Federal Reserve such additional information as it may require. Under the Financial Services Modernization Act of 1999, a bank holding company may apply to the Federal Reserve to become a financial holding company, and thereby engage (directly or through a subsidiary) in certain expanded activities deemed financial in nature, such as securities and insurance underwriting. As of the date of this report, we have not elected to be treated as a financial holding company.



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**Holding Company Bank Ownership.** The BHCA requires every bank holding company to obtain the prior approval of the Federal Reserve before (i) acquiring, directly or indirectly, ownership or control of any voting shares of another bank or bank holding company if, after such acquisition, it would own or control more than 5% of such shares; (ii) acquiring all or substantially all of the assets of another bank or bank holding company; or (iii) merging or consolidating with another bank holding company. In addition, under the Bank Merger Act of 1960, as amended, the prior approval of the FDIC is required for the Bank to merge with another bank or purchase all or substantially all of the assets or assume any of the deposits of another FDIC-insured depository institution. In reviewing applications seeking approval of merger and acquisition transactions, bank regulators consider, among other things, the competitive effect and public benefits of the transactions, the capital position and managerial resources of the combined organization, the risks to the stability of the U.S. banking or financial system, the applicant's performance record under the Community Reinvestment Act of 1977 (the "CRA"), the applicant's compliance with fair housing and other consumer protection laws and the effectiveness of all organizations involved in combating money laundering activities. In addition, failure to implement or maintain adequate compliance programs could cause bank regulators not to approve an acquisition where regulatory approval is required or to prohibit an acquisition even if approval is not required.

**Holding Company Control of Nonbanks.** With some exceptions, the BHCA also prohibits a bank holding company from acquiring or retaining direct or indirect ownership or control of more than 5% of the voting shares of any company which is not a bank or bank holding company, or from engaging directly or indirectly in activities other than those of banking, managing or controlling banks, or providing services for its subsidiaries. The principal exceptions to these prohibitions involve certain non-bank activities that, by statute or by Federal Reserve regulation or order, have been identified as activities closely related to the business of banking or of managing or controlling banks.

**Tying Arrangements.** We are prohibited from engaging in certain tie-in arrangements in connection with any extension of credit, sale or lease of property or furnishing of services. For example, with certain exceptions, neither the Company nor its subsidiaries may condition an extension of credit to a customer on either (i) a requirement that the customer obtain additional services provided by us; or (ii) an agreement by the customer to refrain from obtaining other services from a competitor.

**Support of Subsidiary Banks.** Under Federal Reserve policy, as codified by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), the Company is required to act as a source of financial and managerial strength to Columbia Bank, including at times when we may not be in a financial position to provide such resources, and it may not be in our, or our shareholders', best interests to do so. This means that the Company is required to commit, as necessary, resources to support Columbia Bank. Any capital loans a bank holding company makes to its subsidiary banks are subordinate to deposits and to certain other indebtedness of those subsidiary banks.

**State Law Restrictions.** As a Washington corporation, the Company is subject to certain limitations and restrictions under applicable Washington corporate law. For example, state law restrictions in Washington include limitations and restrictions relating to indemnification of directors, distributions to shareholders, transactions involving directors, officers or interested shareholders, maintenance of books, records, and minutes, and observance of certain corporate formalities.

### **Federal and State Regulation of Columbia Bank**

**General.** The deposits of Columbia Bank, a Washington chartered commercial bank with branches in Washington, Oregon and Idaho, are insured by the FDIC. As a result, Columbia Bank is subject to supervision and regulation by the Washington Department of Financial Institutions' Division of Banks and the FDIC. These agencies have the authority to prohibit banks from engaging in what they believe constitute unsafe or unsound banking practices. With respect to branches of Columbia Bank in Oregon and Idaho, the Bank is also subject to certain laws and regulations governing its activities in those states.

**Consumer Protection.** The Bank is subject to a variety of federal and state consumer protection laws and regulations that govern its relationship with consumers, including laws and regulations that impose certain disclosure requirements and regulate the manner in which we take deposits, make and collect loans, and provide other services. Failure to comply with these laws and regulations may subject the Bank to various penalties, including but not limited to, enforcement actions, injunctions, fines, civil monetary penalties, criminal penalties, punitive damages, and the loss

of certain contractual rights. Columbia Bank has established a compliance management system designed to ensure consumer protection.

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Community Reinvestment. The CRA requires that, in connection with examinations of financial institutions within their jurisdiction, the Federal Reserve or the FDIC evaluate the record of the financial institution in meeting the credit needs of its local communities, including low and moderate-income neighborhoods, consistent with the safe and sound operation of the institution. A bank's community reinvestment record is also considered by the applicable banking agencies in evaluating mergers, acquisitions and applications to open a branch or facility. The Bank's failure to comply with the CRA could, among other things, result in the denial or delay in connection with such transactions. The Bank received a rating of "satisfactory" in its most recently completed CRA examination.

Anti-Money Laundering and Anti-Terrorism. The Bank Secrecy Act (the "BSA") requires all financial institutions, including banks and securities broker-dealers, to, among other things, establish a risk-based system of internal controls reasonably designed to prevent money laundering and the financing of terrorism. It includes a variety of recordkeeping and reporting requirements (such as cash and suspicious activity reporting) as well as due diligence/know-your-customer documentation requirements.

The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, intended to combat terrorism, was renewed with certain amendments in 2006 (the "Patriot Act"). The Patriot Act further augments and strengthens the requirements set forth in the BSA. The Patriot Act, in relevant part, (i) prohibits banks from providing correspondent accounts directly to foreign shell banks; (ii) imposes due diligence requirements on banks opening or holding accounts for foreign financial institutions or wealthy foreign individuals; (iii) requires financial institutions to establish an anti-money-laundering compliance program; and (iv) eliminates civil liability for persons who file suspicious activity reports. The Patriot Act also includes provisions providing the government with power to investigate terrorism, including expanded government access to bank account records. Columbia Bank has established compliance programs designed to comply with the BSA and the Patriot Act.

Transactions with Affiliates; Insider Credit Transactions. Transactions between the Bank and its subsidiaries, on the one hand, and the Company or any other subsidiary, on the other hand, are regulated under federal banking law. The Federal Reserve Act imposes quantitative and qualitative requirements and collateral requirements on covered transactions by the Bank with, or for the benefit of, its affiliates. In addition, subsidiary banks of a bank holding company are subject to restrictions on extensions of credit to the holding company or its subsidiaries, on investments in securities of the holding company or its subsidiaries and on the use of their securities as collateral for loans to any borrower. These regulations and restrictions may limit the Company's ability to obtain funds from Columbia Bank for its cash needs, including funds for payment of dividends, interest and operational expenses.

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 interests of such persons. Extensions of credit (i) must be made on substantially the same terms, including interest rates and collateral, and follow credit underwriting procedures that are at least as stringent as those prevailing at the time for comparable transactions with persons not related to the lending bank; and (ii) 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 insiders. A violation of these restrictions may result in the assessment of substantial civil monetary penalties, regulatory enforcement actions, and other regulatory sanctions. The Columbia Bank board has established controls to ensure compliance with regulatory expectations around affiliated transactions.

Regulation of Management. Federal law (i) sets forth circumstances under which officers or directors of a bank may be removed by the institution's federal supervisory agency; (ii) places restraints on lending by a bank to its executive officers, directors, principal shareholders, and their related interests; and (iii) generally prohibits management personnel of a bank from serving as directors or in other management positions of another financial institution whose assets exceed a specified amount or which has an office within a specified geographic area.

Safety and Soundness Standards. Certain non-capital safety and soundness standards are also imposed upon banks. These standards cover internal controls, information systems and internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation, fees and benefits, such other operational and managerial standards as the agency determines to be appropriate, and standards for asset quality, earnings and stock valuation. An institution that fails to meet these standards may be subject to regulatory sanctions, including limitations on growth. Columbia Bank has established policies and risk management activities designed to ensure the safety and

soundness of the Bank.

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### Interstate Banking and Branching

The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (the “Interstate Act”) together with the Dodd-Frank Act relaxed prior interstate branching restrictions under federal law by permitting, subject to regulatory approval, state and federally chartered commercial banks to establish branches in states where the laws permit banks chartered in such states to establish branches. The Interstate Act requires regulators to consult with community organizations before permitting an interstate institution to close a branch in a low-income area. Federal banking agency regulations prohibit banks from using their interstate branches primarily for deposit production and the federal banking agencies have implemented a loan-to-deposit ratio screen to ensure compliance with this prohibition.

### Dividends; Stress Testing

Columbia is a legal entity separate and distinct from the Bank and its other subsidiaries. As a bank holding company, Columbia is subject to certain restrictions on its ability to pay dividends under applicable banking laws and regulations. Federal bank regulators are authorized to determine under certain circumstances relating to the financial condition of a bank holding company or a bank that the payment of dividends would be an unsafe or unsound practice and to prohibit payment thereof. In particular, federal bank regulators have stated that paying dividends that deplete a banking organization’s capital base to an inadequate level would be an unsafe and unsound banking practice and that banking organizations should generally pay dividends only out of current operating earnings. In addition, in the current financial and economic environment, the Federal Reserve has indicated that bank holding companies should carefully review their dividend policy and has discouraged payment ratios that are at maximum allowable levels unless both asset quality and capital are very strong. A significant portion of our income comes from dividends from the Bank, which is also the primary source of our liquidity. In addition to the restrictions discussed above, the Bank is subject to limitations under Washington law regarding the level of dividends that it may pay to us. Washington law limits a bank’s ability to pay dividends that are greater than the bank’s retained earnings without approval of the applicable banking agency.

In October 2012, as required by the Dodd-Frank Act, the Federal Reserve and the FDIC published final rules regarding company-run stress testing. These rules require bank holding companies and banks with average total consolidated assets greater than \$10 billion to conduct an annual company-run stress test of capital, consolidated earnings and losses under one base and at least two stress scenarios provided by the federal bank regulators. Neither we nor the Bank are currently subject to the stress testing requirements, but we expect that once we are subject to those requirements, the Federal Reserve, the FDIC and the Washington Department of Financial Institutions’ Division of Banks will consider our results as an important factor in evaluating our capital adequacy and that of the Bank, in evaluating any proposed acquisitions and in determining whether any proposed dividends or stock repurchases by us or by the Bank may be an unsafe or unsound practice. While we do not currently have \$10 billion or more in total consolidated assets, we have begun analyzing these requirements and developing action plans to ensure we are prepared to comply with the rules when and if they become applicable.

### Regulatory Capital Requirements

**Prior Capital Guidelines.** The Federal Reserve monitors the capital adequacy of the Company on a consolidated basis, and the FDIC and the Washington Department of Financial Institutions’ Division of Banks monitor the capital adequacy of the Bank. The risk-based capital guidelines applicable to us and the Bank through December 31, 2014 were based on the 1988 capital accord, known as Basel I, of the Basel Committee on Banking Supervision (the “Basel Committee”) as implemented by the federal bank regulators. Assets and off-balance sheet items were assigned to weighted risk categories, and capital classified in one of the two following tiers depending on its characteristic:

- Tier 1 (Core) Capital-common equity, retained earnings, qualifying non-cumulative perpetual preferred stock, minority interests in equity accounts of consolidated subsidiaries (and, under existing standards, a limited amount of qualifying trust preferred securities at the holding company level), less goodwill, most intangible assets and certain other assets.

Tier 2 (Supplementary) Capital-perpetual preferred stock and trust preferred securities not meeting the definition of Tier 1 capital, qualifying mandatory convertible debt securities, qualifying subordinated debt and a limited amount of allowances for loan and lease losses.

Under the requirements in effect through December 31, 2014, we were required to maintain Tier 1 capital and total capital (that is, Tier 1 capital plus Tier 2 capital, less certain deductions) equal to at least 4% and 8%, respectively, of our total risk-weighted assets (including various off-balance sheet items such as letters of credit), with similar required capital ratios for the Bank. See “—Prompt Corrective Action Framework” for a discussion of certain other capital ratios.

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Under those guidelines, bank holding companies and banks were also required to comply with minimum leverage requirements, measured based on the ratio of a bank holding company's or a bank's, as applicable, Tier 1 capital to adjusted quarterly average total assets (as defined for regulatory purposes). These requirements generally necessitated a minimum Tier 1 leverage ratio of 4% for all bank holding companies and banks, with a lower 3% minimum for bank holding companies and banks meeting certain specified criteria, including having the highest composite regulatory supervisory rating.

Basel III and the New Capital Rules. In July 2013, the federal bank regulators approved final rules implementing the Basel Committee's December 2010 final capital framework for strengthening international capital standards, known as Basel III, and various provisions of the Dodd-Frank Act (the "New Capital Rules"). The New Capital Rules substantially revise the risk-based capital requirements applicable to bank holding companies and banks, including us and the Bank, compared to the risk-based capital rules in effect at December 31, 2014. The New Capital Rules revise the components of capital and address other issues affecting the numerator in regulatory capital ratio calculations. The New Capital Rules also address risk weights and other issues affecting the denominator in regulatory capital ratio calculations, including by replacing the prior risk-weighting approach derived from Basel I with a more risk-sensitive approach based, in part, on the standardized approach adopted by the Basel Committee in its 2004 capital accords, known as Basel II. The New Capital Rules also implement the requirements of Section 939A of the Dodd-Frank Act to remove references to credit ratings from the federal bank regulators' rules. Subject to a phase-in period for various provisions, the New Capital Rules became effective for us and for the Bank on January 1, 2015.

The New Capital Rules, among other things (i) specify that Tier 1 capital consists of "Common Equity Tier 1," or CET1, and "Additional Tier 1 capital" instruments meeting specified requirements, (ii) define CET1 narrowly by requiring that most deductions/adjustments to regulatory capital measures be made to CET1 and not to the other components of capital and (iii) expand the scope of the deductions/adjustments to capital as compared to existing regulations.

Under the New Capital Rules, the minimum capital ratios as of January 1, 2015 are (i) 4.5% CET1 to risk-weighted assets, (ii) 6% Tier 1 capital (that is, CET1 plus Additional Tier 1 capital) to risk-weighted assets and (iii) 8% total capital (that is, Tier 1 capital plus Tier 2 capital) to risk-weighted assets.

The New Capital Rules also require a new capital conservation buffer designed to absorb losses during periods of economic stress. The capital conservation buffer is composed entirely of CET1, on top of these minimum risk-weighted asset ratios. In addition, the New Capital Rules provide for a countercyclical capital buffer applicable only to certain covered institutions. We do not expect the countercyclical capital buffer to be applicable to us or the Bank. Banking institutions with a ratio of CET1 to risk-weighted assets above the minimum but below the capital conservation buffer (or below the combined capital conservation buffer and countercyclical capital buffer, when the latter is applied) will face constraints on dividends, equity repurchases and compensation based on the amount of the shortfall.

The implementation of the capital conservation buffer began on January 1, 2016 at the 0.625% level and will be phased in over a three-year period (increasing by 0.625% on each subsequent January 1, until it reaches 2.5% on January 1, 2019). When fully phased-in, the New Capital Rules will require us, and the Bank, to maintain such additional capital conservation buffer of 2.5% of CET1, effectively resulting in minimum ratios of (i) 7% CET1 to risk-weighted assets, (ii) 8.5% Tier 1 capital to risk-weighted assets, and (iii) 10.5% total capital to risk-weighted assets. The New Capital Rules also eliminate the more permissive 3% minimum Tier 1 leverage ratio under the capital guidelines that were in effect through December 31, 2014, resulting in a 4% minimum Tier 1 leverage ratio for all bank holding companies and banks.

The New Capital Rules provide for a number of deductions from and adjustments to CET1. These include, for example, the requirement that mortgage servicing rights, certain deferred tax assets and significant investments in non-consolidated financial entities be deducted from CET1 to the extent that any one such category exceeds 10% of CET1 or all such categories in the aggregate exceed 15% of CET1. Implementation of the deductions and other adjustments to CET1 began on January 1, 2015 and will be phased in over a four-year period (beginning at 40% on January 1, 2015 and an additional 20% per year thereafter). The New Capital Rules also generally preclude certain hybrid securities, such as trust preferred securities, from being counted as Tier 1 capital for most bank holding companies. However, bank holding companies such as us who had less than \$15 billion in assets as of December 31,

2009 (and who continue to have less than \$15 billion in assets) are permitted to include trust preferred securities issued prior to May 19, 2010 as Additional Tier 1 capital under the New Capital Rules.

The New Capital Rules also prescribe a new standardized approach for risk weightings that expands the risk-weighting categories from four Basel I-derived categories (0%, 20%, 50% and 100%) to a much larger and more risk-sensitive number of categories, depending on the nature of the assets, generally ranging from 0% for U.S. government and agency securities to 600% for certain equity exposures and resulting in higher risk weights for a variety of asset categories.

With respect to the Bank, the New Capital Rules also revise the prompt corrective action regulations pursuant to Section 38 of the Federal Deposit Insurance Act (the "FDIA"). See "—Prompt Corrective Action Framework."

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We believe that, as of December 31, 2015, we and the Bank would meet all capital adequacy requirements under the New Capital Rules on a fully phased-in basis as if such requirements were then in effect.

**Liquidity Requirements**

Historically, the regulation and monitoring of bank and bank holding company liquidity has been addressed as a supervisory matter, without required formulaic measures. The Basel III final framework requires banks and bank holding companies to measure their liquidity against specific liquidity tests that, although similar in some respects to liquidity measures historically applied by banks and regulators for management and supervisory purposes, going forward would be required by regulation. One test, referred to as the liquidity coverage ratio is designed to ensure that the banking entity maintains an adequate level of unencumbered high-quality liquid assets equal to the entity's expected net cash outflow for a 30-day time horizon (or, if greater, 25% of its expected total cash outflow) under an acute liquidity stress scenario. The other test, referred to as the net stable funding ratio is designed to promote more medium- and long-term funding of the assets and activities of banking entities over a one-year time horizon. These requirements will incentivize banking entities to increase their holdings of U.S. Treasury securities and other sovereign debt as a component of assets and increase the use of long-term debt as a funding source.

**Prompt Corrective Action Framework**

The FDIA requires the federal bank regulators to take prompt corrective action in respect of depository institutions that fail to meet specified capital requirements. The FDIA establishes five capital categories ("well-capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized" and "critically undercapitalized"), and the federal bank regulators are required to take certain mandatory supervisory actions, and are authorized to take other discretionary actions, with respect to institutions that are undercapitalized, significantly undercapitalized or critically undercapitalized. The severity of these mandatory and discretionary supervisory actions depends upon the capital category in which the institution is placed. Generally, subject to a narrow exception, the FDIA requires the regulator to appoint a receiver or conservator for an institution that is critically undercapitalized.

Under the rules currently in effect and as modified by the New Capital Rules, an insured depository institution generally would be classified in the following categories based on the capital measures indicated:

**"Well capitalized"**

Total capital ratio of at least 10%,  
Tier 1 capital ratio of at least 8%,  
CET1 ratio of at least 6.5%  
Tier 1 leverage ratio of at least 5%, and  
Not subject to any order or written directive requiring a specific capital level.

**"Adequately capitalized"**

Total capital ratio of at least 8%,  
Tier 1 capital ratio of at least 6%  
CET1 ratio of at least 4.5%, and  
Tier 1 leverage ratio of at least 4%.

**"Undercapitalized"**

Total capital ratio of less than 8%,  
Tier 1 capital ratio of less than 6%  
CET1 ratio of less than 4.5%, or  
Tier 1 leverage ratio of less than 4%.

**"Significantly undercapitalized"**

Total capital ratio of less than 6%,  
Tier 1 capital ratio of less than 4%  
CET1 ratio of less than 3%, or  
Tier 1 leverage ratio of less than 3%.

**"Critically undercapitalized"**

Tangible equity to average quarterly tangible assets of 2% or less.

An institution may be downgraded to, or deemed to be in, a capital category that is lower than indicated by its capital ratios if it is determined to be in an unsafe or unsound condition or if it receives an unsatisfactory examination rating with respect to certain matters. A bank's capital category is determined solely for the purpose of applying prompt corrective action regulations, and the capital category may not constitute an accurate representation of the bank's overall financial condition or prospects for other purposes.



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As of December 31, 2015, we and the Bank were well capitalized with CET1 capital ratios of 11.94% and 11.76%, respectively, Tier 1 capital ratios of 11.95% and 11.76%, respectively, total capital ratios of 12.94% and 12.75%, respectively, and Tier 1 leverage ratios of 10.03% and 9.89%, respectively, in each case calculated under the then applicable risk-based capital guidelines.

An institution that is categorized as undercapitalized, significantly undercapitalized or critically undercapitalized is required to submit an acceptable capital restoration plan to its appropriate federal bank regulator. Under the FDIA, in order for the capital restoration plan to be accepted by the appropriate federal banking agency, a bank holding company must guarantee that a subsidiary depository institution will comply with its capital restoration plan, subject to certain limitations. The bank holding company must also provide appropriate assurances of performance. The obligation of a controlling bank holding company under the FDIA to fund a capital restoration plan is limited to the lesser of 5% of an undercapitalized subsidiary's assets or the amount required to meet regulatory capital requirements. An undercapitalized institution is also generally prohibited from increasing its average total assets, making acquisitions and capital distributions, establishing any branches or engaging in any new line of business, except in accordance with an accepted capital restoration plan or with the approval of the FDIC. Institutions that are undercapitalized or significantly undercapitalized and either fail to submit an acceptable capital restoration plan or fail to implement an approved capital restoration plan may be subject to a number of requirements and restrictions, including orders to sell sufficient voting stock to become adequately capitalized, requirements to reduce total assets and cessation of receipt of deposits from correspondent banks. Critically undercapitalized depository institutions failing to submit or implement an acceptable capital restoration plan are subject to appointment of a receiver or conservator.

In addition, the FDIA prohibits an insured depository institution from accepting brokered deposits or offering interest rates on any deposits significantly higher than the prevailing rate in the bank's normal market area or nationally (depending upon where the deposits are solicited), unless it is well capitalized or is adequately capitalized and receives a waiver from the FDIC. A depository institution that is adequately capitalized and accepts brokered deposits under a waiver from the FDIC may not pay an interest rate on any deposit in excess of 75 basis points over certain prevailing market rates.

### The Volcker Rule

The Dodd-Frank Act prohibits banks and their affiliates from engaging in proprietary trading and investing in and sponsoring hedge funds and private equity funds. The statutory provision is commonly called the "Volcker Rule." In December 2013, federal regulators adopted final rules to implement the Volcker Rule that became effective in April 2014. The Federal Reserve, however, issued an order extending the period that institutions have to conform their activities to the requirements of the Volcker Rule to July 21, 2015. Banks with less than \$10 billion in total consolidated assets, such as the Bank, that do not engage in any covered activities, other than trading in certain government, agency, state or municipal obligations, do not have any significant compliance obligations under the rules implementing the Volcker Rule.

### Interchange Fees

Under the Durbin Amendment to the Dodd-Frank Act, the Federal Reserve adopted rules establishing standards for assessing whether the interchange fees that may be charged with respect to certain electronic debit transactions are "reasonable and proportional" to the costs incurred by issuers for processing such transactions.

Interchange fees, or "swipe" fees, are charges that merchants pay to us and other card-issuing banks for processing electronic payment transactions. Under the final rules, the maximum permissible interchange fee is equal to no more than 21 cents plus 5 basis points of the transaction value for many types of debit interchange transactions. The Federal Reserve also adopted a rule to allow a debit card issuer to recover one cent per transaction for fraud prevention purposes if the issuer complies with certain fraud-related requirements required by the Federal Reserve. The Federal Reserve also has rules governing routing and exclusivity that require issuers to offer two unaffiliated networks for routing transactions on each debit or prepaid product.

Currently, we qualify for the small issuer exemption from the interchange fee cap, which applies to any debit card issuer that, together with its affiliates, has total assets of less than \$10 billion as of the end of the previous calendar year. We will become subject to the interchange fee cap beginning July 1 of the year following the time when our total

assets reaches or exceeds \$10 billion. Reliance on the small issuer exemption does not exempt us from federal regulations prohibiting network exclusivity arrangements or from routing restrictions, however, and these regulations have negatively affected the interchange income we have received from our debit card network.



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### Regulatory Oversight and Examination

The Federal Reserve conducts periodic inspections of bank holding companies, which are performed both onsite and offsite. The supervisory objectives of the inspection program are to ascertain whether the financial strength of the bank holding company is being maintained on an ongoing basis and to determine the effects or consequences of transactions between a holding company or its non-banking subsidiaries and its subsidiary banks. For holding companies under \$10 billion in assets, the inspection type and frequency varies depending on asset size, complexity of the organization, and the holding company's rating at its last inspection.

Banks are subject to periodic examinations by their primary regulators. Bank examinations have evolved from reliance on transaction testing in assessing a bank's condition to a risk-focused approach. These examinations are extensive and cover the entire breadth of operations of the bank. Generally, safety and soundness examinations occur on an 18-month cycle for banks under \$500 million in total assets that are well-capitalized and without regulatory issues, and 12-months otherwise. Examinations alternate between the federal and state bank regulatory agency or may occur on a combined schedule. The frequency of consumer compliance and CRA examinations is linked to the size of the institution and its compliance and CRA ratings at its most recent examinations. However, the examination authority of the Federal Reserve and the FDIC allows them to examine supervised banks as frequently as deemed necessary based on the condition of the bank or as a result of certain triggering events.

### Corporate Governance and Accounting

Sarbanes-Oxley Act of 2002. The Sarbanes-Oxley Act of 2002 ("SOX") addresses, among other things, corporate governance, auditing and accounting, enhanced and timely disclosure of corporate information, and penalties for non-compliance. Generally, SOX (i) requires chief executive officers and chief financial officers to certify to the accuracy of periodic reports filed with the SEC; (ii) imposes specific and enhanced corporate disclosure requirements; (iii) accelerates the time frame for reporting of insider transactions and periodic disclosures by public companies; (iv) requires companies to adopt and disclose information about corporate governance practices, including whether or not they have adopted a code of ethics for senior financial officers and whether the audit committee includes at least one "audit committee financial expert;" and (v) requires the SEC, based on certain enumerated factors, to regularly and systematically review corporate filings.

### Deposit Insurance

The Bank's deposits are insured under the FDIA, up to the maximum applicable limits and are subject to deposit insurance assessments designed to tie what banks pay for deposit insurance to the risks they pose. The Dodd-Frank Act broadened the base for FDIC insurance assessments. Assessments are now based on the average consolidated total assets less tangible equity capital of a financial institution. In addition, the Dodd-Frank Act raised the minimum designated reserve ratio (the FDIC is required to set the reserve ratio each year) of the Deposit Insurance Fund (the "DIF") from 1.15% to 1.35%; required that the DIF meet that minimum ratio of insured deposits by 2020; and eliminated the requirement that the FDIC pay dividends to insured depository institutions when the reserve ratio exceeds certain thresholds. The FDIC has established a higher reserve ratio of 2% as a long-term goal beyond what is required by statute. The deposit insurance assessments to be paid by Columbia Bank could increase as a result.

### The Dodd-Frank Act

As a result of the financial crisis, on July 21, 2010, the Dodd-Frank Act was signed into law. The Dodd-Frank Act significantly changed the bank regulatory structure and is affecting the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies, including the Company and Columbia Bank. The full impact of the Dodd-Frank Act may not be known for years. Some of the provisions of the Dodd-Frank Act that may impact our business are summarized below.

Corporate Governance. The Dodd-Frank Act requires publicly traded companies to provide their shareholders with (i) a non-binding shareholder vote on executive compensation, (ii) a non-binding shareholder vote on the frequency of such vote, (iii) disclosure of "golden parachute" arrangements in connection with specified change in control transactions, and (iv) a non-binding shareholder vote on golden parachute arrangements in connection with these change in control transactions.

Prohibition Against Charter Conversions of Troubled Institutions. The Dodd-Frank Act generally prohibits a depository institution from converting from a state to federal charter, or vice versa, while it is the subject to an

enforcement action unless the bank seeks prior approval from its regulator and complies with specified procedures to ensure compliance with the enforcement action.

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Consumer Financial Protection Bureau. The Dodd-Frank Act created a new, independent federal agency called the Consumer Financial Protection Bureau (the “CFPB”). The CFPB has broad rulemaking, supervision and enforcement authority for a wide range of consumer protection laws applicable to banks and thrifts with greater than \$10 billion in assets. Smaller institutions are subject to certain rules promulgated by the CFPB but will continue to be examined and supervised by their federal banking regulators for compliance purposes. The CFPB has issued numerous additional regulations that will likely become industry best practice and increase the compliance burden of Columbia Bank.

Repeal of Demand Deposit Interest Prohibition. The Dodd-Frank Act repealed the federal prohibitions on the payment of interest on demand deposits, thereby permitting depository institutions to pay interest on business transaction and other accounts.

Heightened Requirements for Bank Holding Companies with \$10 Billion or More in Assets

Various federal banking laws and regulations, including rules adopted by the Federal Reserve pursuant to the requirements of the Dodd-Frank Act, impose heightened requirements on certain large banks and bank holding companies. Most of these rules apply primarily to bank holding companies with at least \$50 billion in total consolidated assets, but certain rules also apply to banks and bank holding companies with at least \$10 billion in total consolidated assets. Following the fourth consecutive quarter (and any applicable phase-in period) where our or the Bank’s total consolidated assets, as applicable, equal or exceed \$10 billion, we or the Bank, as applicable, will, among other requirements:

• be required to perform annual stress tests as described above in “Dividends; Stress Testing;”

• be required to establish a dedicated risk committee of our board of directors responsible for overseeing our enterprise-wide risk management policies, which must be commensurate with our capital structure, risk profile, complexity, activities, size and other appropriate risk-related factors, and including as a member at least one risk management expert;

• calculate our FDIC deposit assessment base using a performance score and a loss-severity score system; and

• be examined for compliance with federal consumer protection laws primarily by the CFPB.

While we do not currently have \$10 billion or more in total consolidated assets, we have begun analyzing these requirements and developing action plans to ensure we are prepared to comply with the rules when and if they become applicable. It is reasonable to assume that our total assets will exceed \$10 billion in the future, based on our historic organic growth rates or if we engage in any acquisitions.

Incentive Compensation

The Dodd-Frank Act requires the federal bank regulators and the SEC to establish joint regulations or guidelines prohibiting incentive-based payment arrangements at specified regulated entities, including us and the Bank, having at least \$1 billion in total assets that encourage inappropriate risks by providing an executive officer, employee, director or principal stockholder with excessive compensation, fees, or benefits or that could lead to material financial loss to the entity. In addition, these regulators must establish regulations or guidelines requiring enhanced disclosure to regulators of incentive-based compensation arrangements. The agencies proposed such regulations in April 2011, but the regulations have not been finalized. If the regulations are adopted in the form initially proposed, they will impose limitations on the manner in which we may structure compensation for our executives.

In June 2010, the Federal Reserve and FDIC issued comprehensive final guidance on incentive compensation policies intended to ensure that the incentive compensation policies of banking organizations do not undermine the safety and soundness of such organizations by encouraging excessive risk-taking. The guidance, which covers all employees that have the ability to materially affect the risk profile of an organization, either individually or as part of a group, is based upon the key principles that a banking organization’s incentive compensation arrangements should (i) provide incentives that appropriately balance risk and financial results in a manner that does not encourage employees to expose their organizations to imprudent risk, (ii) be compatible with effective internal controls and risk management and (iii) be supported by strong corporate governance, including active and effective oversight by the organization’s board of directors. These three principles are incorporated into the proposed joint compensation regulations under the Dodd-Frank Act, discussed above.



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The Federal Reserve will review, as part of the regular, risk-focused examination process, the incentive compensation arrangements of banking organizations, such as us, that are not “large, complex banking organizations.” These reviews will be tailored to each organization based on the scope and complexity of the organization’s activities and the prevalence of incentive compensation arrangements. The findings of the supervisory initiatives will be included in reports of examination. Deficiencies will be incorporated into the organization’s supervisory ratings, which can affect the organization’s ability to make acquisitions and take other actions. Enforcement actions may be taken against a banking organization if its incentive compensation arrangements, or related risk management control or governance processes, pose a risk to the organization’s safety and soundness and the organization is not taking prompt and effective measures to correct the deficiencies.

Proposed Legislation

Proposed legislation relating to the banking industry is introduced in almost every legislative session. Certain of such legislation could dramatically affect the regulation of the banking industry. We cannot predict if any such legislation will be adopted or if it is adopted how it would affect the business of Columbia Bank or the Company. Recent history has demonstrated that new legislation or changes to existing laws or regulations usually results in a greater compliance burden and therefore generally increases the cost of doing business.

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, but 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, influence the 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.

ITEM 1A. RISK FACTORS

The following is a discussion of what we currently believe are the most significant risks and uncertainties that may affect our business, financial condition and future results.

National and global economic and other conditions could adversely affect our future results of operations or market price of our stock.

Our business is directly impacted by factors such as economic, political and market conditions, broad trends in industry and finance, and changes in government monetary and fiscal policies and inflation, all of which are beyond our control. Global economies continue to face significant challenges to achieving normalized economic growth rates. The national economy has continued to recover from the recent economic crisis and recession but that recovery has been sluggish and uneven. Business growth across a wide range of industries and regions in the United States remains reduced, and local governments and many businesses continue to experience financial difficulty. Since the recession, economic growth, as noted, has been sluggish and uneven, the financial markets have experienced substantial volatility, unemployment levels generally remain elevated and there are continuing concerns related to the level of U.S. government debt and fiscal actions that may be taken to address that debt. There can be no assurance that economic conditions will continue to improve, and these conditions could worsen. Any renewed deterioration in the economies of the nation as a whole or in our markets would have an adverse effect, which could be material, on our business, financial condition, results of operations and prospects, and could also cause the market price of our stock to decline. While it is impossible to predict how long challenging economic conditions may exist, a slow or fragile recovery could continue to present risks into the future for the industry and our company.

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Economic conditions in the market areas we serve may adversely impact our earnings and could increase our credit risk associated with our loan portfolio, the value of our investment portfolio and the availability of deposits. Substantially all of our loan and deposit customers are businesses and individuals in Washington, Oregon and Idaho, and continuing soft economies in these market areas could have a material adverse effect on our business, financial condition, results of operations and prospects. While housing prices have stabilized, unemployment remains relatively high in Washington and Oregon. A deterioration in the market areas we serve could result in the following consequences, any of which would have an adverse impact, which could be material, on our business, financial condition, results of operations and prospects:

- loan delinquencies may increase;
- problem assets and foreclosures may increase;
- collateral for loans made may decline in value, in turn reducing customers' borrowing power, reducing the value of assets and collateral associated with existing loans;
- certain securities within our investment portfolio could become other than temporarily impaired, requiring a write-down through earnings to fair value, thereby reducing equity;
- low cost or non-interest bearing deposits may decrease; and
- demand for our loan and other products and services may decrease.

Concentrations within our loan portfolio could result in increased credit risk in a challenging economy.

Our loan portfolio is concentrated in commercial real estate and commercial business loans. These types of loans generally are viewed as having more risk of default than residential real estate loans or certain other types of loans or investments. In fact, the FDIC has issued pronouncements alerting banks of its concern about heavy loan concentrations. Because our loan portfolio contains commercial real estate and commercial business loans with relatively large balances, the deterioration of one or a few of these loans may cause a significant increase in our non-performing loans. An increase in non-performing loans could result in a loss of earnings from these loans, an increase in the provision for loan losses, or an increase in loan charge-offs, any of which would have an adverse impact, which could be material, on our business, financial condition, results of operations and prospects.

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.

In conjunction with the recent financial crisis, the real estate market experienced a slow-down due to negative economic trends and credit market disruption, from which the market continues to slowly recover. At December 31, 2015, 60% of our total gross loans, were secured by real estate. Any renewed downturn in the economies or real estate values in the markets we serve could have a material adverse effect on both borrowers' ability to repay their loans and the value of the real property securing such loans. Our ability to recover on defaulted loans would then be diminished, and we would be more likely to suffer losses on defaulted loans, any or all of which would have an adverse impact, which could be material, on our business, financial condition, results of operations and prospects.

Our allowance for loan and lease losses ("ALLL") may not be adequate to cover future loan losses, which could adversely affect earnings.

We maintain an ALLL in an amount that we believe is adequate to provide for losses inherent in our loan portfolio.

While we strive to carefully monitor credit quality and to identify loans that may become non-performing, at any time there are loans in the portfolio that could result in losses, but that have not been identified as non-performing or potential problem loans. We cannot be sure that we will be able to identify deteriorating loans before they become non-performing assets, or that we will be able to limit losses on those loans that have been identified. Additionally, the process for determining the ALLL requires different, subjective and complex judgments about the future impact from current economic conditions that might impair the ability of borrowers to repay their loans. As a result, future significant increases to the ALLL may be necessary.

Future increases to the ALLL may be required based on changes in the composition of the loans comprising the portfolio, deteriorating values in underlying collateral (most of which consists of real estate) and changes in the financial condition of borrowers, such as may result from changes in economic conditions, or as a result of actual future events differing from assumptions used by management in determining the ALLL. Additionally, banking regulators, as an integral part of their supervisory function, periodically review our ALLL. These regulatory agencies

may require us to increase the ALLL. Any increase in the ALLL would have an adverse effect, which could be material, on our financial condition and results of operations.

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Nonperforming assets take significant time to resolve and could adversely affect our results of operations and financial condition.

Our nonperforming assets adversely affect our net income in various ways. We do not record interest income on nonaccrual loans, thereby adversely affecting our income and increasing loan administration costs. Assets acquired by foreclosure or similar proceedings are recorded at the lower of carrying value or fair value less estimated costs to sell. The valuation of these foreclosed assets is periodically updated and resulting losses, if any, are charged to earnings in the period in which they are identified. An increase in the level of nonperforming assets also increases our risk profile and may impact the capital levels our regulators believe is appropriate in light of such risks. We utilize various techniques such as loan sales, workouts, and restructurings to manage our problem assets. Decreases in the value of these problem assets, the underlying collateral, or in the borrowers' performance or financial condition would have an adverse impact, which could be material, on our business, financial condition, results of operations and prospects. In addition, the resolution of nonperforming assets requires significant commitments of time from management and staff, which can be detrimental to performance of their other responsibilities. We may experience further increases in nonperforming loans in the future.

Our acquisitions and the integration of acquired businesses subject us to various risks and may not result in all of the benefits anticipated, and future acquisitions may be dilutive to current shareholders.

We have in the past and may in the future seek to grow our business by acquiring other businesses. Our acquisitions may not have the anticipated positive results, including results relating to: correctly assessing the asset quality of the assets being acquired; the total cost of integration including management attention and resources; the time required to complete the integration successfully; the amount of longer-term cost savings; being able to profitably deploy funds acquired in an acquisition; or the overall performance of the combined entity.

We also may encounter difficulties in obtaining required regulatory approvals and unexpected contingent liabilities can arise from the businesses we acquire. Integration of an acquired business can be complex and costly, sometimes including combining relevant accounting and data processing systems and management controls, as well as managing relevant relationships with employees, clients, suppliers and other business partners. Integration efforts could divert management attention and resources, which could adversely affect our operations or results.

We may also experience difficulties in complying with the technical requirements of our loss-sharing agreements with the FDIC, which could result in some assets which we acquire in FDIC-assisted transactions losing their coverage under such agreements.

Acquisitions may also result in business disruptions that cause us to lose customers or cause customers to remove their accounts from us and move their business to competing financial institutions. It is possible that the integration process related to acquisitions could result in the disruption of our ongoing businesses or inconsistencies in standards, controls, procedures and policies that could adversely affect our ability to maintain relationships with clients, customers, depositors and employees. The loss of key employees in connection with an acquisition could adversely affect our ability to successfully conduct our business.

We may engage in future acquisitions involving the issuance of additional common stock and/or cash. Any such acquisitions and related issuances of stock may have a dilutive effect on earnings per share, book value per share or the percentage ownership of current shareholders. The use of cash as consideration in any such acquisitions could impact our capital position and may require us to raise additional capital.

Furthermore, notwithstanding our recent acquisitions, we cannot provide any assurance as to the extent to which we can continue to grow through acquisitions as this will depend on the availability of prospective target opportunities at valuations we find attractive. In addition, the Pacific Northwest is experiencing intensified consolidation and we face significant competition from numerous other financial services institutions for attractive acquisition candidates, as many of these competitors will have greater financial resources than we do.

Our assumptions regarding the fair value of assets acquired 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 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. If our assumptions are incorrect, significant earnings volatility can occur and credit loss provisions



may be needed to respond to different economic conditions or adverse developments in the acquired loan portfolio. Any increase in future loan losses could have a material adverse impact on our business, financial condition, results of operations and prospects.

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Our management of capital could adversely affect profitability measures and the market price of our common stock and could dilute the holders of our outstanding common stock.

Our capital ratios are significantly higher than regulatory minimums. We may lower our capital ratios through either selective acquisitions that meet our disciplined criteria, organic loan growth, investment in securities, or a combination of all three. We continually evaluate opportunities to expand our business through strategic acquisitions. There can be no assurance that we will be able to negotiate future acquisitions on terms acceptable to us.

Conversely, there may be circumstances under which it would be prudent to consider alternatives for raising capital to take advantage of significant acquisition opportunities or in response to changing economic conditions. In addition, we may need to raise additional capital in the future to have sufficient capital resources and liquidity to meet our commitments and fund our business needs and future growth, particularly if the quality of our assets or earnings were to deteriorate significantly. We may not be able to raise additional capital when needed on terms acceptable to us or at all. Our ability to raise additional capital, if needed, will depend on, among other things, conditions in the capital markets at the time, which are outside our control, and our financial performance. Further, if we need to raise capital in the future, we may have to do so when many other financial institutions are also seeking to raise capital and would then have to compete with those institutions for investors. An inability to raise additional capital on acceptable terms when needed could have a material adverse effect on our business, financial condition, results of operations and prospects. In addition, any capital raising alternatives could dilute the holders of our outstanding common stock and may adversely affect the market price of our common stock.

If the goodwill we have recorded in connection with acquisitions becomes impaired, it could have a material adverse impact on our earnings and shareholders' equity.

Accounting standards require that we account for acquisitions using the acquisition method of accounting. Under acquisition accounting, if the purchase price of an acquired company exceeds the fair value of its net assets, the excess is carried on the acquirer's balance sheet as goodwill. In accordance with generally accepted accounting principles, our goodwill is evaluated for impairment on an annual basis or more frequently if events or circumstances indicate that a potential impairment exists. Such evaluation may be based on a variety of factors, including the quoted price of our common stock, market prices of common stock of other banking organizations, common stock trading multiples, discounted cash flows, and data from comparable acquisitions. Future evaluations of goodwill may result in impairment and ensuing write-downs, which could have a material adverse impact on our earnings and shareholders' equity.

Fluctuating interest rates could adversely affect our business.

Significant increases in market interest rates on loans, or the perception that an increase may occur, could adversely affect both our ability to originate new loans and our ability to grow. Conversely, decreases in interest rates could result in an acceleration of loan prepayments. An increase in market interest rates could also adversely affect the ability of our floating-rate borrowers to meet their higher payment obligations. If this occurred, it could cause an increase in nonperforming assets and charge offs, which could adversely affect our business.

Further, our profitability is dependent to a large extent upon net interest income, which is the difference (or "spread") between the interest earned on loans, securities and other interest-earning assets and the interest paid on deposits, borrowings, and other interest-bearing liabilities. Because of the differences in maturities and repricing characteristics of our interest-earning assets and interest-bearing liabilities, changes in interest rates do not produce equivalent changes in interest income earned on interest-earning assets and interest paid on interest-bearing liabilities.

Accordingly, fluctuations in interest rates could adversely affect our interest rate spread, and, in turn, our profitability. Our business depends on our ability to successfully manage credit risk.

The operation of our business requires us to manage credit risk. As a lender, we are exposed to the risk that our borrowers will be unable to repay their loans according to their terms, and that the collateral securing repayment of their loans, if any, may not be sufficient to ensure repayment. In addition, there are risks inherent in making any loan, including risks with respect to the period of time over which the loan may be repaid, risks relating to proper loan underwriting, risks resulting from changes in economic and industry conditions and risks inherent in dealing with individual borrowers. In order to successfully manage credit risk, we must, among other things, maintain disciplined and prudent underwriting standards and ensure that our bankers follow those standards. The weakening of these

standards for any reason, such as an attempt to attract higher yielding loans, a lack of discipline or diligence by our employees in underwriting and monitoring loans, the inability of our employees to adequately adapt policies and procedures to changes in economic or any other conditions affecting borrowers and the quality of our loan portfolio, may result in loan defaults, foreclosures and additional charge-offs and may necessitate that we increase our ALLL, each of which could adversely affect our net income. As a result, our inability to successfully manage credit risk could have a material adverse effect on our business, financial condition, results of operations and prospects.

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We operate in a highly regulated environment and changes to or increases in, or supervisory enforcement of, banking or other laws and regulations or governmental fiscal or monetary policies could adversely affect us.

We are subject to extensive regulation, supervision and examination by federal and state banking authorities. In addition, as a publicly-traded company, we are subject to regulation by the SEC. Any change in applicable regulations or federal, state or local legislation or in policies or interpretations or regulatory approaches to compliance and enforcement, income tax laws and accounting principles could have a substantial impact on us and our operations. Changes in laws and regulations may also increase our expenses by imposing additional fees or taxes or restrictions on our operations. Additional legislation and regulations that could significantly affect our powers, authority and operations may be enacted or adopted in the future, which could have a material adverse effect on our business, financial condition, results of operations and prospects. Failure to appropriately comply with any such laws, regulations or principles could result in sanctions by regulatory agencies or damage to our reputation, all of which could adversely affect our business, financial condition or results of operations. For example, the Dodd-Frank Act was enacted in July 2010. Among other provisions, the legislation (i) created a new Consumer Financial Protection Bureau (the “CFPB”) with broad powers to regulate consumer financial products such as credit cards and mortgages, (ii) created a Financial Stability Oversight Council comprised of the heads of other regulatory agencies, (iii) resulted in new capital requirements from federal banking agencies, (iv) placed new limits on electronic debit card interchange fees and (v) required the SEC and national stock exchanges to adopt significant new corporate governance and executive compensation reforms, some of which have yet to be promulgated. The Dodd-Frank Act and regulations that have been adopted thereunder have increased the overall costs of regulatory compliance, and further Dodd-Frank Act related regulations may lead to additional costs. In addition, the CFPB has broad rulemaking authority and is the principal federal regulatory agency responsible for the supervision and enforcement of a wide range of consumer protection laws for banks with greater than \$10 billion in assets.

The New Capital Rules implementing Basel III will be phased in through 2019. The New Capital Rules could have an adverse impact on our financial position and future earnings due to, among other things, the increased capital requirements.

Further, regulators have significant discretion and authority to prevent or remedy unsafe or unsound practices or violations of laws or regulations by financial institutions and holding companies in the performance of their supervisory and enforcement duties. Recently, these powers have been utilized more frequently due to the national, regional and local economic conditions we are facing. The exercise of regulatory authority may have an adverse impact, which could be material, on our business, financial condition, results of operations and prospects. Additionally, our business is affected significantly by the fiscal and monetary policies of the U.S. federal government and its agencies, including the Federal Reserve.

We cannot accurately predict the full effects of recent legislation or the various other governmental, regulatory, monetary and fiscal initiatives which have been and may be enacted on the financial markets, on the Company and on the Bank. The terms and costs of these activities, or any worsening of current financial market and economic conditions, could materially and adversely affect our business, financial condition and results of operations, as well as the trading price of our common stock.

We will be subject to heightened regulatory requirements if we exceed \$10 billion in assets.

It is reasonable to assume that our total assets will exceed \$10 billion in the future, based on our historic organic growth rates or if we engage in any acquisitions. The Dodd-Frank Act and its implementing regulations impose various additional requirements on bank holding companies with \$10 billion or more in total assets, including compliance with portions of the Federal Reserve’s enhanced prudential oversight requirements and annual stress testing requirements. In addition, banks with \$10 billion or more in total assets are primarily examined by the CFPB with respect to various federal consumer financial protection laws and regulations. Currently, our bank is subject to regulations adopted by the CFPB, but the FDIC is primarily responsible for examining our bank’s compliance with consumer protection laws and those CFPB regulations. As a relatively new agency with evolving regulations and practices, there is uncertainty as to how the CFPB’s examination and regulatory authority might impact our business.



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Compliance with these requirements may necessitate that we hire additional compliance or other personnel, design and implement additional internal controls, or incur other significant expenses, any of which could have a material adverse effect on our business, financial condition or results of operations. Compliance with the annual stress testing requirements, part of which must be publicly disclosed, may also be misinterpreted by the market generally or our customers and, as a result, may adversely affect our stock price or our ability to retain our customers or effectively compete for new business opportunities. To ensure compliance with these heightened requirements when effective, our regulators may require us to fully comply with these requirements or take actions to prepare for compliance even before our or the Bank's total assets equal or exceed \$10 billion. As a result, we may incur compliance-related costs before we might otherwise be required, including if we do not continue to grow at the rate we expect or at all. Our regulators may also consider our preparation for compliance with these regulatory requirements when examining our operations generally or considering any request for regulatory approval we may make, even requests for approvals on unrelated matters.

We may be required, in the future, to recognize impairment with respect to investment securities.

Our securities portfolio currently includes securities with unrecognized losses. At December 31, 2015, gross unrealized losses in our securities portfolio were \$18.3 million. We may continue to observe declines in the fair market value of these securities. Securities issued by certain states and municipalities have recently come under scrutiny due to concerns about credit quality. Although management believes the credit quality of the Company's state and municipal securities portfolio to be good, there can be no assurance that the credit quality of these securities will not decline in the future. We evaluate the securities portfolio for any other than temporary impairment each reporting period, as required by generally accepted accounting principles in the United States. There can be no assurance, however, that future evaluations of the securities portfolio will not require us to recognize impairment charges with respect to these and other holdings. For example, it is possible that government-sponsored programs to allow mortgages to be refinanced to lower rates could materially adversely impact the yield on our portfolio of mortgage-backed securities, since a significant portion of our investment portfolio is composed of such securities. Substantial competition in our market areas could adversely affect us.

Commercial banking is a highly competitive business. We compete with other commercial banks, savings and loan associations, credit unions and finance, insurance and other non-depository companies operating in our market areas. We also experience competition, especially for deposits, from Internet-based banking institutions, which have grown rapidly in recent years. We are subject to substantial competition for loans and deposits from other financial institutions. Some of our competitors are not subject to the same degree of regulation and restriction as we are and/or have greater financial resources than we do. Some of our competitors have severe liquidity issues, which could impact the pricing of deposits, loans and other financial products in our markets. Our inability to effectively compete in our market areas could have a material adverse impact on our business, financial condition, results of operations and prospects.

We may not be able to attract or retain key employees.

Our success depends in significant part on the skills of our management team and our ability to retain, recruit and motivate key officers and employees. We expect our future success to be driven in large part by the relationships maintained with our clients by our executives and other key employees. Leadership changes will occur from time to time, and we cannot predict whether significant resignations will occur or whether we will be able to recruit additional qualified personnel. Competition for senior executives and skilled personnel in the financial services and banking industry is intense, which means the cost of hiring, incentivizing and retaining skilled personnel may continue to increase. We need to continue to attract and retain key personnel and to recruit qualified individuals to succeed existing key personnel to ensure the continued growth and successful operation of our business. The unexpected loss of any such employees, or the inability to recruit and retain qualified personnel in the future, could have a material adverse impact on our business, financial condition, results of operations and prospects.

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Changes in accounting standards could materially impact our financial statements.

From time to time, the Financial Accounting Standards Board (the “FASB”) and the SEC change the financial accounting and reporting standards that govern the preparation of our financial statements. These changes can materially impact how we record and report our financial condition and results of operations.

In December 2012, the FASB proposed amendments to its guidance on the credit impairment of financial instruments. The proposed amendments would introduce a new impairment model based on current expected credit losses (“CECL”) rather than incurred losses. The CECL model would apply to most debt instruments, including loan receivables and loan commitments.

Unlike the incurred loss models in existing GAAP, the CECL model does not specify a threshold for the recognition of an impairment allowance. Rather, the Company would recognize an impairment allowance equal to its current estimate of expected credit losses for financial instruments as of the end of the reporting period. Measuring expected credit losses will most likely be a significant challenge for all entities, including the Company. In addition, to estimate expected credit losses, the Company could incur one-time and recurring costs, some of which may be related to system changes and data collection. Further, the impairment allowance measured under a CECL model could differ materially from the impairment allowance measured under the Company’s incurred loss model. To initially apply the proposed amendments, for most debt instruments, the Company would record a cumulative-effect adjustment to its consolidated balance sheet as of the beginning of the first reporting period in which the guidance is effective (a modified retrospective approach). The FASB anticipates issuing the final standard during the second quarter of 2016. The FASB has not yet indicated an effective date for the final standard.

In February 2016, the FASB issued Accounting Standards Update (“ASU”) 2016-02, Leases. The amendments included in this ASU create a new accounting model for both lessees and lessors. Substantially all of the Company’s leases would be reported on our balance sheet. The Company would recognize a right-of-use asset and a lease liability, initially measured at the present value of lease payments. The recognition pattern generally would depend on whether the leased asset is property or non-property. For non-property, the discount on the lease liability would be recognized as interest separately from the amortization of the right-of-use asset. For property, the Company would recognize a single lease cost, combining the unwinding of the discount on the lease liability with the amortization of the right-of-use asset, on a straight-line basis. On transition, the Company would recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. The final standard will be effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years.

There can be no assurance as to the level of dividends we may pay on our common stock.

Holders of our common stock are only entitled to receive such dividends as our Board of Directors may declare out of funds legally available for such payments. Although we have historically declared cash dividends on our common stock, we are not required to do so and there may be circumstances under which we would eliminate our common stock dividend in the future. This could adversely affect the market price of our common stock.

We rely on dividends and other payments from our bank for substantially all of our revenue.

We are a separate and distinct legal entity from the Bank, and we receive substantially all of our operating cash flows from dividends and other payments from the Bank. These dividends and payments are the principal source of funds to pay dividends on our capital stock and interest and principal on any debt we may have. Various federal and state laws and regulations limit the amount of dividends that the Bank may pay to us. Also, our right to participate in a distribution of assets upon a subsidiary’s liquidation or reorganization is subject to the prior claims of the subsidiary’s creditors. In the event the Bank is unable to pay dividends to us, we may not be able to service debt, pay obligations, or pay dividends on our common stock. The inability to receive dividends from the Bank could have a material adverse impact on our business, financial condition, results of operations and prospects.

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Our ability to sustain or improve upon existing performance is dependent upon our ability to respond to technological change, and we may have fewer resources than some of our competitors to continue to invest in technological improvements.

The financial services industry is undergoing rapid technological changes with frequent introductions of new technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and to reduce costs. Many of our competitors have substantially greater resources to invest in technological improvements than we do. Our future success will depend, in part, upon our ability to address the needs of our clients by using technology to provide products and services that will satisfy client demands for convenience, as well as to create additional efficiencies in our operations. We may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to our customers. In addition, the implementation of technological changes and upgrades to maintain current systems and integrate new ones may also cause service interruptions, transaction processing errors and system conversion delays and may cause us to fail to comply with applicable laws. There can be no assurance that we will be able to successfully manage the risks associated with our increased dependency on technology.

A failure in or breach of our operational or security systems, or those of our third party service providers, including as a result of cyber attacks, could disrupt our business, result in unintentional disclosure or misuse of confidential or proprietary information, damage our reputation, increase our costs and cause losses.

As a financial institution, our operations rely heavily on the secure processing, storage and transmission of confidential and other information on our computer systems and networks. Any failure, interruption or breach in security or operational integrity of these systems could result in failures or disruptions in our online banking system, customer relationship management, general ledger, deposit and loan servicing and other systems. The security and integrity of our systems could be threatened by a variety of interruptions or information security breaches, including those caused by computer hacking, cyber attacks, electronic fraudulent activity or attempted theft of financial assets. We cannot assure you that any such failures, interruption or security breaches will not occur, or if they do occur, that they will be adequately addressed. While we have certain protective policies and procedures in place, the nature and sophistication of the threats continue to evolve. We may be required to expend significant additional resources in the future to modify and enhance our protective measures.

Additionally, we face the risk of operational disruption, failure, termination or capacity constraints of any of the third parties that facilitate our business activities, including exchanges, clearing agents, clearing houses or other financial intermediaries. Such parties could also be the source of an attack on, or breach of, our operational systems. Any failures, interruptions or security breaches in our information systems could damage our reputation, result in a loss of customer business, result in a violation of privacy or other laws, or expose us to civil litigation, regulatory fines or losses not covered by insurance, all of which could have a material adverse impact on our business, financial condition, results of operations and prospects.

Significant legal or regulatory actions could subject us to substantial uninsured liabilities and reputational harm and have a material adverse effect on our business and results of operations.

We are from time to time subject to claims and proceedings related to our operations. These claims and legal actions, which could include supervisory or enforcement actions by our regulators, or criminal proceedings by prosecutorial authorities, could involve large monetary claims, including civil money penalties or fines imposed by government authorities and significant defense costs. To mitigate the cost of some of these claims, we maintain insurance coverage in amounts and with deductibles that we believe are appropriate for our operations. However, our insurance coverage does not cover any civil money penalties or fines imposed by government authorities and may not cover all other claims that might be brought against us or continue to be available to us at a reasonable cost. As a result, we may be exposed to substantial uninsured liabilities, which could adversely affect our business, prospects, results of operations and financial condition. Substantial legal liability or significant regulatory action against us could cause significant reputational harm to us and/or could have a material adverse impact on our business, financial condition, results of operations and prospects.





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We are subject to a variety of operational risks, including reputational risk, legal risk and compliance risk, and the risk of fraud or theft by employees or outsiders, which may adversely affect our business and results of operations.

We are exposed to many types of operational risks, including reputational risk, legal and compliance risk, the risk of fraud or theft by employees or outsiders, and unauthorized transactions by employees or operational errors, including clerical or record-keeping errors or those resulting from faulty or disabled computer or telecommunications systems. If personal, non-public, confidential or proprietary information of customers in our possession were to be mishandled or misused, we could suffer significant regulatory consequences, reputational damage and financial loss. Such mishandling or misuse could include, for example, if such information were erroneously provided to parties who are not permitted to have the information, either by fault of our systems, employees, or counterparties, or where such information is intercepted or otherwise inappropriately taken by third parties.

Because the nature of the financial services business involves a high volume of transactions, certain errors may be repeated or compounded before they are discovered and successfully rectified. Our necessary dependence upon automated systems to record and process transactions and our large transaction volume may further increase the risk that technical flaws or employee tampering or manipulation of those systems will result in losses that are difficult to detect. We also may be subject to disruptions of our operating systems arising from events that are wholly or partially beyond our control (for example, computer viruses or electrical or telecommunications outages, or natural disasters, disease pandemics or other damage to property or physical assets) which may give rise to disruption of service to customers and to financial loss or liability. We are further exposed to the risk that our external vendors may be unable to fulfill their contractual obligations (or will be subject to the same risk of fraud or operational errors by their respective employees as we are) and to the risk that we (or our vendors') business continuity and data security systems prove to be inadequate. The occurrence of any of these risks could result in a diminished ability of us to operate our business (for example, by requiring us to expend significant resources to correct the defect), as well as potential liability to clients, reputational damage and regulatory intervention, which could have a material adverse impact on our business, financial condition, results of operations and prospects.

Our business is subject to the risks of earthquakes, tsunamis, floods, fires and other natural catastrophic events. A major catastrophe, such as an earthquake, tsunami, flood, fire or other natural disaster could result in a prolonged interruption of our business. For example, our headquarters are located in Tacoma, Washington and we have operations throughout the Pacific Northwest, a geographical region that has been or may be affected by earthquake, tsunami and flooding activity. The occurrence of any of these natural disasters could negatively impact our performance by disrupting our operations or damaging our facilities, which could have a material adverse effect on our financial condition, results of operations and cash flows.

We have various anti-takeover measures that could impede a takeover.

Our articles of incorporation include certain provisions that could make it more difficult to acquire us by means of a tender offer, a proxy contest, merger or otherwise. These provisions include certain non-monetary factors that our board of directors may consider when evaluating a takeover offer, and a requirement that any "Business Combination" be approved by the affirmative vote of no less than 66 2/3% of the total shares attributable to persons other than a "Control Person." These provisions may have the effect of lengthening the time required for a person to acquire control of us through a tender offer, proxy contest or otherwise, and may deter any potentially hostile offers or other efforts to obtain control of us. This could deprive our shareholders of opportunities to realize a premium for their Columbia common stock, even in circumstances where such action is favored by a majority of our shareholders.

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

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## ITEM 2. PROPERTIES

The Company's principal properties include our corporate headquarters which is located at 13th & A Street, Tacoma, Washington, two operations facilities in Lakewood, Washington and one operations facility in Wilsonville, Oregon. The Company's branch network as of December 31, 2015 is made up of 149 branches located throughout several Washington, Oregon and Idaho counties compared to 154 branches at December 31, 2014. The number of branches per state, as well as whether they are owned or operated under a lease agreement is detailed in the following table.

	Number of Branches	Occupancy Type	
		Owned	Leased
Washington branches	74	58	16
Oregon branches	59	28	31
Idaho branches	16	10	6
Total Columbia Bank branches	149	96	53

For additional information concerning our premises and equipment and lease obligations, see Notes 9 and 17, respectively, to the Consolidated Financial Statements in "Item 8. Financial Statements and Supplementary Data" of this report.

## ITEM 3. LEGAL PROCEEDINGS

The Company and its subsidiaries are party to routine litigation arising in the ordinary course of business. Management believes that, based on information currently known to it, any liabilities arising from such litigation will not have a material adverse impact on the Company's financial conditions, results of operations or cash flows.

## ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

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## PART II

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

## Quarterly Common Stock Prices and Dividends

The Company's common stock is traded on the NASDAQ Global Select Market under the symbol "COLB". Quarterly high and low sales prices and dividend information for the last two years are presented in the following table. The prices shown do not include retail mark-ups, mark-downs or commissions:

2015	High	Low	Cash Dividends Declared		
			Regular	Special	Total Cash Dividends Declared
First quarter	\$29.48	\$24.60	\$0.16	\$0.14	\$0.30
Second quarter	\$33.39	\$28.28	0.18	0.16	0.34
Third quarter	\$33.70	\$28.63	0.18	0.16	0.34
Fourth quarter	\$36.27	\$29.52	0.18	0.18	0.36
For the year	\$36.27	\$24.60	\$0.70	\$0.64	\$1.34

  

2014	High	Low	Cash Dividends Declared		
			Regular	Special	Total Cash Dividends Declared
First quarter	\$30.36	\$24.75	\$0.12	\$—	\$0.12
Second quarter	\$29.31	\$25.68	0.12	0.12	0.24
Third quarter	\$27.13	\$24.50	0.14	0.14	0.28
Fourth quarter	\$28.71	\$23.90	0.16	0.14	0.30
For the year	\$30.36	\$23.90	\$0.54	\$0.40	\$0.94

On December 31, 2015, the last sale price for our stock on the NASDAQ Global Select Market was \$32.51. At January 31, 2016, the number of shareholders of record was 2,875. This figure does not represent the actual number of beneficial owners of common stock because shares are frequently held in "street name" by securities dealers and others for the benefit of individual owners who may vote the shares.

At December 31, 2015, a total of 44,686 stock options were outstanding. Additional information about stock options and other equity compensation plans is included in Note 22 to the Consolidated Financial Statements in "Item 8. Financial Statements and Supplementary Data" of this report.

The payment of future cash dividends is at the discretion of our board of directors and subject to a number of factors, including results of operations, general business conditions, growth, financial condition and other factors deemed relevant to capital management strategies by the board of directors. In addition, the payment of cash dividends is subject to Federal regulatory requirements for capital levels and other restrictions. In this regard, current guidance from the Federal Reserve provides, among other things, that dividends per share on the Company's common stock generally should not exceed earnings per share, measured over the previous four fiscal quarters.

Subsequent to year end, on January 28, 2016, the Company declared a quarterly cash dividend of \$0.18 per share and common share equivalent for holders of preferred stock, and a special cash dividend of \$0.20 per common share and common share equivalent for holders of preferred stock, both payable on February 24, 2016, to shareholders of record at the close of business on February 10, 2016.

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## Equity Compensation Plan Information

The following table provides information as of December 31, 2015, regarding securities issued and to be issued under our equity compensation plans that were in effect during 2015:

	Year Ended December 31, 2015		Number of Shares Remaining Available for Future Issuance Under Equity Compensation Plans (2)
	Number of Shares to be Issued Upon Exercise of Outstanding Options and Rights (1)	Weighted-Average Exercise Price of Outstanding Options and Rights	
Equity compensation plans approved by security holders	44,686	\$57.26	1,959,820
Equity compensation plans not approved by security holders	—	—	—

(1) Includes shares to be issued upon exercise of options under the West Coast Bancorp plan, which was assumed as a result of the West Coast acquisition.

(2) Includes 1,460,210 shares available for future issuance under the current stock option and equity compensation plan and 499,610 shares available for purchase under the Employee Stock Purchase Plan as of December 31, 2015.

The following table provides information about repurchases of common stock by the Company during the quarter ended December 31, 2015:

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 (2)
10/1/2015 - 10/31/2015	413	\$31.82	—	—
11/1/2015 - 11/30/2015	—	—	—	—
12/1/2015 - 12/31/2015	430	32.44	—	—
	843	\$32.13	—	

(1) Common shares repurchased by the Company during the quarter relate to shares withheld to pay taxes due upon vesting of restricted stock.

(2) The Company does not have a current share repurchase plan.

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## Five-Year Stock Performance Graph

The following graph shows a five-year comparison of the total return to shareholders of Columbia's common stock, the NASDAQ Composite Index (which is a broad nationally recognized index of stock performance by companies listed on the Nasdaq Stock Market), the SNL Bank NASDAQ (comprised of banks and bank holding companies listed on the NASDAQ Stock Market) and the KBW Regional Banking Index (comprised of 50 banks and bank holding companies headquartered throughout the country, including Columbia). As the KBW Regional Banking Index is used frequently by management and investors when comparing Columbia's stock performance to that of similarly sized institutions, the comparison to the SNL Bank NASDAQ that we have used in the past is being replaced by a comparison to the KBW Regional Banking Index going forward.

The definition of total return includes appreciation in market value of the stock as well as the actual cash and stock dividends paid to shareholders. The graph assumes that the value of the investment in Columbia's common stock, the NASDAQ Composite, the SNL Bank NASDAQ and the KBW Regional Banking Index was \$100 on December 31, 2010, and that all dividends were reinvested.

Index	Period Ending					
	12/31/2010	12/31/2011	12/31/2012	12/31/2013	12/31/2014	12/31/2015
Columbia Banking System, Inc.	100.00	92.92	90.94	141.85	147.77	181.64
NASDAQ Composite	100.00	99.21	116.82	163.75	188.03	201.40
KBW Regional Banking Index	100.00	94.85	107.43	157.74	161.57	171.25
SNL Bank NASDAQ	100.00	88.73	105.75	152.00	157.42	169.94

Sources: SNL Financial LC, Charlottesville, VA and Bloomberg LP, New York City, NY

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## ITEM 6. SELECTED FINANCIAL DATA

## Five-Year Summary of Selected Consolidated Financial Data (1)

	2015	2014	2013	2012	2011	
	(dollars in thousands except per share amounts)					
For the Year						
Interest income	\$328,891	\$308,042	\$296,935	\$248,504	\$251,271	
Interest expense	\$4,004	\$3,994	\$5,840	\$9,577	\$14,535	
Net interest income	\$324,887	\$304,048	\$291,095	\$238,927	\$236,736	
Provision (recapture) for loan and lease losses	\$8,591	\$6,727	\$(101)	\$39,367	\$5,752	
Noninterest income (loss)	\$91,473	\$59,750	\$26,700	\$27,058	\$(9,283)	
Noninterest expense	\$266,149	\$239,286	\$230,886	\$162,913	\$155,759	
Net income	\$98,827	\$81,574	\$60,016	\$46,143	\$48,037	
Net income applicable to common shareholders	\$98,690	\$81,478	\$59,984	\$46,143	\$48,037	
Per Common Share						
Earnings (Basic)	\$1.71	\$1.53	\$1.24	\$1.16	\$1.22	
Earnings (Diluted)	\$1.71	\$1.52	\$1.21	\$1.16	\$1.21	
Book Value	\$21.48	\$21.34	\$20.50	\$19.25	\$19.23	
Averages						
Total assets	\$8,655,243	\$7,468,091	\$6,558,517	\$4,826,283	\$4,509,010	
Interest-earning assets	\$7,685,734	\$6,561,047	\$5,754,543	\$4,246,724	\$3,871,424	
Loans	\$5,609,261	\$4,782,369	\$4,140,826	\$2,900,520	\$2,607,266	
Securities, including Federal Home Loan Bank stock	\$2,031,859	\$1,708,575	\$1,474,744	\$1,011,294	\$928,891	
Deposits	\$7,146,828	\$6,187,342	\$5,420,577	\$3,875,666	\$3,541,399	
Shareholders' equity	\$1,246,952	\$1,109,581	\$979,099	\$761,185	\$730,726	
Financial Ratios						
Net interest margin (tax equivalent)	4.35	% 4.76	% 5.16	% 5.77	% 6.27	%
Return on average assets	1.14	% 1.09	% 0.92	% 0.96	% 1.07	%
Return on average common equity	7.93	% 7.36	% 6.14	% 6.06	% 6.57	%
Average equity to average assets	14.41	% 14.86	% 14.93	% 15.77	% 16.21	%
At Year End						
Total assets	\$8,951,697	\$8,578,846	\$7,161,582	\$4,906,335	\$4,785,945	
Loans	\$5,815,027	\$5,445,378	\$4,517,296	\$2,947,103	\$2,885,244	
Allowance for loan and lease losses	\$68,172	\$69,569	\$72,454	\$82,300	\$57,985	
Securities, including Federal Home Loan Bank stock	\$2,170,416	\$2,131,622	\$1,696,640	\$1,023,484	\$1,050,325	
Deposits	\$7,438,829	\$6,924,722	\$5,959,475	\$4,042,085	\$3,815,529	
Core deposits	\$7,127,866	\$6,619,944	\$5,696,357	\$3,802,366	\$3,510,435	
Shareholders' equity	\$1,242,128	\$1,228,175	\$1,053,249	\$764,008	\$759,338	
Nonperforming Assets						
Nonaccrual loans	\$21,464	\$31,352	\$34,015	\$37,395	\$53,483	
Other real estate owned and other personal property owned	13,738	22,225	36,037	27,464	60,030	
Total nonperforming assets	\$35,202	\$53,577	\$70,052	\$64,859	\$113,513	
Nonperforming loans to year end loans	0.37	% 0.58	% 0.75	% 1.27	% 1.85	%
Nonperforming assets to year end assets	0.39	% 0.62	% 0.98	% 1.32	% 2.37	%

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Allowance for loan and lease losses to year end loans	1.17	%	1.28	%	1.60	%	2.79	%	2.01	%
Net loan charge-offs	\$9,988		\$9,612		\$9,745		\$15,052		\$14,815	
Other nonfinancial data										
Full-time equivalent employees	1,868		1,934		1,695		1,198		1,256	
Banking branches	149		154		142		99		102	

These unaudited schedules provide selected financial information concerning the Company that should be read in (1) conjunction with “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations” of this report.



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## Consolidated Five-Year Financial Data (1)

	Years ended December 31,				
	2015	2014	2013	2012	2011
	(in thousands, except per share amounts)				
Interest Income:					
Loans	\$286,166	\$268,279	\$266,284	\$219,433	\$218,420
Taxable securities	30,774	28,754	20,459	18,276	21,870
Tax-exempt securities	11,842	10,830	9,837	9,941	10,142
Deposits in banks	109	179	355	854	839
Total interest income	328,891	308,042	296,935	248,504	251,271
Interest Expense:					
Deposits	2,977	3,005	3,962	5,887	10,478
Federal Home Loan Bank advances	474	396	(404)	2,608	2,980
Prepayment charge on Federal Home Loan Bank advances	—	—	1,548	603	—
Long-term obligations	—	—	—	—	579
Other borrowings	553	593	734	479	498
Total interest expense	4,004	3,994	5,840	9,577	14,535
Net Interest Income	324,887	304,048	291,095	238,927	236,736
Provision (recapture) for loan and lease losses	8,591	6,727	(101)	39,367	5,752
Net interest income after provision (recapture) for loan and lease losses	316,296	297,321	291,196	199,560	230,984
Noninterest income (loss)	91,473	59,750	26,700	27,058	(9,283)
Noninterest expense	266,149	239,286	230,886	162,913	155,759
Income before income taxes	141,620	117,785	87,010	63,705	65,942
Provision for income taxes	42,793	36,211	26,994	17,562	17,905
Net Income	\$98,827	\$81,574	\$60,016	\$46,143	\$48,037
Less: Dividends on preferred stock	137	96	32	—	—
Net Income Applicable to Common Shareholders	\$98,690	\$81,478	\$59,984	\$46,143	\$48,037
Per Common Share					
Earnings basic	\$1.71	\$1.53	\$1.24	\$1.16	\$1.22
Earnings diluted	\$1.71	\$1.52	\$1.21	\$1.16	\$1.21
Average number of common shares outstanding (basic)	57,019	52,618	47,993	39,260	39,103
Average number of common shares outstanding (diluted)	57,032	53,183	49,051	39,263	39,180
Total assets at year end	\$8,951,697	\$8,578,846	\$7,161,582	\$4,906,335	\$4,785,945
Cash dividends declared per common share	\$1.34	\$0.94	\$0.41	\$0.98	\$0.27

These unaudited schedules provide selected financial information concerning the Company that should be read in (1) conjunction with “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations” of this report.

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## Selected Quarterly Financial Data (1)

The following table presents selected unaudited consolidated quarterly financial data for each quarter of 2015 and 2014. The information contained in this table reflects all adjustments, which, in the opinion of management, are necessary for a fair presentation of the results of the interim periods.

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year Ended December 31,
	(in thousands, except per share amounts)				
2015					
Total interest income	\$81,417	\$82,040	\$82,665	\$82,769	\$328,891
Total interest expense	1,053	1,030	971	950	4,004
Net interest income	80,364	81,010	81,694	81,819	324,887
Provision for loan and lease losses	1,209	2,202	2,831	2,349	8,591
Noninterest income	22,767	21,462	22,499	24,745	91,473
Noninterest expense	66,734	68,471	64,067	66,877	266,149
Income before income taxes	35,188	31,799	37,295	37,338	141,620
Provision for income taxes	10,827	9,853	11,515	10,598	42,793
Net income	\$24,361	\$21,946	\$25,780	\$26,740	\$98,827
Per common share (2)					
Earnings (basic)	\$0.42	\$0.38	\$0.45	\$0.46	\$1.71
Earnings (diluted)	\$0.42	\$0.38	\$0.45	\$0.46	\$1.71
2014					
Total interest income	\$74,925	\$76,087	\$77,133	\$79,897	\$308,042
Total interest expense	985	963	913	1,133	3,994
Net interest income	73,940	75,124	76,220	78,764	304,048
Provision for loan and lease losses	1,922	2,117	980	1,708	6,727
Noninterest income	14,008	14,627	15,930	15,185	59,750
Noninterest expense	57,386	57,764	59,982	64,154	239,286
Income before income taxes	28,640	29,870	31,188	28,087	117,785
Provision for income taxes	8,796	8,643	9,605	9,167	36,211
Net income	\$19,844	\$21,227	\$21,583	\$18,920	\$81,574
Per common share (2)					
Earnings (basic)	\$0.38	\$0.40	\$0.41	\$0.34	\$1.53
Earnings (diluted)	\$0.37	\$0.40	\$0.41	\$0.34	\$1.52

These unaudited schedules provide selected financial information concerning the Company that should be read in (1) conjunction with "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation" of this report.

(2) Due to averaging of shares, quarterly earnings per share may not add up to the totals reported for the full year.

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

This discussion should be read in conjunction with our Consolidated Financial Statements and related notes in "Item 8. Financial Statements and Supplementary Data" of this report. In the following discussion, unless otherwise noted, references to increases or decreases in average balances in items of income and expense for a particular period and balances at a particular date refer to the comparison with corresponding amounts for the period or date for the previous year.

**Critical Accounting Policies**

We have established certain accounting policies in preparing our Consolidated Financial Statements that are in accordance with accounting principles generally accepted in the United States. Our significant accounting policies are presented in Note 1 to the Consolidated Financial Statements in "Item 8. Financial Statements and Supplementary Data" of this report. Certain of these policies require the use of judgments, estimates and economic assumptions which may prove inaccurate or are subject to variation that may significantly affect our reported results of operations and financial position for the periods presented or in future periods. Management believes that the judgments, estimates and economic assumptions used in the preparation of the Consolidated Financial Statements are appropriate given the factual circumstances at the time. We consider the following policies to be most critical in understanding the judgments that are involved in preparing our consolidated financial statements.

**Allowance for Loan and Lease Losses**

The ALLL is established to absorb known and inherent losses in our loan and lease portfolio. Our methodology in determining the appropriate level of the ALLL includes components for a general valuation allowance in accordance with the Contingencies topic of the Financial Accounting Standards Board Accounting Standards Codification ("FASB ASC"), a specific valuation allowance in accordance with the Receivables topic of the FASB ASC and an unallocated component. Both quantitative and qualitative factors are considered in determining the appropriate level of the ALLL. Quantitative factors include loss experience over a historical base period, estimated loss emergence period, and the evaluation of specific loss estimates for problem loans. Qualitative factors include existing general economic and business conditions in our market areas as well as the duration of the current business cycle. These qualitative factors have a high degree of subjectivity. Changes in any of the factors mentioned could have a significant impact on our calculation of the ALLL. Our ALLL policy and the judgments, estimates and economic assumptions involved are described in greater detail in the "Allowance for Loan and Lease Losses and Unfunded Commitments and Letters of Credit" section of this discussion and in Note 1 to the Consolidated Financial Statements in "Item 8. Financial Statements and Supplementary Data" of this report.

**Business Combinations**

The Company applies the acquisition method of accounting for business combinations. Under the acquisition method, the acquiring entity in a business combination recognizes 100 percent of the assets acquired and liabilities assumed at their acquisition date fair values. Management utilizes prevailing valuation techniques appropriate for the asset or liability being measured in determining these fair values. Any excess of the purchase price over amounts allocated to assets acquired, including identifiable intangible assets, and liabilities assumed is recorded as goodwill. Where amounts allocated to assets acquired and liabilities assumed is greater than the purchase price, a bargain purchase gain is recognized. Acquisition-related costs are expensed as incurred.

**Purchased Credit Impaired Loans**

Loans acquired at a discount for which it is probable that all contractual payments will not be received are generally accounted for under ASC Topic 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality ("ASC 310-30"). In addition, certain purchased loans with evidence of deteriorated credit quality may be accounted for under this topic even if it is not yet probable that all contractual payments will not be received. These loans are recorded at fair value at the time of acquisition. Estimated credit losses are included in the determination of fair value, and therefore, an allowance for loan losses is not recorded on the acquisition date. The excess of expected cash flows at acquisition over the initial investment in acquired loans ("accretable yield") is recorded as interest income over the life of the loans if the timing and amount of the future cash flows is reasonably estimable. Subsequent to acquisition, the Company aggregates individual loans with common risk characteristics into pools of loans. Increases in estimated

cash flows over those expected at the acquisition date are recognized as interest income, prospectively. Decreases in expected cash flows after the acquisition date are recognized by recording an allowance for loan losses.

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Loans accounted for under ASC 310-30 are generally considered accruing and performing loans as the loans accrete interest income over the estimated life of the loan when cash flows are reasonably estimable. Accordingly, purchased credit impaired loans that are contractually past due are still considered to be accruing and performing loans. If