Customers Bancorp, Inc.
Form 10-Q
November 07, 2014
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**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**Form 10-Q**

x **Quarterly report pursuant Section 13 or 15(d) of the Securities Exchange Act of 1934**
**For the quarterly period ended September 30, 2014**

¨ **Transition report pursuant Section 13 or 15(d) of the Securities Exchange Act of 1934**
**For the transition period from _____ to _____.**

**001-35542**

**(Commission File number)**

**(Exact name of registrant as specified in its charter)**

| **Pennsylvania** | **27-2290659** |
|---|---|
| **(State or other jurisdiction of** | **(IRS Employer** |
| **incorporation or organization)** | **Identification No.)** |

**1015 Penn Avenue**

**Suite 103**

**Wyomissing PA 19610**

**(Address of principal executive offices)**

**(610) 933-2000**

**(Registrant s telephone number, including area code)**

**N/A**

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

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

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

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

| | |
|---|---|
| Large accelerated filer ¨ | Accelerated filer x |
| Non-accelerated filer ¨ (Do not check if a smaller reporting company) | 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 x

On November 3, 2014, 25,613,305 shares of Voting Common Stock and 1,121,730 shares of Class B Non-Voting Common Stock were issued and outstanding.

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**CUSTOMERS BANCORP, INC. AND SUBSIDIARIES**

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**CUSTOMERS BANCORP, INC. AND SUBSIDIARIES**

**CONSOLIDATED BALANCE SHEET UNAUDITED**

(amounts in thousands, except share and per share data)

| | September 30, 2014 | December 31, 2013 |
|---|---|---|
| **ASSETS** | | |
| Cash and due from banks | **$ 89,728** | $ 60,709 |
| Interest-earning deposits | **241,578** | 172,359 |
| Cash and cash equivalents | **331,306** | 233,068 |
| Investment securities available for sale, at fair value | **409,303** | 497,573 |
| Loans held for sale, (includes $1,231,039 and $747,593, respectively, at fair value) | **1,395,720** | 747,593 |
| Loans receivable not covered under Loss Sharing Agreements with the FDIC | **4,065,672** | 2,398,353 |
| Loans receivable covered under Loss Sharing Agreements with the FDIC | **44,463** | 66,725 |
| Allowance for loan losses | **(31,083)** | (23,998) |
| Total loans receivable, net of allowance for loan losses | **4,079,052** | 2,441,080 |
| FHLB, Federal Reserve Bank, and other restricted stock | **85,732** | 43,514 |
| Accrued interest receivable | **13,744** | 8,362 |
| FDIC loss sharing receivable | **5,995** | 10,046 |
| Bank premises and equipment, net | **11,147** | 11,625 |
| Bank-owned life insurance | **137,575** | 104,433 |
| Other real estate owned (includes $10,208 and $6,953, respectively, covered under Loss Sharing Agreements with the FDIC) | **17,755** | 12,265 |
| Goodwill and other intangibles | **3,667** | 3,676 |
| Other assets | **41,439** | 39,938 |
| **Total assets** | **$ 6,532,435** | $ 4,153,173 |
| **LIABILITIES AND SHAREHOLDERS EQUITY** | | |
| Liabilities: | | |
| Deposits: | | |
| Demand, non-interest bearing | **$ 697,415** | $ 478,103 |
| Interest bearing | **3,586,725** | 2,481,819 |
| Total deposits | **4,284,140** | 2,959,922 |
| Federal funds purchased | **0** | 13,000 |
| FHLB advances | **1,594,500** | 706,500 |
| Other borrowings | **88,250** | 63,250 |
| Subordinated debt | **112,000** | 2,000 |
| Accrued interest payable and other liabilities | **27,746** | 21,878 |

| | | |
|---|---|---|
| Total liabilities | **6,106,636** | 3,766,550 |
| Shareholders equity: | | |
| Preferred stock, no par value or as set by the board; 100,000,000 shares authorized, none issued | **0** | 0 |
| Common stock, par value $1.00 per share; 200,000,000 shares authorized; 27,267,295 and 24,756,411 shares issued as of September 30, 2014 and December 31, 2013; 26,735,035; and 24,224,151 shares outstanding as of September 30, 2014 and December 31, 2013 | **27,267** | 24,756 |
| Additional paid in capital | **354,561** | 307,231 |
| Retained earnings | **55,245** | 71,008 |
| Accumulated other comprehensive loss, net | **(3,020)** | (8,118) |
| Treasury stock, at cost (532,260 shares as of September 30, 2014 and December 31, 2013) | **(8,254)** | (8,254) |
| Total shareholders equity | **425,799** | 386,623 |
| **Total liabilities and shareholders equity** | **$ 6,532,435** | $ 4,153,173 |

*See accompanying notes to the unaudited consolidated financial statements.*

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**CUSTOMERS BANCORP, INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF INCOME UNAUDITED**

(amounts in thousands, except share data)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 |
| Interest income: | | | | |
| Loans receivable | $ 39,640 | $ 22,485 | $ 103,216 | $ 57,780 |
| Loans held for sale | 8,503 | 9,495 | 20,301 | 31,536 |
| Investment securities | 2,361 | 1,423 | 7,944 | 3,334 |
| Other | 794 | 342 | 1,805 | 789 |
| Total interest income | 51,298 | 33,745 | 133,266 | 93,439 |
| Interest expense: | | | | |
| Deposits | 6,179 | 5,470 | 17,321 | 15,742 |
| Other borrowings | 1,494 | 789 | 3,834 | 868 |
| FHLB advances | 1,711 | 272 | 3,348 | 840 |
| Subordinated debt | 1,700 | 16 | 1,826 | 49 |
| Total interest expense | 11,084 | 6,547 | 26,329 | 17,499 |
| Net interest income | 40,214 | 27,198 | 106,937 | 75,940 |
| Provision for loan losses | 5,035 | 750 | 12,288 | 2,748 |
| Net interest income after provision for loan losses | 35,179 | 26,448 | 94,649 | 73,192 |
| Non-interest income: | | | | |
| Mortgage warehouse transactional fees | 2,154 | 3,090 | 6,128 | 10,626 |
| Bank-owned life insurance | 976 | 615 | 2,646 | 1,658 |
| Gain (loss) on sale of loans | 695 | (6) | 1,266 | 402 |
| Mortgage loan and banking income | 212 | 50 | 2,175 | 50 |
| Deposit fees | 192 | 198 | 618 | 487 |
| Gain on sale of investment securities | 0 | 0 | 3,191 | 0 |
| Other | 873 | 714 | 3,298 | 1,784 |
| Total non-interest income | 5,102 | 4,661 | 19,322 | 15,007 |
| Non-interest expense: | | | | |
| Salaries and employee benefits | 12,070 | 8,963 | 33,012 | 24,868 |
| FDIC assessments, taxes, and regulatory fees | 3,320 | 1,105 | 8,529 | 3,510 |
| Occupancy | 2,931 | 2,289 | 8,162 | 6,309 |
| Professional services | 1,671 | 1,191 | 5,834 | 3,149 |
| Technology, communications and bank operations | 1,485 | 1,121 | 4,666 | 3,023 |
| Other real estate owned | 603 | 401 | 1,845 | 962 |
| Loan workout | 388 | 928 | 1,306 | 1,674 |

| | | | | |
|---|---|---|---|---|
| Advertising and promotion | 261 | 450 | 1,104 | 973 |
| Loss contingency | 0 | 0 | 0 | 2,000 |
| Other | 1,950 | 1,899 | 6,592 | 5,254 |
| Total non-interest expense | 24,679 | 18,347 | 71,050 | 51,722 |
| Income before income tax expense | 15,602 | 12,762 | 42,921 | 36,477 |
| Income tax expense | 3,940 | 4,494 | 12,885 | 12,794 |
| **Net income** | $ 11,662 | $ 8,268 | $ 30,036 | $ 23,683 |
| Basic earnings per share (1) | $ 0.44 | $ 0.30 | $ 1.12 | $ 1.00 |
| Diluted earnings per share (1) | 0.42 | 0.30 | 1.08 | 0.98 |

(1) Earnings per share amounts have been adjusted to reflect the 10% stock dividend declared on May 15, 2014 and issued on June 30, 2014.

*See accompanying notes to the unaudited consolidated financial statements.*

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**CUSTOMERS BANCORP, INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME UNAUDITED**

(amounts in thousands)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 |
| Net income | $ 11,662 | $ 8,268 | $ 30,036 | $ 23,683 |
| Unrealized gains (losses) on securities: | | | | |
| Unrealized holding gains (losses) on securities arising during the period (1) | (1,886) | (10) | 11,335 | (7,079) |
| Income tax effect (1) | 660 | 3 | (3,967) | 2,478 |
| Less: reclassification adjustment for gains on securities included in net income | 0 | 0 | (3,191) | 0 |
| Income tax effect | 0 | 0 | 1,117 | 0 |
| Net unrealized gains (losses) | (1,226) | (7) | 5,294 | (4,601) |
| Unrealized gains (losses) on cash flow hedges: | | | | |
| Unrealized gains (losses) on cash flow hedges arising during the period | 661 | 0 | (296) | 0 |
| Income tax effect | (235) | 0 | 100 | 0 |
| Net unrealized gains (losses) | 426 | 0 | (196) | 0 |
| Other comprehensive income (loss), net of tax | (800) | (7) | 5,098 | (4,601) |
| **Comprehensive income** | $ 10,862 | $ 8,261 | $ 35,134 | $ 19,082 |

(1) Includes immaterial gains or losses on foreign currency items for the three and nine months ended September 30, 2014 and 2013.

*See accompanying notes to the unaudited consolidated financial statements.*

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**CUSTOMERS BANCORP, INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY UNAUDITED**

(amounts in thousands, except share data)

| | For the nine months ended September 30, 2014 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Shares of Common Stock Outstanding | Common Stock | Additional Paid in Capital | Retained Earnings | Accumulated Other Comprehensive Income/(Loss) | Treasury Stock | Total |
| **Balance, January 1, 2014** | 24,224,151 | $ 24,756 | $ 307,231 | $ 71,008 | $ (8,118) | $ (8,254) | $ 386,623 |
| Net income | | | | 30,036 | | | 30,036 |
| Other comprehensive income | | | | | 5,098 | | 5,098 |
| Stock dividend | 2,429,375 | 2,429 | 43,364 | (45,799) | | | (6) |
| Share-based compensation expense | | | 3,124 | | | | 3,124 |
| Issuance of common stock under share-based compensation arrangements | 81,509 | 82 | 842 | | | | 924 |
| **Balance, September 30, 2014** | 26,735,035 | $ 27,267 | $ 354,561 | $ 55,245 | $ (3,020) | $ (8,254) | $ 425,799 |

| | For the nine months ended September 30, 2013 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Shares of Common Stock Outstanding | Common Stock | Additional Paid in Capital | Retained Earnings | Accumulated Other Comprehensive Income/(Loss) | Treasury Stock | Total |
| **Balance, January 1, 2013** | 18,459,502 | $ 18,507 | $ 212,090 | $ 38,314 | $ 1,064 | $ (500) | $ 269,475 |
| Net income | | | | 23,683 | | | 23,683 |
| Other comprehensive loss | | | | | (4,601) | | (4,601) |
| Share-based compensation expense | | | 2,461 | | | | 2,461 |
| Public offering of common stock, net of costs of $5,994 | 6,179,104 | 6,179 | 91,328 | | | | 97,507 |
| Exercise and redemption of warrants | 31,904 | 32 | 76 | | | | 108 |
| Issuance of common stock under share-based compensation arrangements | 23,413 | 24 | 228 | | | | 252 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| **Balance, September 30, 2013** | 24,693,923 | $ 24,742 | $ 306,183 | $ 61,997 | $ (3,537) | $ (500) | $ 388,885 |

*See accompanying notes to the unaudited consolidated financial statements.*

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**CUSTOMERS BANCORP, INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CASH FLOWS UNAUDITED**

(amounts in thousands)

| | Nine Months Ended September 30, | |
|---|---|---|
| | **2014** | **2013** |
| **Cash Flows from Operating Activities** | | |
| Net income | **$ 30,036** | $ 23,683 |
| Adjustments to reconcile net income to net cash (used in) provided by operating activities: | | |
| Provision for loan losses, net of change to FDIC receivable | **12,288** | 2,748 |
| Loss contingency | **0** | 2,000 |
| Provision for depreciation and amortization | **2,782** | 2,115 |
| Share-based compensation | **3,124** | 2,461 |
| Deferred taxes | **117** | (5) |
| Net amortization of investment securities premiums and discounts | **574** | 368 |
| Gain on sale of investment securities | **(3,191)** | 0 |
| Gain on sale of mortgages and other loans | **(3,401)** | (402) |
| Origination of loans held for sale | **(12,298,823)** | (17,177,835) |
| Proceeds from the sale of loans held for sale | **11,817,512** | 17,697,088 |
| Increase in FDIC loss sharing receivable | **(2,713)** | (1,332) |
| Amortization (accretion) of fair value discounts | **(231)** | (724) |
| Net loss on sales of other real estate owned | **728** | 254 |
| Valuation and other adjustments to other real estate owned | **641** | 161 |
| Earnings on investment in bank-owned life insurance | **(2,646)** | (1,658) |
| Increase in accrued interest receivable and other assets | **(8,874)** | (3,888) |
| Increase in accrued interest payable and other liabilities | **6,474** | 42,976 |
| **Net Cash (Used In) Provided by Operating Activities** | **(445,603)** | 588,010 |
| **Cash Flows from Investing Activities** | | |
| Proceeds from maturities, calls and principal repayments of securities available for sale | **35,716** | 14,816 |
| Proceeds from sales of investment securities available for sale | **213,249** | 0 |
| Purchases of investment securities available for sale | **(149,940)** | (390,735) |
| Net increase in loans | **(1,625,024)** | (638,992) |
| Purchase of loan portfolios | **(308,242)** | (155,306) |
| Proceeds from sales of loans | **109,913** | 4,276 |
| Purchases of bank-owned life insurance | **(30,465)** | (27,965) |
| Net (purchases of) proceeds from FHLB, Federal Reserve Bank, and other restricted stock | **(42,218)** | 11,050 |
| Reimbursements from the FDIC on loss sharing agreements | **3,329** | 6,134 |
| Purchases of bank premises and equipment | **(1,321)** | (2,740) |
| Proceeds from sales of other real estate owned | **6,509** | 4,582 |

| | | |
|---|---|---|
| **Net Cash Used In Investing Activities** | **(1,788,494)** | (1,174,880) |
| **Cash Flows from Financing Activities** | | |
| Net increase in deposits | **1,324,193** | 802,556 |
| Net increase (decrease) in short-term borrowed funds | **610,000** | (339,000) |
| Net increase in long-term FHLB borrowings | **265,000** | 35,000 |
| Exercise and redemption of warrants | **0** | 108 |
| Net proceeds from issuance of long-term debt | **133,142** | 60,336 |
| Net proceeds from stock offering | **0** | 97,507 |
| **Net Cash Provided by Financing Activities** | **2,332,335** | 656,507 |
| **Net Increase in Cash and Cash Equivalents** | **98,238** | 69,637 |
| **Cash and Cash Equivalents Beginning** | **233,068** | 186,016 |
| **Cash and Cash Equivalents Ending** | **$ 331,306** | $ 255,653 |
| **Supplementary Cash Flows Information** | | |
| Interest paid | **$ 23,840** | $ 17,268 |
| Income taxes paid | **18,375** | 7,743 |
| **Non-cash items:** | | |
| Transfer of loans to other real estate owned | **$ 13,368** | $ 10,259 |
| Transfer of loans held for investment to held for sale | **164,681** | 0 |
| Issuance of common stock under share-based compensation arrangements | **924** | 252 |

*See accompanying notes to the unaudited consolidated financial statements.*

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**CUSTOMERS BANCORP, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS**

## NOTE 1 DESCRIPTION OF THE BUSINESS

Customers Bancorp, Inc. (the Bancorp , Customers Bancorp , or the Company ) is a bank holding company engaged in banking activities through its wholly owned subsidiary, Customers Bank (the Bank ). Customers Bancorp has made certain equity investments through its wholly owned subsidiaries CB Green Ventures Pte Ltd. and CUBI India Ventures Pte Ltd.

Customers Bancorp, Inc. and its wholly owned subsidiary, Customers Bank, serve residents and businesses in Southeastern Pennsylvania (Bucks, Berks, Chester, Philadelphia and Delaware Counties), Rye, New York (Westchester County); Hamilton, New Jersey (Mercer County); Boston, Massachusetts; and Providence, Rhode Island. The Bank has 14 branches and provides commercial and consumer banking products, primarily loans and deposits. The Bank also provides liquidity to residential mortgage originators nationwide through commercial loans to mortgage companies. Customers Bank is subject to regulation of the Pennsylvania Department of Banking and Securities and the Federal Reserve Bank and is periodically examined by those regulatory authorities.

## NOTE 2 ACQUISITION ACTIVITY

***Acquisition Activity***

*New England Lending Acquisitions*

On January 15, 2014, Customers Bank purchased $277.9 million of residential adjustable-rate jumbo mortgage loans (indexed to one-year LIBOR) from Michigan-based Flagstar Bank. The purchase price was 100.75% of loans outstanding.

On March 28, 2013, Customers Bank completed the purchase of certain commercial loans from Flagstar Bank. Under the terms of the agreement, Customers Bank acquired $182.3 million in commercial loan and related commitments, of which $155.1 million was drawn at the date of acquisition. Also, as part of the agreement, Customers Bank assumed the leases for two of Flagstar s commercial lending offices in New England. The purchase price was 98.7% of loans outstanding.

## NOTE 3 SIGNIFICANT ACCOUNTING POLICIES AND BASIS OF PRESENTATION

**Basis of Presentation**

The interim unaudited consolidated financial statements of Customers Bancorp, Inc. and subsidiaries have been prepared pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (the SEC ). These interim unaudited consolidated financial statements reflect all normal and recurring adjustments that are, in the opinion of management, necessary to present a fair statement of the financial position and the results of operations and cash flows of Customers Bancorp and subsidiaries for the interim periods presented. Certain information and footnote disclosures normally included in the annual consolidated financial statements have been omitted from these interim unaudited consolidated financial statements as permitted by SEC rules and regulations. The December 31, 2013 consolidated balance sheet presented in this report has been derived from Customers Bancorp s audited 2013 consolidated financial statements. Management believes that the disclosures are adequate to present fairly the

consolidated financial statements as of the dates and for the periods presented. These interim unaudited consolidated financial statements should be read in conjunction with the 2013 consolidated financial statements of Customers Bancorp and subsidiaries included in the Company s Annual Report on Form 10-K for the year ended December 31, 2013 filed with the SEC on March 12, 2014. That Form 10-K describes Customers Bancorp s significant accounting policies, which include its policies on Principles of Consolidation; Cash and Cash Equivalents; Restrictions on Cash and Amounts Due from Banks; Investment Securities; Loan Accounting Framework; Allowance for Loan Losses; Goodwill; Investments in FHLB, Federal Reserve Bank, and other restricted stock; Other Real Estate Owned; FDIC Loss Sharing Receivable; Bank Owned Life Insurance; Bank Premises and Equipment; Treasury Stock; Income Taxes; Share-Based Compensation; Comprehensive Income; Earnings per Share; Segment Information; and Accounting Changes. Certain prior period amounts have been reclassified to conform to current period presentation. Results for interim periods are not necessarily indicative of those that may be expected for the fiscal year. Presented below are Customers Bancorp s significant accounting policies that were updated during the nine months ended September 30, 2014 to address new or evolving activities and recently issued accounting standards and updates that were issued or effective during 2014.

**Derivative Instruments and Hedging Activities**

The Financial Accounting Standards Board ( FASB ) ASC 815, *Derivatives and Hedging* ( ASC 815 ), provides the disclosure requirements for derivatives and hedging activities with the intent to provide users of financial statements with an enhanced understanding of: (a) how and why an entity uses derivative instruments, (b) how the entity accounts for derivative instruments and related hedged items, and (c) how derivative instruments and related hedged items affect an entity s financial position, financial performance, and cash flows. Further, qualitative disclosures are required that explain the Bancorp s objectives and strategies for using derivatives, as well as quantitative disclosures about the fair value of and gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative instruments.

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As required by ASC 815, Customers Bancorp records all derivatives on the balance sheet at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative, whether Customers has elected to designate a derivative in a hedging relationship and apply hedge accounting and whether the hedging relationship has satisfied the criteria necessary to apply hedge accounting. Derivatives designated and qualifying as a hedge of the exposure to changes in the fair value of an asset, liability, or firm commitment attributable to a particular risk, such as interest rate risk, are considered fair value hedges. Derivatives designated and qualifying as a hedge of the exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges. Derivatives may also be designated as hedges of the foreign currency exposure of a net investment in a foreign operation. Hedge accounting generally provides for the matching of the timing of gain or loss recognition on the hedging instrument with the recognition of the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk in a fair value hedge or the earnings effect of the hedged forecasted transactions in a cash flow hedge. The Bancorp may enter into derivative contracts that are intended to economically hedge certain of its risks, even though hedge accounting does not apply or the Company elects not to apply hedge accounting.

Prior to first quarter 2014, none of Customer Bancorp s financial derivatives were designated in qualifying hedge relationships in accordance with the applicable accounting guidance. As such, all changes in fair value of the financial derivatives were recognized directly in earnings. In March 2014, Customers Bancorp entered into a $150.0 million notional balance forward starting pay fixed interest rate swap to hedge the variable cash flows associated with the forecasted issuance of debt. The Bancorp documented and designated this swap as a cash flow hedge. The effective portion of changes in the fair value of financial derivatives designated and qualifying as cash flow hedges is recorded in Accumulated Other Comprehensive Income and is subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings. The ineffective portion of the change in fair value of the financial derivatives is recognized directly in earnings. Amounts reported in accumulated other comprehensive income related to financial derivatives will be reclassified to interest expense as interest payments are made on the Company s variable-rate debt.

Customers Bancorp purchased credit derivatives with a notional balance of $13.4 million to hedge the performance risk of one of its counterparties during first quarter 2014. These derivatives were not designated in hedge relationships for accounting purposes and are being recorded at their fair value, with fair value changes recorded directly in earnings.

In accordance with the FASB s fair value measurement guidance, Customers Bancorp made an accounting policy election to measure the credit risk of its derivative financial instruments that are subject to master netting agreements on a net basis by counterparty portfolio.

**Recently Issued Accounting Standards**

In August 2014, the FASB issued Accounting Standard Update ( ASU ) 2014-15, *Presentation of Financial Statements Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity s Ability to Continue as a Going Concern.* The guidance in this ASU is intended to define management s responsibility to evaluate whether there is substantial doubt about an organization s ability to continue as a going concern and to provide related footnote disclosures. The guidance in this ASU is effective for annual periods ending after December 15, 2016, and interim periods within annual periods beginning after December 15, 2016. Early application is permitted for annual or interim reporting periods for which the financial statements have not previously been issued. The Bancorp does not expect this ASU to have a significant impact on its financial condition or results of operation.

In August 2014, the FASB issued ASU 2014-14*, Receivables Troubled Debt Restructurings by Creditors (Subtopic 310-40): Classification of Certain Government-Guaranteed Mortgage Loans upon Foreclosure.* The guidance in this

ASU affects creditors that hold government-guaranteed mortgage loans, including those guaranteed by the FHA and the VA. It requires that a mortgage loan be derecognized and a separate other receivable be recognized upon foreclosure if the following conditions are met:

1. The loan has a government guarantee that is not separable from the loan before foreclosure.

2. At the time of foreclosure, the creditor has the intent to convey the real estate property to the guarantor and make a claim on the guarantee, and the creditor has the ability to recover under that claim.

3. At the time of foreclosure, any amount of the claim that is determined on the basis of the fair value of the real estate is fixed.

Upon foreclosure, the separate other receivable should be measured based on the amount of the loan balance (principal and interest) expected to be recovered from the guarantor. The guidance in this ASU is effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. Early adoption is permitted if ASU 2014-04 has been adopted. The guidance may be applied using a prospective transition method in which a reporting entity applies the guidance to foreclosures that occur after the date of adoption, or a modified retrospective transition using a cumulative-effect adjustment (through a reclassification to a separate other receivable) as of the beginning of the annual period of adoption. Prior periods should not be adjusted. A reporting entity must apply the same method of transition as elected under ASU 2014-04.The Bancorp does not expect this ASU to have a significant impact on its financial condition or results of operation.

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In August 2014, the FASB issued ASU 2014-13*, Consolidation (Topic 810): Measuring the Financial Assets and the Financial Liabilities of a Consolidated Collateralized Financing Entity.* The guidance in this ASU applies to a reporting entity that is required to consolidate a collateralized financing entity under the Variable Interest Entities guidance when: (*1*) the reporting entity measures all of the financial assets and the financial liabilities of that consolidated collateralized financing entity at fair value in the consolidated financial statements based on other Codification Topics; and (*2*) the changes in the fair values of those financial assets and financial liabilities are reflected in earnings. The guidance in this ASU is effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2015. Early adoption is permitted as of the beginning of an annual period. The Bancorp does not expect this ASU to have a significant impact on its financial condition or results of operation.

In June 2014, the FASB issued ASU 2014-12, *Compensation Stock Compensation*. The guidance in this ASU requires that a performance target that affects vesting and that could be achieved after the requisite service period is treated as a performance condition. As such, the performance target should not be reflected in estimating the grant-date fair value of the award. Compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the period(s) for which the requisite has already been rendered. If the performance target becomes probable of being achieved before the end of the requisite period, the remaining unrecognized cost should be recognized prospectively over the remaining requisite service period. The total amount of compensation cost recognized during and after the requisite service period should reflect the number of awards that are expected to vest and should be adjusted to reflect those awards that ultimately vest. The requisite service period ends when the employee can cease rendering service and still be eligible to vest in the award if the performance target is achieved. As indicated in the definition of vest, the stated vesting period (which includes the period in which the performance target could be achieved) may differ from the requisite service period. The guidance in this ASU is effective for annual and interim periods beginning after December 15, 2015. The Bancorp does not expect this ASU to have a significant impact on its financial condition or results of operation.

In June 2014, the FASB issued ASU 2014-11, *Transfers and Servicing*. The amendments in this update require that repurchase-to-maturity transactions be accounted for as secured borrowings consistent with the accounting for other repurchase agreements. In addition, the amendments require separate accounting for a transfer of a financial asset executed contemporaneously with a repurchase agreement with the same counterparty (a repurchase financing), which will result in secured borrowing accounting for the repurchase agreement. The amendments require an entity to disclose information about transfers accounted for as sales in transactions that are economically similar to repurchase agreements, in which the transferor retains substantially all of the exposure to the economic return on the transferred financial asset throughout the term of the transaction. In addition the amendments require disclosure of the types of collateral pledged in repurchase agreements, securities lending transactions, and repurchase-to-maturity transactions and the tenor of those transactions. The guidance in this ASU is effective for annual and interim periods beginning after December 15, 2014. The Bancorp does not expect this ASU to have a significant impact on its financial condition or results of operation.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers*. This ASU establishes a comprehensive revenue recognition standard for virtually all industries in U.S. GAAP, including those that previously followed industry-specific guidance such as the real estate and construction industries. The revenue standard s core principal is built on the contract between a vendor and a customer for the provision of goods and services. It attempts to depict the exchange of rights and obligations between the parties in the pattern of revenue recognition based on the consideration to which the vendor is entitled. To accomplish this, the standard requires five basic steps: (i) identify the contract with the customer, (ii) identify the performance obligations in the contract, (iii) identify the transaction price, (iv) allocate the transaction price to the performance obligations in the contract, (v) recognize revenue when (or as)

the entity satisfies the performance obligation. Three basic transition methods are available full retrospective, retrospective with certain practical expedients, and a cumulative effect approach. Under the cumulative effect alternative, an entity would apply the new revenue standard only to contracts that are incomplete under legacy U.S. GAAP at the date of initial application and recognize the cumulative effect of the new standard as an adjustment to the opening balance of retained earnings. The guidance in this ASU is effective for annual periods and interim reporting periods within those annual periods, beginning after December 15, 2016. The Bancorp does not expect this ASU to have a significant impact on its financial condition or results of operation.

In January 2014, the FASB issued ASU 2014-04, *Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure*, a consensus of the FASB Emerging Issues Task Force. The guidance in this ASU clarifies that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. The ASU also requires additional related interim and annual disclosures. The guidance in this ASU is effective for annual and interim periods beginning after December 15, 2014. The Bancorp does not expect this ASU to have a significant impact on its financial condition or results of operation.

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In January 2014, the FASB issued ASU 2014-01, *Accounting for Investments in Qualified Affordable Housing Projects*, a consensus of the FASB Emerging Issues Task Force. This ASU provides guidance on accounting for investments by a reporting entity in flow-through limited liability entities that manage or invest in affordable housing projects that qualify for the low-income housing tax credit. The guidance in this ASU is effective for annual periods and interim reporting periods within those annual periods, beginning after December 15, 2014. The Bancorp does not expect this ASU to have a significant impact on its financial condition or results of operation.

In February 2013, the FASB issued ASU 2013-04, *Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation Is Fixed at the Reporting Date*, a consensus of the FASB Emerging Issues Task Force. The guidance in this ASU requires an entity to measure obligations resulting from joint and several liability arrangements for which the total amount of the obligation within the scope of this guidance is fixed at the reporting date, as the sum of the following: (a) the amount the reporting entity agreed to pay on the basis of its arrangement among its co-obligors, and (b) any additional amount the reporting entity expects to pay on behalf of its co-obligors. The guidance in this ASU was effective in first quarter 2014. This ASU has not had a significant impact on the Bancorp s financial condition or results of operation.

**NOTE 4 CHANGES IN ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS) BY COMPONENT (1)**

The following tables present the changes in accumulated other comprehensive income (loss) by component for the three months and nine months ended September 30, 2014 and 2013.

| | For the Three Months Ended September 30, 2014 | | |
|---|---|---|---|
| (amounts in thousands) | Unrealized (Losses) on Available-for-sale Securities (2) | Unrealized Gains and (Losses) on Cash Flow Hedges | Total |
| Beginning balance - July 1, 2014 | $ (1,598) | $ (622) | $ (2,220) |
| Other comprehensive income (loss) before reclassifications | (1,226) | 426 | (800) |
| Amounts reclassified from accumulated other comprehensive loss to net income | 0 | 0 | 0 |
| Net current-period other comprehensive income (loss) | (1,226) | 426 | (800) |
| Ending balance - September 30, 2014 | $ (2,824) | $ (196) | $ (3,020) |

| | For the Nine Months Ended September 30, 2014 | | |
|---|---|---|---|
| (amounts in thousands) | Unrealized Gains and | Unrealized Losses on | Total |

| | (Losses) on Available-for-sale Securities (2) | Cash Flow Hedges | |
|---|---|---|---|
| Beginning balance - January 1, 2014 | $ (8,118) | $ 0 | $ (8,118) |
| Other comprehensive income (loss) before reclassifications | 7,368 | (196) | 7,172 |
| Amounts reclassified from accumulated other comprehensive loss to net income (3) | (2,074) | 0 | (2,074) |
| Net current-period other comprehensive income (loss) | 5,294 | (196) | 5,098 |
| Ending balance - September 30, 2014 | $ (2,824) | $ (196) | $ (3,020) |

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**For the Three Months Ended September 30, 2013**

| (amounts in thousands) | | Unrealized Losses on Available-for-sale Securities (2)(4) |
|---|---|---|
| Beginning balance - July 1, 2013 | $ | (3,530) |
| Other comprehensive loss before reclassifications | | (7) |
| Amounts reclassified from accumulated other comprehensive loss to net income | | 0 |
| Net current-period other comprehensive (loss) | | (7) |
| Ending balance September 30, 2013 | $ | (3,537) |

**For the Nine Months Ended September 30, 2013**

| (amounts in thousands) | | Unrealized Gains and (Losses) on Available-for-sale Securities (2)(4) |
|---|---|---|
| Beginning balance - January 1, 2013 | $ | 1,064 |
| Other comprehensive loss before reclassifications | | (4,601) |
| Amounts reclassified from accumulated other comprehensive loss to net income | | 0 |
| Net current-period other comprehensive (loss) income | | (4,601) |
| Ending balance September 30, 2013 | $ | (3,537) |

(1) All amounts are net of tax. Amounts in parentheses indicate reductions to accumulated other comprehensive income.
(2) Includes immaterial gains or losses on foreign currency items for the three and nine months ended September 30, 2014 and 2013.
(3) Reclassification amounts are reported as gain on sale of investment securities on the Consolidated Statements of Income.
(4) Prior to first quarter 2014, all amounts deferred in accumulated other comprehensive income/(loss) were related to available-for-sale securities.

**NOTE 5 EARNINGS PER SHARE**

The following are the components and results of the Bancorp s earnings per share calculation for the periods presented. Share and per share amounts have been adjusted to reflect the 10% stock dividend declared on May 15, 2014 and issued on June 30, 2014.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 |
| (dollars in thousands, except per share data) | | | | |
| Net income available to common shareholders | $ 11,662 | $ 8,268 | $ 30,036 | $ 23,683 |
| Weighted-average number of common shares outstanding - basic | 26,730,347 | 27,146,109 | 26,713,953 | 23,644,329 |
| Share-based compensation plans | 1,001,966 | 523,586 | 949,584 | 421,659 |
| Warrants | 252,527 | 201,188 | 252,043 | 193,599 |
| Weighted-average number of common shares - diluted | 27,984,840 | 27,870,883 | 27,915,580 | 24,259,587 |
| Basic earnings per share | $ 0.44 | $ 0.30 | $ 1.12 | $ 1.00 |
| Diluted earnings per share | $ 0.42 | $ 0.30 | $ 1.08 | $ 0.98 |

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The following is a summary of securities that could potentially dilute basic earnings per share in future periods that were not included in the computation of diluted earnings per share because to do so would have been anti-dilutive for the periods presented. Share-based compensation awards and eligible warrants have been adjusted to reflect the 10% stock dividend declared on May 15, 2014 and issued on June 30, 2014.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 |
| Anti-dilutive securities: | | | | |
| Share-based compensation awards | 116,370 | 101,470 | 116,420 | 95,842 |
| Warrants | 118,745 | 118,745 | 118,745 | 118,745 |
| Total anti-dilutive securities | 235,115 | 220,215 | 235,165 | 214,587 |

**NOTE 6 INVESTMENT SECURITIES**

The amortized cost and approximate fair value of investment securities as of September 30, 2014 and December 31, 2013 are summarized in the tables below:

| | September 30, 2014 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| (amounts in thousands) | | | | |
| ***Available for Sale:*** | | | | |
| Mortgage-backed securities (1) | $ 390,580 | $ 1,837 | $ (4,898) | $ 387,519 |
| Equity securities (2) | 23,074 | 31 | (1,321) | 21,784 |
| | $ 413,654 | $ 1,868 | $ (6,219) | $ 409,303 |

| | December 31, 2013 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| (amounts in thousands) | | | | |
| ***Available for Sale:*** | | | | |
| Mortgage-backed securities (1) | $ 461,988 | $ 207 | $ (10,659) | $ 451,536 |
| Corporate notes | 25,000 | 344 | (21) | 25,323 |
| Equity securities (2) | 23,074 | 0 | (2,360) | 20,714 |
| | $ 510,062 | $ 551 | $ (13,040) | $ 497,573 |

(1) Comprised primarily of mortgage-backed securities issued by government-sponsored agencies, including FHLMC, FNMA, and GNMA.
(2) Comprised primarily of equity securities in a foreign entity.

The following table presents proceeds from the sale of available-for-sale investment securities and gross gains and gross losses realized on those sales for the three and nine months ended September 30, 2014 and 2013:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 |
| (amounts in thousands) | | | | |
| Proceeds from sale of available-for-sale securities | $ 0 | $ 0 | $ 213,249 | $ 0 |
| Gross gains | $ 0 | $ 0 | $ 3,191 | $ 0 |
| Gross losses | 0 | 0 | 0 | 0 |
| Net gains | $ 0 | $ 0 | $ 3,191 | $ 0 |

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These gains and losses were determined using the specific identification method and were reported as gains on sale of investment securities included in non-interest income.

The following table presents available-for-sale debt securities by stated maturity. Debt securities backed by mortgages have expected maturities that differ from contractual maturities because borrowers have the right to call or prepay and are, therefore, classified separately with no specific maturity date:

| | September 30, 2014 | |
|---|---|---|
| | Amortized Cost | Fair Value |
| (amounts in thousands) | | |
| Due in one year or less | $ 0 | $ 0 |
| Due after one year through five years | 0 | 0 |
| Due after five years through ten years | 0 | 0 |
| Due after ten years | 0 | 0 |
| Mortgage-backed securities | 390,580 | 387,519 |
| Total debt securities | $ 390,580 | $ 387,519 |

The Bancorp s investments gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at September 30, 2014 and December 31, 2013 were as follows:

| | September 30, 2014 | | | | | |
|---|---|---|---|---|---|---|
| | Less Than 12 Months | | 12 Months or More | | Total | |
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| (amounts in thousands) | | | | | | |
| ***Available for Sale:*** | | | | | | |
| Mortgage-backed securities (1) | $ 90,123 | $ (742) | $ 118,521 | $ (4,156) | $ 208,644 | $ (4,898) |
| Equity securities (2) | 20,747 | (1,320) | 5 | (1) | 20,752 | (1,321) |
| Total | $ 110,870 | $ (2,062) | $ 118,526 | $ (4,157) | $ 229,396 | $ (6,219) |

| | December 31, 2013 | | | | | |
|---|---|---|---|---|---|---|
| | Less Than 12 Months | | 12 Months or More | | Total | |
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| (amounts in thousands) | | | | | | |
| ***Available for Sale:*** | | | | | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| Mortgage-backed securities (1) | $ 425,623 | $ (10,061) | $ 5,274 | $ (598) | 430,897 | $ (10,659) |
| Corporate notes | 4,982 | (18) | 4,997 | (3) | 9,979 | (21) |
| Equity securities (2) | 20,714 | (2,360) | 0 | 0 | 20,714 | (2,360) |
| Total | $ 451,319 | $ (12,439) | $ 10,271 | $ (601) | $ 461,590 | $ (13,040) |

(1) Comprised primarily of mortgage-backed securities issued by government-sponsored agencies, including FHLMC, FNMA, and GNMA.

(2) Comprised primarily of equity securities in a foreign entity.

At September 30, 2014, there were ten available-for-sale investment securities in the less-than-twelve-month category and twenty-two available-for-sale investment securities in the twelve-month-or-more category. The unrealized losses on the mortgage-backed securities are guaranteed by government-sponsored entities and primarily relate to changes in market interest rates. All amounts are expected to be recovered when market prices recover or at maturity. The unrealized losses on the equity securities reflect decreases in market price or adverse changes in foreign currency exchange rates. Customers evaluated the financial condition and capital strength of the issuer of these securities and concluded that the decline in fair value was temporary and would recover by way of increases in market price or positive changes in foreign currency exchange rates. The Company intends to hold these securities for the foreseeable future and does not intend to sell the securities before the price recovers. Customers considers it more likely than not that it will not be required to sell the securities. Accordingly, Customers has concluded that the securities are not other-than-temporarily impaired as of September 30, 2014.

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At September 30, 2014 and December 31, 2013, Customers Bank had pledged investment securities aggregating $387.1 million and $451.1 million fair value, respectively, as collateral against its borrowings primarily with the FHLB. The FHLB does not have the ability to sell or repledge these securities.

## NOTE 7 LOANS HELD FOR SALE

The composition of loans held for sale as of September 30, 2014 and December 31, 2013 was as follows:

| (amounts in thousands) | **September 30, 2014** | December 31, 2013 |
|---|---|---|
| Mortgage warehouse loans at fair value | **$ 1,226,920** | $ 740,694 |
| Residential mortgage loans at fair value | **4,119** | 6,899 |
| Multi-family loans at lower of cost or fair value | **164,681** | 0 |
| Loans held for sale | **$ 1,395,720** | $ 747,593 |

Effective September 30, 2014, Customers Bank transferred $164.7 million of multi-family loans from held for investment to held for sale because the Company was actively marketing these loans and no longer had the intent to retain these loans in its portfolio. Customers Bank transferred these loans at their amortized cost, which was lower than the estimated fair value at the time of transfer.

## NOTE 8 LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES

The following table presents loans receivable as of September 30, 2014 and December 31, 2013:

| (amounts in thousands) | **September 30, 2014** | **December 31, 2013** |
|---|---|---|
| Construction | $ 6,755 | $ 14,627 |
| Commercial real estate/multi-family | 18,366 | 24,258 |
| Commercial and industrial | 3,520 | 5,814 |
| Residential real estate | 12,769 | 18,733 |
| Manufactured housing | 3,053 | 3,293 |
| Total loans receivable **covered** under FDIC loss sharing agreements (1) | 44,463 | 66,725 |
| Construction | 56,603 | 36,901 |
| Commercial real estate/multi-family | 3,153,980 | 1,835,186 |
| Commercial and industrial | 432,917 | 239,509 |
| Mortgage warehouse | 8 | 866 |
| Manufactured housing | 129,798 | 139,471 |
| Residential real estate | 290,621 | 145,188 |
| Consumer | 1,684 | 2,144 |

| | | |
|---|---|---|
| Total loans receivable **not covered** under FDIC loss sharing agreements | 4,065,611 | 2,399,265 |
| Total loans receivable | 4,110,074 | 2,465,990 |
| Deferred (fees) costs, net (2) | 61 | (912) |
| Allowance for loan losses | (31,083) | (23,998) |
| Loans receivable, net | $ 4,079,052 | $ 2,441,080 |

(1) Loans that were acquired in two FDIC-assisted transactions and are covered under loss sharing agreements with the FDIC are referred to as covered loans throughout these financial statements.

(2) Includes $3.5 million and $0.6 million of unamortized premiums on purchased loans at September 30, 2014 and December 31, 2013, respectively.

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***Non-Covered Loans***

The following tables summarize **non-covered** loans by class and performance status as of September 30, 2014 and December 31, 2013:

| | September 30, 2014 | | | | | | |
|---|---|---|---|---|---|---|---|
| (amounts in thousands) | 30-89 Days Past Due (1) | 90 Days Or More Past Due(1) | Total Past Due (1) | Non-Accrual | Current (2) | Purchased-Credit-Impaired Loans (3) | Total Loans (4) |
| Commercial and industrial | $ 405 | $ 0 | $ 405 | $ 1,956 | $ 429,358 | $ 1,198 | $ 432,917 |
| Commercial real estate | 146 | 0 | 146 | 5,523 | 3,115,862 | 32,449 | 3,153,980 |
| Construction | 0 | 0 | 0 | 451 | 55,925 | 227 | 56,603 |
| Residential real estate | 585 | 0 | 585 | 1,070 | 279,390 | 9,576 | 290,621 |
| Consumer | 0 | 0 | 0 | 0 | 1,420 | 264 | 1,684 |
| Mortgage warehouse | 0 | 0 | 0 | 0 | 8 | 0 | 8 |
| Manufactured housing (5) | 6,652 | 4,082 | 10,734 | 895 | 114,055 | 4,114 | 129,798 |
| **Total** | $ 7,788 | $ 4,082 | $ 11,870 | $ 9,895 | $ 3,996,018 | $ 47,828 | $ 4,065,611 |

| | December 31, 2013 | | | | | | |
|---|---|---|---|---|---|---|---|
| (amounts in thousands) | 30-89 Days Past Due (1) | 90 Days Or More Past Due(1) | Total Past Due (1) | Non-Accrual | Current (2) | Purchased-Credit-Impaired Loans (3) | Total Loans (4) |
| Commercial and industrial | $ 10 | $ 0 | $ 10 | $ 123 | $ 237,453 | $ 1,923 | $ 239,509 |
| Commercial real estate | 0 | 0 | 0 | 9,924 | 1,788,144 | 37,118 | 1,835,186 |
| Construction | 0 | 0 | 0 | 2,049 | 33,922 | 930 | 36,901 |
| Residential real estate | 555 | 0 | 555 | 969 | 133,158 | 10,506 | 145,188 |
| Consumer | 0 | 0 | 0 | 0 | 1,728 | 416 | 2,144 |
| Mortgage warehouse | 0 | 0 | 0 | 0 | 866 | 0 | 866 |
| Manufactured housing (5) | 7,921 | 3,772 | 11,693 | 448 | 122,416 | 4,914 | 139,471 |
| **Total** | $ 8,486 | $ 3,772 | $ 12,258 | $ 13,513 | $ 2,317,687 | $ 55,807 | $ 2,399,265 |

(1) Includes past due loans that are accruing interest because collection is considered probable.
(2) Loans where next payment due is less than 30 days from the report date.
(3) Purchased-credit-impaired loans aggregated into a pool are accounted for as a single asset with a single composite interest rate and an aggregate expectation of cash flows, and the past due status of the pools, or that of the individual loans within the pools, is not meaningful. Because of the credit impaired nature of the loans, the loans are recorded at a discount reflecting estimated future cash flows and the Bank recognizes interest income on

each pool of loans reflecting the estimated yield and passage of time. Such loans are considered to be performing. Purchased-credit-impaired loans that are not in pools accrete interest when the timing and amount of their expected cash flows are reasonably estimable, and are reported as performing loans.

(4) Amounts exclude deferred costs and fees and the allowance for loan losses.

(5) Manufactured housing loans purchased in 2010 are subject to cash reserves held at the Bank that are used to fund past-due payments when the loan becomes 90 days or more delinquent. Subsequent purchases are subject to varying provisions in the event of borrowers delinquencies.

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***Covered Loans***

The following tables summarize **covered** loans by class and performance status as of September 30, 2014 and December 31, 2013:

| | September 30, 2014 | | | | | | |
|---|---|---|---|---|---|---|---|
| (amounts in thousands) | 30-89 Days Past Due (1) | 90 Days Or More Past Due (1) | Total Past Due (1) | Non-Accrual | Current (2) | Purchased - Credit Impaired Loans (3) | Total Loans (4) |
| Commercial and industrial | $ 0 | $ 0 | $ 0 | $ 217 | $ 2,961 | $ 342 | $ 3,520 |
| Commercial real estate | 0 | 0 | 0 | 290 | 11,226 | 6,850 | 18,366 |
| Construction | 0 | 0 | 0 | 2,411 | 0 | 4,344 | 6,755 |
| Residential real estate | 0 | 0 | 0 | 1,007 | 10,926 | 836 | 12,769 |
| Manufactured housing | 17 | 0 | 17 | 135 | 2,758 | 143 | 3,053 |
| **Total** | $ 17 | $ 0 | $ 17 | $ 4,060 | $ 27,871 | $ 12,515 | $ 44,463 |

| | December 31, 2013 | | | | | | |
|---|---|---|---|---|---|---|---|
| (amounts in thousands) | 30-89 Days Past Due (1) | 90 Days Or More Past Due (1) | Total Past Due (1) | Non-Accrual | Current (2) | Purchased-Credit Impaired Loans (3) | Total Loans (4) |
| Commercial and industrial | $ 295 | $ 0 | $ 295 | $ 2 | $ 3,172 | $ 2,345 | $ 5,814 |
| Commercial real estate | 245 | 0 | 245 | 1,691 | 13,586 | 8,736 | 24,258 |
| Construction | 0 | 0 | 0 | 3,382 | 1,967 | 9,278 | 14,627 |
| Residential real estate | 90 | 0 | 90 | 564 | 14,108 | 3,971 | 18,733 |
| Manufactured housing | 56 | 0 | 56 | 11 | 3,081 | 145 | 3,293 |
| **Total** | $ 686 | $ 0 | $ 686 | $ 5,650 | $ 35,914 | $ 24,475 | $ 66,725 |

(1) Includes past due loans that are accruing interest because collection is considered probable.
(2) Purchased loans in FDIC assisted transactions with no evidence of credit deterioration since origination.
(3) Purchased-credit-impaired loans aggregated into a pool are accounted for as a single asset with a single composite interest rate and an aggregate expectation of cash flows, and the past due status of the pools, or that of the individual loans within the pools, is not meaningful. Because of the credit impaired nature of the loans, the loans are recorded at a discount reflecting estimated future cash flows and the Bank recognizes interest income on each pool of loans reflecting the estimated yield and passage of time. Such loans are considered to be performing. Purchased-credit-impaired loans that are not in pools accrete interest when the timing and amount of their

expected cash flows are reasonably estimable, and are reported as performing loans.

(4) Amounts exclude deferred costs and fees and allowance for loan losses.

*Allowance for Loan Losses and FDIC Loss Sharing Receivable*

Losses incurred on covered loans are eligible for partial reimbursement by the FDIC. Subsequent to the purchase date, the expected cash flows on the covered loans are subject to evaluation. Decreases in the present value of expected cash flows on the covered loans are recognized by increasing the allowance for loan losses with a related charge to the provision for loan losses. At the same time, the FDIC indemnification asset is increased reflecting an estimated future collection from the FDIC, which is recorded as a reduction to the provision for loan losses. If the expected cash flows on the covered loans increase such that a previously recorded impairment can be reversed, the Bancorp records a reduction in the allowance for loan losses (with a related credit to the provision for loan losses) accompanied by a reduction in the FDIC receivable balance and a charge to the provision for loan losses. Increases in expected cash flows of covered loans and decreases in expected cash flows of the FDIC loss sharing receivable, when there are no previously recorded impairments, are considered together and recognized over the remaining life of the loans as interest income. The FDIC loss sharing receivable balance will be reduced through a charge to the provision for loan losses, with no offsetting reduction to the allowance for loan losses, as the FDIC loss sharing arrangements reach their contractual maturities and the estimated losses in the covered loans have not yet emerged or been realized in a final disposition event. The FDIC loss sharing arrangements for non-single family loans expire in third quarter 2015. The loss sharing arrangements for single family loans expire in third quarter 2020.

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The following table presents changes in the allowance for loan losses and the FDIC loss sharing receivable for the three months ended September 30, 2014 and 2013.

| | Allowance for Loan Losses For the Three Months Ended September 30, | |
|---|---|---|
| (amounts in thousands) | 2014 | 2013 |
| Beginning balance | $ 28,186 | $ 28,142 |
| Provision for loan losses (1) | 3,222 | 750 |
| Charge-offs | (792) | (2,294) |
| Recoveries | 467 | 202 |
| Ending balance | $ 31,083 | $ 26,800 |

| | FDIC Loss Sharing Receivable For the Three Months Ended September 30, | |
|---|---|---|
| (amounts in thousands) | 2014 | 2013 |
| Beginning balance | $ 8,919 | $ 14,169 |
| (Decreased)/Increased estimated cash flows (2) | (1,813) | 0 |
| Other activity, net (a) | 741 | (125) |
| Cash receipts from FDIC | (1,852) | (3,006) |
| Ending balance | $ 5,995 | $ 11,038 |
| (1) Provision for loan losses | $ 3,222 | $ 750 |
| (2) Effect attributable to FDIC loss share arrangements | 1,813 | 0 |
| Net amount reported as provision for loan losses | $ 5,035 | $ 750 |

(a) Includes external costs, such as legal fees, real estate taxes, and appraisal expenses, which qualify for reimbursement under loss sharing arrangements

The following table presents changes in the allowance for loan losses and the FDIC loss sharing receivable for the nine months ended September 30, 2014 and 2013.

| | Allowance for Loan Losses For the Nine Months Ended September 30, | |
|---|---|---|
| (amounts in thousands) | 2014 | 2013 |
| Beginning balance | $ 23,998 | $ 25,837 |
| Provision for loan losses (1) | 8,853 | 6,470 |

| | | | | |
|---|---|---|---|---|
| Charge-offs | | (2,733) | | (5,950) |
| Recoveries | | 965 | | 443 |
| Ending balance | $ | 31,083 | $ | 26,800 |

| | FDIC Loss Sharing Receivable For the Nine Months Ended September 30, | | | |
|---|---|---|---|---|
| (amounts in thousands) | | 2014 | | 2013 |
| Beginning balance | $ | 10,046 | $ | 12,343 |
| (Decreased)/Increased estimated cash flows (2) | | (3,435) | | 3,722 |
| Other activity, net (a) | | 2,713 | | 1,107 |
| Cash receipts from FDIC | | (3,329) | | (6,134) |
| Ending balance | $ | 5,995 | $ | 11,038 |
| (1) Provision for loan losses | $ | 8,853 | $ | 6,470 |
| (2) Effect attributable to FDIC loss share arrangements | | 3,435 | | (3,722) |
| Net amount reported as provision for loan losses | $ | 12,288 | $ | 2,748 |

(a) Includes external costs, such as legal fees, real estate taxes, and appraisal expenses, which qualify for reimbursement under loss sharing arrangements.

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*Loans Individually Evaluated for Impairment* ***Covered and Non-Covered***

The following tables present the recorded investment (net of charge-offs), unpaid principal balance, and related allowance for loans that are individually evaluated for impairment as of September 30, 2014 and December 31, 2013 and the average recorded investment and interest income recognized for the three and nine months ended September 30, 2014 and 2013. Purchased-credit-impaired loans are considered to be performing and are not included in the tables below.

| | September 30, 2014 | | | For the Three Months Ended September 30, 2014 | | For the Nine Months Ended September 30, 2014 | |
|---|---|---|---|---|---|---|---|
| (amounts in thousands) | Recorded Investment Net of Charge offs | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized | Average Recorded Investment | Interest Income Recognized |
| **With no related allowance recorded:** | | | | | | | |
| Commercial and industrial | $ 15,765 | $ 16,183 | $ | $ 15,377 | $ 216 | $ 13,690 | $ 520 |
| Commercial real estate | 23,993 | 24,138 | | 20,817 | 288 | 18,978 | 634 |
| Construction | 2,325 | 3,594 | | 2,325 | | 2,438 | |
| Consumer | 21 | 21 | | 52 | | 27 | |
| Residential real estate | 1,913 | 1,913 | | 1,924 | | 2,157 | 19 |
| **With an allowance recorded:** | | | | | | | |
| Commercial and industrial | 2,120 | 2,120 | 1,066 | 1,888 | 11 | 1,770 | 26 |
| Commercial real estate | 1,322 | 1,322 | 841 | 2,118 | 3 | 2,234 | 5 |
| Construction | 1,542 | 1,542 | 722 | 1,548 | | 1,449 | |
| Consumer | 114 | 114 | 32 | 84 | | 74 | 1 |
| Residential real estate | 343 | 343 | 235 | 296 | | 273 | 1 |
| **Total** | $ 49,458 | $ 51,290 | $ 2,896 | $ 46,429 | $ 518 | $ 43,090 | $ 1,206 |

| | December 31, 2013 | | | For the Three Months Ended September 30, 2013 | | For the Nine Months Ended September 30, 2013 | |
|---|---|---|---|---|---|---|---|
| (amounts in thousands) | Recorded Investment Net of Charge offs | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized | Average Recorded Investment | Interest Income Recognized |
| **With no related allowance recorded:** | | | | | | | |
| Commercial and industrial | $ 13,097 | $ 13,159 | $ | $ 12,400 | $ 177 | $ 8,202 | $ 453 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Commercial real estate | 14,397 | 15,249 | | 22,205 | 116 | 24,338 | 537 |
| Construction | 2,777 | 4,046 | | 4,220 | 4 | 5,462 | 9 |
| Consumer | | | | 49 | 6 | 75 | 8 |
| Residential real estate | 2,831 | 2,831 | | 2,550 | 10 | 2,588 | 27 |
| **With an allowance recorded:** | | | | | | | |
| Commercial and industrial | 2,469 | 3,739 | 829 | 2,755 | 30 | 1,637 | 108 |
| Commercial real estate | 2,261 | 3,167 | 946 | 5,922 | 152 | 6,768 | 166 |
| Construction | 1,132 | 1,132 | 351 | 3,255 | 11 | 4,185 | 11 |
| Consumer | 64 | 64 | 17 | 27 | 3 | 64 | 4 |
| Residential real estate | 252 | 252 | 199 | 504 | 4 | 939 | 5 |
| **Total** | $ 39,280 | $ 43,639 | $ 2,342 | $ 53,887 | $ 513 | $ 54,258 | $ 1,328 |

*Troubled Debt Restructurings*

At September 30, 2014 and 2013, there were $5.5 million and $6.9 million, respectively, in loans reported as troubled debt restructurings ( TDRs ). TDRs are reported as impaired loans in the calendar year of their restructuring and are evaluated to determine whether they should be placed on non-accrual status. In subsequent years, a TDR may be returned to accrual status if it satisfies a minimum six-month performance requirement; however, it will remain classified as impaired. Generally, the Bancorp requires sustained performance for nine months before returning a TDR to accrual status.

Modification of purchased-credit-impaired loans that are accounted for within loan pools in accordance with the accounting standards for purchased-credit-impaired loans do not result in the removal of these loans from the pool even if modifications would otherwise be considered a TDR. Accordingly, as each pool is accounted for as a single asset with a single composite interest rate and an aggregate expectation of cash flows, modifications of loans within such pools are not considered TDRs.

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The following is an analysis of loans modified in a troubled debt restructuring by type of concession for the three and nine months ended September 30, 2014 and 2013. There were no modifications that involved forgiveness of debt.

| (amounts in thousands) | TDRs in Compliance with Their Modified Terms and Accruing Interest | TDRs in Compliance with Their Modified Terms and Not Accruing Interest | Total |
|---|---|---|---|
| **Three Months Ended September 30, 2014** | | | |
| Extended under forbearance | $ 81 | $ 0 | $ 81 |
| Multiple extensions resulting from financial difficulty | 0 | 0 | 0 |
| Interest-rate reductions | 0 | 168 | 168 |
| Total | $ 81 | $ 168 | $ 249 |
| **Nine Months Ended September 30, 2014** | | | |
| Extended under forbearance | $ 448 | $ 0 | $ 448 |
| Multiple extensions resulting from financial difficulty | 0 | 0 | 0 |
| Interest-rate reductions | 47 | 471 | 518 |
| Total | $ 495 | $ 471 | $ 966 |
| **Three Months Ended September 30, 2013** | | | |
| Extended under forbearance | $ 0 | $ 0 | $ 0 |
| Multiple extensions resulting from financial difficulty | 0 | 0 | 0 |
| Interest-rate reductions | 0 | 12 | 12 |
| Total | $ 0 | $ 12 | $ 12 |
| **Nine Months Ended September 30, 2013** | | | |
| Extended under forbearance | $ 0 | $ 0 | $ 0 |
| Multiple extensions resulting from financial difficulty | 0 | 0 | 0 |
| Interest-rate reductions | 93 | 1,179 | 1,272 |
| Total | $ 93 | $ 1,179 | $ 1,272 |

The following table provides, by class, the number of loans modified in troubled debt restructurings and the related recorded investment during the three and nine months ended September 30, 2014 and 2013.

| | TDRs in Compliance with Their Modified Terms and Accruing Interest | | TDRs in Compliance with Their Modified Terms and Not Accruing Interest | |
|---|---|---|---|---|
| (amounts in thousands) | Number of Loans | Recorded Investment | Number of Loans | Recorded Investment |
| **Three Months Ended September 30, 2014** | | | | |
| Commercial and industrial | 0 | $ 0 | 0 | $ 0 |
| Commercial real estate | 0 | 0 | 0 | 0 |
| Construction | 0 | 0 | 0 | 0 |
| Manufactured housing | 0 | 0 | 2 | 168 |
| Residential real estate | 0 | 0 | 0 | 0 |
| Consumer | 2 | 81 | 0 | 0 |
| Total | 2 | $ 81 | 2 | $ 168 |
| **Nine Months Ended September 30, 2014** | | | | |
| Commercial and industrial | 0 | $ 0 | 0 | $ 0 |
| Commercial real estate | 0 | 0 | 0 | 0 |
| Construction | 0 | 0 | 0 | 0 |
| Manufactured housing | 1 | 47 | 7 | 471 |
| Residential real estate | 0 | 0 | 0 | 0 |
| Consumer | 9 | 448 | 0 | 0 |
| Total | 10 | $ 495 | 7 | $ 471 |

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| | TDRs in Compliance with Their Modified Terms and Accruing Interest | | TDRs in Compliance with Their Modified Terms and Not Accruing Interest | |
|---|---|---|---|---|
| (amounts in thousands) | Number of Loans | Recorded Investment | Number of Loans | Recorded Investment |
| **Three Months Ended September 30, 2013** | | | | |
| Commercial and industrial | 0 | $ 0 | 0 | $ 0 |
| Commercial real estate | 0 | 0 | 0 | 0 |
| Construction | 0 | 0 | 0 | 0 |
| Manufactured housing | 0 | 0 | 1 | 12 |
| Residential real estate | 0 | 0 | 0 | 0 |
| Consumer | 0 | 0 | 0 | 0 |
| Total | 0 | $ 0 | 1 | $ 12 |
| **Nine Months Ended September 30, 2013** | | | | |
| Commercial and industrial | 0 | $ 0 | 0 | $ 0 |
| Commercial real estate | 0 | 0 | 0 | 0 |
| Construction | 0 | 0 | 0 | 0 |
| Manufactured housing | 2 | 60 | 11 | 1,179 |
| Residential real estate | 0 | 0 | 0 | 0 |
| Consumer | 1 | 33 | 0 | 0 |
| Total | 3 | $ 93 | 11 | $ 1,179 |

At September 30, 2014 and 2013, there were no commitments to lend additional funds to debtors whose terms have been modified in troubled debt restructuring.

For the three and nine months ended September 30, 2014 and 2013, the recorded investment of loans determined to be TDRs was $0.2 million, $1.0 million, $12 thousand and $1.3 million, respectively, both before and after restructuring. During the three month period ended September 30, 2014, two manufactured housing TDR loans defaulted with a recorded investment of $0.2 million. During the nine month period ended September 30, 2014, seven manufactured housing TDR loans defaulted with a recorded investment of $0.5 million. There were no TDRs that defaulted in the three and nine month periods ended September 30, 2013.

Loans modified in troubled debt restructurings are evaluated for impairment. The nature and extent of impairment of TDRs, including those which have experienced a subsequent default, is considered in the determination of an appropriate level of allowance for credit losses. There were no specific allowances resulting from TDR modifications during the three and nine months ended September 30, 2014 and 2013.

*Credit Quality Indicators*

Commercial and industrial, commercial real estate, residential real estate and construction loans are rated based on an internally assigned risk rating system which is assigned at the time of loan origination and reviewed on a periodic or

on an as needed basis. Consumer, mortgage warehouse and manufactured housing loans are evaluated based on the payment activity of the loan and are not assigned internal risk ratings.

To facilitate the monitoring of credit quality within the commercial and industrial, commercial real estate, construction, and residential real estate classes, and for purposes of analyzing historical loss rates used in the determination of the allowance for loan losses for the respective portfolio class, the Bank utilizes the following categories of risk ratings: pass/satisfactory (includes risk rating 1 through 6), special mention, substandard, doubtful, and loss. The risk rating categories, which are derived from standard regulatory rating definitions, are assigned upon initial approval of credit to borrowers and updated periodically thereafter. Pass/satisfactory ratings, which are assigned to those borrowers who do not have identified potential or well-defined weaknesses and for whom there is a high likelihood of orderly repayment, are updated periodically based on the size and credit characteristics of the borrower. All other categories are updated on a quarterly basis during the month preceding the end of the calendar quarter. While assigning risk ratings involves judgment, the risk-rating process allows management to identify riskier credits in a timely manner and allocate the appropriate resources to manage those loans.

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The risk rating grades are defined as follows:

1 *Pass/Excellent*

Loans rated 1 represent a credit extension of the highest quality. The borrower s historic (at least five years) cash flows manifest extremely large and stable margins of coverage. Balance sheets are conservative, well capitalized, and liquid. After considering debt service for proposed and existing debt, projected cash flows continue to be strong and provide ample coverage. The borrower typically reflects broad geographic and product diversification and has access to alternative financial markets.

2 *Pass/Superior*

Loans rated 2 are those for which the borrower has a strong financial condition, balance sheet, operations, cash flow, debt capacity and coverage with ratios better than industry norms. The borrowers of these loans exhibit a limited leverage position, borrowers are virtually immune to local economies in stable growing industries, and where management is well respected and the company has ready access to public markets.

3 *Pass/Strong*

Loans rated 3 are those loans for which the borrower has above average financial condition and flexibility; more than satisfactory debt service coverage, balance sheet and operating ratios are consistent with or better than industry peers, have little industry risk, move in diversified markets and are experienced and competent in their industry. These borrowers access to capital markets is limited mostly to private sources, often secured, but the borrower typically has access to a wide range of refinancing alternatives.

4 *Pass/Good*

Loans rated 4 have a sound primary and secondary source of repayment. The borrower may have access to alternative sources of financing, but sources are not as widely available as they are to a higher grade borrower. These loans carry a normal level of risk, with very low loss exposure. The borrower has the ability to perform according to the terms of the credit facility. The margins of cash flow coverage are satisfactory but vulnerable to more rapid deterioration than the higher quality loans.

5 *Satisfactory*

Loans rated 5 are extended to borrowers who are determined to be a reasonable credit risk and demonstrate the ability to repay the debt from normal business operations. Risk factors may include reliability of margins and cash flows, liquidity, dependence on a single product or industry, cyclical trends, depth of management, or limited access to alternative financing sources. The borrower s historical financial information may indicate erratic performance, but current trends are positive and the quality of financial information is adequate, but is not as detailed and sophisticated as information found on higher grade loans. If adverse circumstances arise, the impact on the borrower may be significant.

6 *Satisfactory/Bankable with Care*

Loans rated 6 are those for which the borrower has higher than normal credit risk; however, cash flow and asset values are generally intact. These borrowers may exhibit declining financial characteristics, with increasing leverage and decreasing liquidity and may have limited resources and access to financial alternatives. Signs of weakness in these

borrowers may include delinquent taxes, trade slowness and eroding profit margins.

7 *Special Mention*

Loans rated Special Mention are credit facilities that may have potential developing weaknesses and deserve extra attention from the account manager and other management personnel. In the event that potential weaknesses are not corrected or mitigated, deterioration in the ability of the borrower to repay the debt in the future may occur. This grade is not assigned to loans that bear certain peculiar risks normally associated with the type of financing involved, unless circumstances have caused the risk to increase to a level higher than would have been acceptable when the credit was originally approved. Loans where significant actual, not potential, weaknesses or problems are clearly evident are graded in the category below.

8 *Substandard*

Loans are classified Substandard when the loans are inadequately protected by the current sound worth and payment capacity of the obligor or of the collateral pledged, if any. Loans so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt and are characterized by the distinct possibility that the Company will sustain some loss if the weaknesses are not corrected.

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9 *Doubtful*

The Bank assigns a doubtful rating to loans that have all the attributes of a substandard rating with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The possibility of loss is extremely high, but because of certain important and reasonable specific pending factors that may work to the advantage of and strengthen the credit quality of the loan, its classification as an estimated loss is deferred until its more exact status may be determined. Pending factors may include a proposed merger or acquisition, liquidation proceeding, capital injection, perfecting liens on additional collateral or refinancing plans.

10 *Loss*

The Bank assigns a loss rating to loans considered uncollectible and of such little value that their continuance as an active asset is not warranted. Amounts classified as loss are immediately charged off.

Risk ratings are not established for home equity loans, consumer loans, and installment loans, mainly because these portfolios consist of a larger number of homogenous loans with smaller balances. Instead, these portfolios are evaluated for risk mainly based upon aggregate payment history through the monitoring of delinquency levels and trends and are classified as performing and nonperforming. The following tables present the credit ratings of the **non-covered** loan portfolio as of September 30, 2014 and December 31, 2013:

| | September 30, 2014 | | | |
|---|---|---|---|---|
| (amounts in thousands) | **Commercial and Industrial** | **Commercial Real Estate** | **Construction** | **Residential Real Estate** |
| Pass/Satisfactory | $ 417,350 | $ 3,123,392 | $ 56,131 | $ 288,554 |
| Special Mention | 13,461 | 21,674 | 21 | 4 |
| Substandard | 2,106 | 8,914 | 451 | 1,607 |
| Total loans receivable, non-covered | $ 432,917 | $ 3,153,980 | $ 56,603 | $ 290,621 |

| (amounts in thousands) | **Consumer** | **Mortgage Warehouse** | **Manufactured Housing** |
|---|---|---|---|
| Performing | $ 1,684 | $ 8 | $ 118,169 |
| Nonperforming (1) | 0 | 0 | 11,629 |
| Total loans receivable, non-covered | $ 1,684 | $ 8 | $ 129,798 |

**December 31, 2013**

**Construction**

| (amounts in thousands) | Commercial and Industrial | Commercial Real Estate | | Residential Real Estate |
|---|---|---|---|---|
| Pass/Satisfactory | $ 228,748 | $ 1,808,804 | $ 34,822 | $ 142,588 |
| Special Mention | 10,314 | 12,760 | 29 | 940 |
| Substandard | 447 | 13,622 | 2,050 | 1,660 |
| Total loans receivable, non-covered | $ 239,509 | $ 1,835,186 | $ 36,901 | $ 145,188 |

| (amounts in thousands) | Consumer | Mortgage Warehouse | Manufactured Housing |
|---|---|---|---|
| Performing | $ 2,144 | $ 866 | $ 127,330 |
| Nonperforming (1) | 0 | 0 | 12,141 |
| Total loans receivable, non-covered | $ 2,144 | $ 866 | $ 139,471 |

(1) Includes loans that are past due and still accruing interest and loans on nonaccrual status.

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The following tables present the credit ratings of the **covered** loan portfolio as of September 30, 2014 and December 31, 2013:

| | September 30, 2014 | | | |
|---|---|---|---|---|
| (amounts in thousands) | Commercial and Industrial | Commercial Real Estate | Construction | Residential Real Estate |
| Pass/Satisfactory | $ 3,179 | $ 9,271 | $ 0 | $ 11,361 |
| Special Mention | 0 | 5,333 | 0 | 0 |
| Substandard | 341 | 3,762 | 6,755 | 1,408 |
| Total loans receivable, covered | $ 3,520 | $ 18,366 | $ 6,755 | $ 12,769 |

| (amounts in thousands) | Manufactured Housing |
|---|---|
| Performing | $ 2,901 |
| Nonperforming (1) | 152 |
| Total loans receivable, covered | $ 3,053 |

| | December 31, 2013 | | | |
|---|---|---|---|---|
| (amounts in thousands) | Commercial and Industrial | Commercial Real Estate | Construction | Residential Real Estate |
| Pass/Satisfactory | $ 3,688 | $ 14,330 | $ 1,967 | $ 14,137 |
| Special Mention | 223 | 2,989 | 0 | 455 |
| Substandard | 1,903 | 6,939 | 12,660 | 4,141 |
| Total loans receivable, covered | $ 5,814 | $ 24,258 | $ 14,627 | $ 18,733 |

| (amounts in thousands) | Manufactured Housing |
|---|---|
| Performing | $ 3,226 |
| Nonperforming (1) | 67 |
| Total loans receivable, covered | $ 3,293 |

(1) Includes loans that are past due and still accruing interest and loans on nonaccrual status.

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***Allowance for loan losses***

The changes in the allowance for loan losses for the three and nine months ended September 30, 2014 and 2013 and the loans and allowance for loan losses by loan class based on impairment evaluation method are as follows. The amounts presented for the provision for loan losses below do not include the effect of changes to estimated benefits resulting from the FDIC loss share arrangements for the covered loans.

| (amounts in thousands) | Commercial and Industrial | Commercial Real Estate | Construction | Residential Real Estate | Manufactured Housing | Consumer | Mortgage Warehouse | Total |
|---|---|---|---|---|---|---|---|---|
| **Three Months Ended September 30, 2014** | | | | | | | | |
| Beginning Balance, July 1, 2014 | $ 3,193 | $ 20,089 | $ 2,187 | $ 2,028 | $ 401 | $ 138 | $ 150 | $ 28,186 |
| Charge-offs | (91) | (278) | (284) | (139) | 0 | 0 | 0 | (792) |
| Recoveries | 67 | 369 | 4 | 23 | 0 | 4 | 0 | 467 |
| Provision for loan losses | 1,335 | 2,139 | (208) | 217 | (80) | (31) | (150) | 3,222 |
| Ending Balance, September 30, 2014 | $ 4,504 | $ 22,319 | $ 1,699 | $ 2,129 | $ 321 | $ 111 | $ 0 | $ 31,083 |
| | | | | | | | | |
| **Nine Months Ended September 30, 2014** | | | | | | | | |
| Beginning Balance, January 1, 2014 | $ 2,638 | $ 15,705 | $ 2,385 | $ 2,490 | $ 614 | $ 130 | $ 36 | $ 23,998 |
| Charge-offs | (536) | (1,438) | (284) | (442) | 0 | (33) | 0 | (2,733) |
| Recoveries | 292 | 395 | 7 | 265 | 0 | 6 | 0 | 965 |
| Provision for loan losses | 2,110 | 7,657 | (409) | (184) | (293) | 8 | (36) | 8,853 |
| Ending Balance, September 30, 2014 | $ 4,504 | $ 22,319 | $ 1,699 | $ 2,129 | $ 321 | $ 111 | $ 0 | $ 31,083 |
| **At September 30, 2014** | | | | | | | | |
| **Loans:** | | | | | | | | |
| Individually evaluated for impairment | $ 17,885 | $ 25,315 | $ 3,867 | $ 2,256 | $ 0 | $ 135 | $ 0 | $ 49,458 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Collectively evaluated for impairment | 417,012 | 3,107,732 | 54,920 | 290,722 | 128,594 | 1,285 | 8 | 4,000,273 |
| Loans acquired with credit deterioration | 1,540 | 39,299 | 4,571 | 10,412 | 4,257 | 264 | 0 | 60,343 |
| Total loans receivable, excluding deferred fees and costs | $ 436,437 | $ 3,172,346 | $ 63,358 | $ 303,390 | $ 132,851 | $ 1,684 | $ 8 | $ 4,110,074 |
| **Allowance for loan losses:** | | | | | | | | |
| Individually evaluated for impairment | $ 1,066 | $ 841 | $ 722 | $ 235 | $ 0 | $ 32 | $ 0 | $ 2,896 |
| Collectively evaluated for impairment | 3,179 | 15,756 | 391 | 917 | 88 | 29 | 0 | 20,360 |
| Loans acquired with credit deterioration | 259 | 5,722 | 586 | 977 | 233 | 50 | 0 | 7,827 |
| Total Allowance for loan losses | $ 4,504 | $ 22,319 | $ 1,699 | $ 2,129 | $ 321 | $ 111 | $ 0 | $ 31,083 |

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| (amounts in thousands) | Commercial and Industrial | Commercial Real Estate | Construction | Residential Real Estate | Manufactured Housing | Consumer | Mortgage Warehouse | Residual Reserve | Total |
|---|---|---|---|---|---|---|---|---|---|
| **Three Months Ended September 30, 2013** | | | | | | | | | |
| Beginning Balance, July 1, 2013 | $ 2,485 | $ 16,685 | $ 4,317 | $ 3,552 | $ 678 | $ 106 | $ 56 | $ 263 | $ 28,142 |
| Charge-offs | (1,311) | (851) | 0 | (116) | 0 | (16) | 0 | 0 | (2,294) |
| Recoveries | 16 | 186 | 0 | 0 | 0 | 0 | 0 | 0 | 202 |
| Provision for loan losses | 2,029 | (349) | (1,163) | (216) | 1 | 13 | (14) | 449 | 750 |
| Ending Balance, September 30, 2013 | $ 3,219 | $ 15,671 | $ 3,154 | $ 3,220 | $ 679 | $ 103 | $ 42 | $ 712 | $ 26,800 |
| **Nine Months Ended September 30, 2013** | | | | | | | | | |
| Beginning Balance, January 1, 2013 | $ 1,477 | $ 15,439 | $ 3,991 | $ 3,233 | $ 750 | $ 154 | $ 71 | $ 722 | $ 25,837 |
| Charge-offs | (1,407) | (2,742) | (1,470) | (315) | 0 | (16) | 0 | 0 | (5,950) |
| Recoveries | 181 | 246 | 0 | 7 | 0 | 9 | 0 | 0 | 443 |
| Provision for loan losses | 2,968 | 2,728 | 633 | 295 | (71) | (44) | (29) | (10) | 6,470 |
| Ending Balance, September 30, 2013 | $ 3,219 | $ 15,671 | $ 3,154 | $ 3,220 | $ 679 | $ 103 | $ 42 | $ 712 | $ 26,800 |
| **At September 30, 2013** | | | | | | | | | |
| **Loans:** | | | | | | | | | |
| Individually evaluated for impairment | $ 20,162 | $ 22,910 | $ 3,978 | $ 3,205 | $ 0 | $ 75 | $ 0 | $ 0 | $ 50,330 |
| | 195,857 | 1,449,009 | 39,058 | 134,582 | 140,869 | 1,258 | 1,006 | 0 | 1,961,639 |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Collectively evaluated for impairment | | | | | | | | | |
| Loans acquired with credit deterioration | 4,601 | 48,634 | 13,830 | 14,949 | 5,189 | 556 | 0 | 0 | 87,759 |
| Total loans receivable, excluding deferred fees and costs | $ 220,620 | $ 1,520,553 | $ 56,866 | $ 152,736 | $ 146,058 | $ 1,889 | $ 1,006 | $ 0 | $ 2,099,728 |
| **Allowance for loan losses:** | | | | | | | | | |
| Individually evaluated for impairment | $ 961 | $ 2,233 | $ 368 | $ 187 | $ 0 | $ 1 | $ 0 | $ 0 | $ 3,750 |
| Collectively evaluated for impairment | 1,991 | 8,315 | 241 | 1,115 | 80 | 40 | 42 | 712 | 12,536 |
| Loans acquired with credit deterioration | 267 | 5,123 | 2,545 | 1,918 | 599 | 62 | 0 | 0 | 10,514 |
| Total Allowance for loan losses | $ 3,219 | $ 15,671 | $ 3,154 | $ 3,220 | $ 679 | $ 103 | $ 42 | $ 712 | $ 26,800 |

The non-covered manufactured housing portfolio was purchased in August 2010. A portion of the purchase price may be used to reimburse the Bank under the specified terms in the purchase agreement for defaults of the underlying borrower and other specified items. At September 30, 2014 and 2013, funds available for reimbursement, if necessary, were $3.2 million and $2.7 million, respectively. Each quarter, these funds are evaluated to determine if they would be sufficient to absorb the probable incurred losses within the manufactured housing portfolio.

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The changes in accretable yield related to purchased-credit-impaired loans for the three and nine months ended September 30, 2014 and 2013 were as follows:

| **For the Three Months Ended September 30,** (amounts in thousands) | **2014** | **2013** |
|---|---|---|
| Accretable yield balance, beginning of period | $ 19,691 | $ 27,649 |
| Accretion to interest income | (839) | (1,362) |
| Reclassification from nonaccretable difference and disposals, net | (378) | (754) |
| Accretable yield balance, end of period | $ 18,474 | $ 25,533 |

| **For the Nine Months Ended September 30,** (amounts in thousands) | **2014** | **2013** |
|---|---|---|
| Accretable yield balance, beginning of period | $ 22,557 | $ 32,174 |
| Accretion to interest income | (2,462) | (5,034) |
| Reclassification from nonaccretable difference and disposals, net | (1,621) | (1,607) |
| Accretable yield balance, end of period | $ 18,474 | $ 25,533 |

**NOTE 9 BORROWINGS**

On June 26, 2014, Customers Bancorp, Inc. closed a private placement transaction in which it issued $25 million of 4.625% senior notes due 2019, and Customers Bank closed a private placement transaction in which it issued $110 million of fixed-to-floating rate subordinated notes due 2029. The aggregate net proceeds from the sale of the notes totaled $133.1 million.

The senior notes bear interest at a rate of 4.625%, and interest will be paid semi-annually in arrears in June and December. The subordinated notes will bear interest at an annual fixed rate of 6.125% until June 26, 2024, and interest will be paid semiannually. From June 26, 2024, the subordinated notes will bear an annual interest rate equal to three-month LIBOR plus 344.3 basis points until maturity on June 26, 2029. Customers Bank has the ability to call the subordinated notes, in whole or in part, at a redemption price equal to 100 percent of the principal balance at certain times on or after June 26, 2024.

The subordinated notes qualify as Tier 2 capital for regulatory capital purposes.

During the nine months ended September 30, 2014, Customers Bank borrowed $275 million of long-term FHLB advances. On May 13, 2014, $100 million was issued at a fixed rate of 1.04% with a maturity date of May 15, 2017. On May 20, 2014, there were two additional issuances of $50 million, at fixed rates of 0.54 % and 1.44%, maturing on May 20, 2016 and May 21, 2018, respectively. On September 9, 2014, $75 million was issued at a fixed rate of 1.30% with a maturity date of September 11, 2017.

**NOTE 10 SHARE-BASED COMPENSATION**

The following information includes the effects of changes in stock options and exercise prices and restricted stock units resulting from the 10% stock dividend declared on May 15, 2014 and issued on June 30, 2014.

*Stock Options*

There were no stock options granted during the three months ended September 30, 2014. During the nine months ended September 30, 2014, options to purchase an aggregate of 114,978 shares of voting common stock were granted to certain officers and team members. The options are subject to five-year cliff vesting. The fair values of the options were estimated using the Black-Scholes option pricing model. The following table presents the weighted-average assumptions used and the resulting weighted-average fair value of each option granted.

| | September 30, 2014 |
|---|---|
| Weighted-average risk-free interest rate | 2.20% |
| Expected dividend yield | 0.00% |
| Weighted-average expected volatility | 17.55% |
| Weighted-average expected life (in years) | 7.00 |
| Weighted-average fair value of each option granted | $ 4.45 |

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The following table summarizes stock option activity for the nine months ended September 30, 2014.

| | Number of Options | Weighted-average Exercise Price | Weighted-average Remaining Contractual Term in Years | Aggregate Intrinsic Value |
|---|---|---|---|---|
| | (dollars in thousands, except Weighted-average exercise price) | | | |
| Outstanding at January 1, 2014 | 3,057,435 | $ 12.42 | | |
| Granted | 114,978 | 17.71 | | |
| Forfeited | (12,096) | 17.68 | | |
| Outstanding at September 30, 2014 | 3,160,317 | $ 12.59 | 7.44 | $ 16,996 |
| Exercisable at September 30, 2014 | 13,683 | $ 16.67 | 2.79 | $ 48 |

There were no restricted stock units granted during the three months ended September 30, 2014. During the nine months ended September 30, 2014, 157,459 restricted stock units were granted to certain officers and team members. Of the aggregate restricted stock units, 52,537 were granted under the Bonus Recognition and Retention Program and are subject to five-year cliff vesting. The remainders are subject to three-year cliff vesting. The following table summarizes restricted stock activity for the nine months ended September 30, 2014.

| | Restricted Stock Units | Weighted-average Grant-date Fair Value |
|---|---|---|
| Outstanding and unvested at January 1, 2014 | 674,810 | $ 11.81 |
| Granted | 157,459 | 17.65 |
| Vested | (37,857) | 10.91 |
| Forfeited | (4,597) | 13.54 |
| Outstanding and unvested at September 30, 2014 | 789,815 | $ 13.00 |

Total share-based compensation expense for the nine months ended September 30, 2014 and 2013 was $3.1 million and $2.5 million, respectively.

Customers Bancorp has a policy that permits its directors to elect to receive shares of voting common stock in lieu of their cash retainers. In January 2014, Customers Bancorp issued 28,095 shares of voting common stock with a fair value of $0.5 million to the directors as compensation for their services during 2013. During the nine months ended September 30, 2014, Customers Bancorp issued 22,560 shares of voting common stock with a fair value of $0.4 million to directors as compensation for their services during the first nine months of 2014. The fair values were determined based on the opening price of the common stock on the day the shares were issued.

**NOTE 11 REGULATORY MATTERS**

The Bank and the Bancorp are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet the minimum capital requirements can result in certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Bancorp s financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank and Bancorp must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance sheet items, as calculated under the regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

Quantitative measures established by regulation to ensure capital adequacy require the Bank and Bancorp to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital to risk-weighted assets and of Tier 1 capital to average assets (as defined in the regulations). At September 30, 2014 and December 31, 2013, the Bank and Bancorp met all capital adequacy requirements to which they were subject.

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To be categorized as well capitalized, an institution must maintain minimum total risk based, Tier 1 risk based and Tier 1 leveraged ratios as set forth in the following table:

| | Actual | | For Capital Adequacy Purposes | | To Be Well Capitalized Under Prompt Corrective Action Provisions | |
|---|---|---|---|---|---|---|
| (dollars in thousands) | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| **As of September 30, 2014:** | | | | | | |
| **Total capital (to risk weighted assets)** | | | | | | |
| Customers Bancorp, Inc. | $ 563,506 | 11.22% | $ 401,910 | 8.0% | N/A | N/A |
| Customers Bank | $ 589,714 | 11.81% | $ 399,448 | 8.0% | $ 499,310 | 10.0% |
| **Tier 1 capital (to risk weighted assets)** | | | | | | |
| Customers Bancorp, Inc. | $ 422,423 | 8.41% | $ 200,955 | 4.0% | N/A | N/A |
| Customers Bank | $ 448,631 | 8.99% | $ 199,724 | 4.0% | $ 299,586 | 6.0% |
| **Tier 1 capital (to average assets)** | | | | | | |
| Customers Bancorp, Inc. | $ 422,423 | 7.07% | $ 239,016 | 4.0% | N/A | N/A |
| Customers Bank | $ 448,631 | 7.55% | $ 237,820 | 4.0% | $ 297,275 | 5.0% |
| **As of December 31, 2013:** | | | | | | |
| **Total capital (to risk weighted assets)** | | | | | | |
| Customers Bancorp, Inc. | $ 411,527 | 13.21% | $ 249,196 | 8.0% | N/A | N/A |
| Customers Bank | $ 435,432 | 14.11% | $ 246,936 | 8.0% | $ 308,670 | 10.0% |
| **Tier 1 capital (to risk weighted assets)** | | | | | | |
| Customers Bancorp, Inc. | $ 387,529 | 12.44% | $ 124,598 | 4.0% | N/A | N/A |
| Customers Bank | $ 411,434 | 13.33% | $ 123,468 | 4.0% | $ 185,202 | 6.0% |
| **Tier 1 capital (to average assets)** | | | | | | |
| Customers Bancorp, Inc. | $ 387,529 | 10.11% | $ 153,310 | 4.0% | N/A | N/A |
| Customers Bank | $ 411,434 | 10.81% | $ 152,191 | 4.0% | $ 190,239 | 5.0% |

**NOTE 12 DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS**

The Bancorp uses fair value measurements to record fair value adjustments to certain assets and liabilities and to disclose the fair value of its financial instruments. FASB ASC 825, *Financial Instruments*, requires disclosure of the estimated fair value of an entity s assets and liabilities considered to be financial instruments. For the Bancorp, as for most financial institutions, the majority of its assets and liabilities are considered to be financial instruments. However, many of these instruments lack an available trading market as characterized by a willing buyer and willing seller engaging in an exchange transaction. For fair value disclosure purposes, the Bancorp utilized certain fair value measurement criteria under the FASB ASC 820, *Fair Value Measurements and Disclosures*, as explained below.

In accordance with ASC 820, the fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Bancorp s various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument.

The fair value guidance provides a consistent definition of fair value, focusing on an exit price in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment. The fair value is a reasonable point within the range that is most representative of fair value under current market conditions.

| | |
|---|---|
| Level 1: | Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities. |
| Level 2: | Quoted prices in markets that are not active, or inputs that are observable either directly or indirectly, for substantially the full term of the asset or liability. |
| Level 3: | Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported with little or no market activity). |

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A financial instrument s level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

The following methods and assumptions were used to estimate the fair values of the Bancorp s financial instruments as of September 30, 2014 and December 31, 2013:

**Cash and cash equivalents:**

The carrying amounts reported in the balance sheet for cash and cash equivalents approximate those assets fair values. These assets are included as Level 1 fair values, based upon the lowest level of input that is significant to the fair value measurements.

**Investment securities:**

The fair value of investment securities available for sale are determined by obtaining quoted market prices on nationally recognized and foreign securities exchanges (Level 1), matrix pricing (Level 2), which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific securities but rather by relying on the securities relationship to other benchmark quoted prices, or externally developed models that use unobservable inputs due to limited or no market activity of the instrument (Level 3). These assets are included as Level 1, 2, or 3 fair values, based upon the lowest level of input that is significant to the fair value measurements.

The carrying amount of FHLB, Federal Reserve Bank, and other restricted stock approximates fair value, and considers the limited marketability of such securities. These assets are included as Level 2 fair values, based upon the lowest level of input that is significant to the fair value measurements.

**Loans held for sale - Residential mortgage loans:**

The Bancorp generally estimates the fair values of residential mortgage loans held for sale based on commitments on hand from investors within the secondary market for loans with similar characteristics. These assets are included as Level 2 fair values, based upon the lowest level of input that is significant to the fair value measurements.

**Loans held for sale - Mortgage warehouse loans:**

The fair value of mortgage warehouse loans is the amount of cash initially advanced to fund the mortgage, plus accrued interest and fees, as specified in the respective agreements. The loan is used by mortgage companies as short-term bridge financing between the funding of mortgage loans and the finalization of the sale of the loans to an investor. Changes in fair value are not expected to be recognized since at inception of the transaction the underlying loans have already been sold to an approved investor. Additionally, the interest rate is variable, and the transaction is short-term, with an average life of 17 days from purchase to sale. These assets are included as Level 2 fair values, based upon the lowest level of input that is significant to the fair value measurements.

**Loans held for sale Multi-family loans:**

The fair values of multi-family loans held for sale are estimated using pricing indications from letters of intent with third party investors or recent sale transactions within the secondary markets for loans with similar characteristics. These assets are included as Level 3 fair values, based upon the lowest level of input that is significant to the fair value measurements.

**Loans receivable, net of allowance for loan losses:**

The fair values of loans held for investment are estimated using discounted cash flow analyses, using market rates at the balance sheet date that reflect the credit and interest rate-risk inherent in the loans. Projected future cash flows are calculated based upon contractual maturity or call dates, projected repayments and prepayments of principal. Generally, for variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. These assets are included as Level 3 fair values, based upon the lowest level of input that is significant to the fair value measurements.

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**Impaired loans:**

Impaired loans are those that are accounted for under ASC 450, *Contingencies*, in which the Bancorp has measured impairment generally based on the fair value of the loan s collateral. Fair value is generally determined based upon independent third-party appraisals of the properties that collateralize the loans, or discounted cash flows based upon the expected proceeds. These assets are included as Level 3 fair values, based upon the lowest level of input that is significant to the fair value measurements.

**FDIC loss sharing receivable:**

The FDIC loss sharing receivable is measured separately from the related covered assets, as it is not contractually embedded in the assets and is not transferable with the assets should the assets be sold. Fair value is estimated using projected cash flows related to the loss sharing agreements based on the estimated losses to be incurred on the loans and the expected reimbursements for losses using the applicable loss share percentages. These cash flows are discounted to reflect the estimated timing of the receipt of the loss share reimbursement from the FDIC. This asset is included as Level 3 fair value, based upon the lowest level of input that is significant to the fair value measurements.

**Other real estate owned:**

The fair value of OREO is determined using appraisals, which may be discounted based on management s review and changes in market conditions (Level 3 Inputs). All appraisals must be performed in accordance with the Uniform Standards of Professional Appraisal Practice ( USPAP ). Appraisals are certified to the Bancorp and performed by appraisers on the Bancorp s approved list of appraisers. Evaluations are completed by a person independent of management. The content of the appraisal depends on the complexity of the property. Appraisals are completed on a retail value and an as is value . These assets are included as Level 3 fair values, based upon the lowest level of input that is significant to the fair value measurements.

**Accrued interest receivable and payable:**

The carrying amount of accrued interest receivable and accrued interest payable approximates its fair value. These assets and liabilities are included as Level 2 fair values, based upon the lowest level of input that is significant to the fair value measurements.

**Deposit liabilities:**

The fair values disclosed for deposits (e.g., interest and noninterest checking, passbook savings and money market deposit accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). These liabilities are included as Level 1 fair values, based upon the lowest level of input that is significant to the fair value measurements. Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered in the market on certificates to a schedule of aggregated expected monthly maturities on time deposits. These liabilities are included as Level 2 fair values, based upon the lowest level of input that is significant to the fair value measurements.

**Federal funds purchased:**

For these short-term instruments, the carrying amount is considered a reasonable estimate of fair value. These liabilities are included as Level 1 fair values, based upon the lowest level of input that is significant to the fair value measurements.

**Borrowings:**

Borrowings consist of long-term and short-term FHLB advances, five-year senior unsecured notes, and subordinated debt. For the short-term borrowings, the carrying amount is considered a reasonable estimate of fair value and is included as Level 1. Fair values of long-term FHLB advances are estimated using discounted cash flow analysis, based on quoted prices for new FHLB advances with similar credit risk characteristics, terms and remaining maturity. The prices obtained from this active market represent a market value that is deemed to represent the transfer price if the liability were assumed by a third party. Fair values of privately placed subordinated and senior unsecured debt are estimated by a third-party financial advisor using discounted cash flow analysis, based on market rates currently offered on such debt with similar credit-risk characteristics, terms and remaining maturity. These liabilities are included as Level 2 fair values, based upon the lowest level of input that is significant to the fair value measurements. The $63 million senior unsecured notes issued during third quarter 2013 are traded on The NASDAQ Stock Market, and their price can be obtained daily. This fair value measurement is classified as Level 1.

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**Derivatives (Assets and Liabilities):**

The fair values of interest rate swaps and credit derivatives are determined using models that incorporate readily observable market data into a market standard methodology. This methodology nets the discounted future fixed cash receipts and the discounted expected variable cash payments. The discounted variable cash payments are based on expectations of future interest rates derived from observable market interest rate curves. In addition, fair value is adjusted for the effect of nonperformance risk by incorporating credit valuation adjustments for the Bancorp and its counterparties. These assets and liabilities are included as Level 2 fair values, based upon the lowest level of input that is significant to the fair value measurements.

The fair values of the residential mortgage loan commitments are derived from the estimated fair values that can be generated when the underlying mortgage loan is sold in the secondary market. The Bancorp uses commitments on hand from third party investors to estimate an exit price, and adjusts for the probability of the commitment being exercised based on the Bancorp s internal experience (i.e., pull-through rate). These assets and liabilities are included as Level 3 fair values, based upon the lowest level of input that is significant to the fair value measurements.

**Off-balance-sheet financial instruments:**

Fair values for the Bancorp s off-balance-sheet financial instruments (lending commitments and letters of credit) are based on fees currently charged in the market to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties credit standing. These financial instruments are included as Level 2 fair values, based upon the lowest level of input that is significant to the fair value measurements.

The following information should not be interpreted as an estimate of the fair value of the entire Bancorp since a fair value calculation is only provided for a limited portion of the Bancorp s assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making these estimates, comparisons between the Bancorp s disclosures and those of other companies may not be meaningful.

The estimated fair values of the Bancorp s financial instruments were as follows at September 30, 2014 and December 31, 2013.

| | | | Fair Value Measurements at September 30, 2014 | | |
|---|---|---|---|---|---|
| (amounts in thousands) | Carrying Amount | Estimated Fair Value | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| **Assets:** | | | | | |
| Cash and cash equivalents | $ 331,306 | $ 331,306 | $ 331,306 | $ 0 | $ 0 |
| Investment securities, available for sale | 409,303 | 409,303 | 21,784 | 387,519 | 0 |
| Loans held for sale | 1,395,720 | 1,396,972 | 0 | 1,231,039 | 165,933 |
| | 4,079,052 | 4,232,480 | 0 | 0 | 4,232,480 |

| | | | | | |
|---|---|---|---|---|---|
| Loans receivable, net of allowance for loan losses | | | | | |
| FHLB, Federal Reserve Bank and other restricted stock | 85,732 | 85,732 | 0 | 85,732 | 0 |
| Accrued interest receivable | 13,744 | 13,744 | 0 | 13,744 | 0 |
| FDIC loss sharing receivable | 5,995 | 5,995 | 0 | 0 | 5,995 |
| Derivatives | 5,720 | 5,720 | 0 | 5,685 | 35 |
| **Liabilities:** | | | | | |
| Deposits | $ 4,284,140 | $ 4,303,335 | $ 770,664 | $ 3,532,671 | $ 0 |
| FHLB advances | 1,594,500 | 1,595,951 | 1,224,500 | 371,451 | 0 |
| Other borrowings | 88,250 | 90,913 | 65,780 | 25,133 | 0 |
| Subordinated debt | 112,000 | 113,001 | 0 | 113,001 | 0 |
| Derivatives | 6,127 | 6,127 | 0 | 6,127 | 0 |
| Accrued interest payable | 4,163 | 4,163 | 0 | 4,163 | 0 |

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| | | | Fair Value Measurements at December 31, 2013 | | |
|---|---|---|---|---|---|
| (amounts in thousands) | Carrying Amount | Estimated Fair Value | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| **Assets:** | | | | | |
| Cash and cash equivalents | $ 233,068 | $ 233,068 | $ 233,068 | $ 0 | $ 0 |
| Investment securities, available for sale | 497,573 | 497,573 | 20,714 | 476,859 | 0 |
| Loans held for sale | 747,593 | 747,593 | 0 | 747,593 | 0 |
| Loans receivable, net of allowance for loan losses | 2,441,080 | 2,444,900 | 0 | 0 | 2,444,900 |
| FHLB, Federal Reserve Bank and other stock | 43,514 | 43,514 | 0 | 43,514 | 0 |
| Accrued interest receivable | 8,362 | 8,362 | 0 | 8,362 | 0 |
| FDIC loss sharing receivable | 10,046 | 10,046 | 0 | 0 | 10,046 |
| Derivatives | 3,763 | 3,763 | 0 | 3,523 | 240 |
| **Liabilities:** | | | | | |
| Deposits | $ 2,959,922 | $ 2,977,948 | $ 536,116 | $ 2,441,832 | $ 0 |
| Federal funds purchased | 13,000 | 13,000 | 13,000 | 0 | 0 |
| FHLB advances | 706,500 | 708,025 | 596,500 | 111,525 | 0 |
| Other borrowings | 63,250 | 64,768 | 64,768 | 0 | 0 |
| Subordinated debt | 2,000 | 2,000 | 0 | 2,000 | 0 |
| Derivatives | 3,537 | 3,537 | 0 | 3,537 | 0 |
| Accrued interest payable | 1,675 | 1,675 | 0 | 1,675 | 0 |

For financial assets and liabilities measured at fair value on a recurring and nonrecurring basis, the fair value measurements by level within the fair value hierarchy used at September 30, 2014 and December 31, 2013 were as follows:

| | September 30, 2014 Fair Value Measurements at the End of the Reporting Period Using | | | |
|---|---|---|---|---|
| (amounts in thousands) | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total |
| **Measured at Fair Value on a Recurring Basis:** | | | | |

| | | | | |
|---|---|---|---|---|
| **Assets** | | | | |
| Available-for-sale securities: | | | | |
| Mortgage-backed securities | $ 0 | $ 387,519 | $ 0 | $ 387,519 |
| Equity securities | 21,784 | 0 | 0 | 21,784 |
| Derivatives (1) | 0 | 5,685 | 35 | 5,720 |
| Loans held for sale fair value option | 0 | 1,231,039 | 0 | 1,231,039 |
| Total assets - recurring fair value measurements | $ 21,784 | $ 1,624,243 | $ 35 | $ 1,646,062 |
| **Liabilities** | | | | |
| Derivatives (2) | $ 0 | $ 6,127 | $ 0 | $ 6,127 |
| **Measured at Fair Value on a Nonrecurring Basis:** | | | | |
| **Assets** | | | | |
| Impaired loans, net of specific reserves of $2,896 | $ 0 | $ 0 | $ 2,545 | $ 2,545 |
| Other real estate owned | 0 | 0 | 7,978 | 7,978 |
| Total assets - nonrecurring fair value measurements | $ 0 | $ 0 | $ 10,523 | $ 10,523 |

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| | December 31, 2013 Fair Value Measurements at the End of the Reporting Period Using | | | |
|---|---|---|---|---|
| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total |
| (amounts in thousands) | | | | |
| **Measured at Fair Value on a Recurring Basis:** | | | | |
| **Assets** | | | | |
| Available-for-sale securities: | | | | |
| Mortgage-backed securities | $ 0 | $ 451,536 | $ 0 | $ 451,536 |
| Corporate notes | 0 | 25,323 | 0 | 25,323 |
| Equity securities | 20,714 | 0 | 0 | 20,714 |
| Derivatives (1) | 0 | 3,523 | 240 | $ 3,736 |
| Loans held for sale fair value option | 0 | 747,593 | 0 | 747,593 |
| Total assets - recurring fair value measurements | $ 20,714 | $ 1,227,975 | $ 240 | $ 1,248,929 |
| **Liabilities** | | | | |
| Derivatives (2) | 0 | $ 3,537 | 0 | $ 3,537 |
| **Measured at Fair Value on a Nonrecurring Basis:** | | | | |
| **Assets** | | | | |
| Impaired loans, net of specific reserves of $2,342 | $ 0 | $ 0 | $ 3,836 | $ 3,836 |
| Other real estate owned | 0 | 0 | 335 | 335 |
| Total assets - nonrecurring fair value measurements | $ 0 | $ 0 | $ 4,171 | $ 4,171 |

(1) Included in Other Assets
(2) Included in Other Liabilities

The changes in Level 3 assets measured at fair value on a recurring basis for the three and nine months ended September 30, 2014 and 2013 are summarized as follows.

| For the Three Months Ended September 30, 2014 | Residential Mortgage Loan |
|---|---|

| | Commitments |
|---|---|
| (amounts in thousands) | |
| Balance at July 1, 2014 | $ 54 |
| Issuances | 35 |
| Settlements | (54) |
| Balance at September 30, 2014 | $ 35 |

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There were no Level 3 assets or liabilities measured a fair value on a recurring basis during the three months ended September 30, 2013.

| For the Nine Months Ended September 30, 2014 (amounts in thousands) | Residential Mortgage Loan Commitments |
|---|---|
| Balance at January 1, 2013 | $ 240 |
| Issuances | 192 |
| Settlements | (397) |
| Balance at September 30, 2014 | $ 35 |

| For the Nine Months Ended September 30, 2013 (amounts in thousands) | Loans Held for Sale (1) |
|---|---|
| Balance at January 1, 2013 | $ 0 |
| Transfer from Level 2 to Level 3 (1) | 3,173 |
| Recoveries | (1,463) |
| Sales | (1,013) |
| Transfer from loans held for sale to other assets (1) | (697) |
| Balance at September 30, 2013 | $ 0 |

(1) The Bancorp s policy is to recognize transfers between fair value levels when events or circumstances warrant transfers. There were no transfers between levels during the first nine months of 2014. During first quarter 2013, a suspected fraud was discovered in the Bank s loans held-for-sale portfolio. Total loans involved in this fraud initially appeared to be $5.2 million, and management believed the range of possible loss to have been between $1.5 million and $3.2 million. Accordingly, management provided a loss contingency of $2.0 million at March 31, 2013. Due to the uncertainty surrounding the amount of loss, management transferred these loans and the related loss contingency from Level 2 to Level 3. During second quarter 2013, the Bank determined that an aggregate of $1.0 million of the loans were not involved in the fraud, and these loans were subsequently sold. In addition, the Bank recovered $1.5 million in cash from the alleged perpetrator. Since it was determined that these assets no longer met the definition of a loan, and since the Bank is pursuing restitution through the involved parties, the Bank determined this to be a receivable. As a result, the remaining aggregate $2.7 million of loans and the related $2.0 million reserve were transferred to other assets.

The following table summarizes financial assets and financial liabilities measured at fair value as of September 30, 2014 and December 31, 2013 on a recurring and nonrecurring basis for which the Bancorp utilized Level 3 inputs to measure fair value.

| | Quantitative Information about Level 3 Fair Value Measurements | | | |
|---|---|---|---|---|
| **September 30, 2014** (amounts in thousands) | **Fair Value Estimate** | **Valuation Technique** | **Unobservable Input** | **Range (Weighted Average) (3)** |
| Impaired loans | $ 2,545 | Collateral appraisal (1) | Liquidation expenses (2) | -8% |
| Other real estate owned | $ 7,978 | Collateral appraisal (1) | Liquidation expenses (2) | -8% |
| Residential mortgage loan commitments | $ 35 | Adjusted market bid | Pull-through rate | 80% |

| | Quantitative Information about Level 3 Fair Value Measurements | | | |
|---|---|---|---|---|
| **December 31, 2013** (amounts in thousands) | **Fair Value Estimate** | **Valuation Technique** | **Unobservable Input** | **Range (Weighted Average) (3)** |
| Impaired loans | $ 3,836 | Collateral appraisal (1) | Liquidation expenses (2) | -3% to -8% (-5.5%) |
| Other real estate owned | $ 335 | Collateral appraisal (1) | Liquidation expenses (2) | -3% to -8% (-5.5%) |
| Residential mortgage loan commitments | $ 240 | Adjusted market bid | Pull-through rate | 80% |

(1) Obtained from approved independent appraisers. Appraisals are current and in compliance with credit policy. The Bancorp does not discount appraisals.
(2) Fair value is adjusted for costs to sell.
(3) Presented as a percentage of the value determined by appraisal.

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## NOTE 13 DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

### Risk Management Objectives of Using Derivatives

Customers Bancorp is exposed to certain risks arising from both its business operations and economic conditions. Customers Bancorp manages economic risks, including interest rate, liquidity, and credit risk, primarily by managing the amount, sources, and durations of its assets and liabilities. Specifically, Customers Bancorp enters into derivative financial instruments to manage exposures that arise from business activities that result in the receipt or payment of future known and uncertain cash amounts, the value of which are determined by interest rates. Customers Bancorp s derivative financial instruments are used to manage differences in the amount, timing, and duration of Customers Bancorp s known or expected cash receipts and its known or expected cash payments principally related to certain fixed-rate borrowings. Customers Bancorp also has interest-rate derivatives resulting from a service provided to certain qualifying customers, and therefore, they are not used to manage the Bank s interest-rate risk in assets or liabilities. The Bank manages a matched book with respect to its derivative instruments used in this customer service in order to minimize its net risk exposure resulting from such transactions.

### Cash Flow Hedges of Interest Rate Risk

Customers Bancorp s objectives in using interest-rate derivatives are to add stability to interest expense and to manage exposure to interest rate movements. To accomplish this objective, the Bancorp primarily uses interest rate swaps as part of its interest-rate-risk management strategy. Interest-rate swaps designated as cash flow hedges involve the receipt of variable amounts from a counterparty in exchange for the Bancorp making fixed-rate payments over the life of the agreements without exchange of the underlying notional amount.

The effective portion of changes in the fair value of derivatives designated and qualifying as cash flow hedges is recorded in accumulated other comprehensive income and is subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings. During the three and nine months ended September 30, 2014, such derivatives were used to hedge the variable cash flows associated with a forecasted issuance of debt. The ineffective portion of the change in fair value of the derivatives is to be recognized directly in earnings. During the three and nine months ended September 30, 2014, Customers Bancorp did not record any hedge ineffectiveness.

Amounts reported in accumulated other comprehensive income related to derivatives will be reclassified to interest expense as interest payments are made on the Bancorp s variable-rate debt. The Bancorp does not expect to reclassify any amounts from accumulated other comprehensive income to interest expense during the next 12 months as Customers Bancorp s derivatives are effective after April 2016.

Customers Bancorp is hedging its exposure to the variability in future cash flows for forecasted transactions over a maximum period of 24 months (excluding forecasted transactions related to the payment of variable interest on existing financial instruments).

At September 30, 2014, Customers Bancorp had one outstanding interest rate derivative with a notional amount of $150.0 million that was designated as a cash flow hedge of interest rate risk.

### Derivatives Not Designated as Hedging Instruments

The Bank executes interest rate swaps with commercial banking customers to facilitate their respective risk management strategies (typically the loan customers will swap a floating rate loan to a fixed rate loan). The customer interest rate swaps are simultaneously offset by interest rate swaps that the Bank executes with a third party in order to

minimize interest rate risk exposure resulting from such transactions. Since the interest rate swaps associated with this program do not meet the hedge accounting requirements, changes in the fair value of both the customer swaps and the offsetting third-party market swaps are recognized directly in earnings. At September 30, 2014, the Bancorp had 42 interest rate swaps with an aggregate notional amount of $249.6 million related to this program. At December 31, 2013, the Bancorp had 28 interest rate swaps with an aggregate notional amount of $150.3 million related to this program.

The Bank enters into residential mortgage loan commitments in connection with its mortgage banking activities to fund mortgage loans at specified rates and times in the future. These commitments are short-term in nature and generally expire in 30 to 60 days. The residential mortgage loan commitments that relate to the origination of mortgage loans that will be held for sale are considered derivative instruments under applicable accounting guidance and are reported at fair value, with changes in fair value recorded directly to earnings. At September 30, 2014 and December 31, 2013, the Bank had an outstanding notional balance of residential mortgage loan commitments of $1.8 million and $7.1 million, respectively.

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During first quarter 2014, the Bank purchased credit derivatives to hedge the performance risk associated with one of its counterparties. These derivatives are not designated as hedging instruments and are reported at fair value, with changes in fair value reported directly in earnings. At September 30, 2014, the Bank had an outstanding notional balance of credit derivatives of $13.4 million.

**Fair Value of Derivative Instruments on the Balance Sheet**

The following table presents the fair value of the Bancorp s derivative financial instruments as well as their classification on the balance sheet as of September 30, 2014 and December 31, 2013.

| | September 30, 2014 | | | |
|---|---|---|---|---|
| | Derivative Assets | | Derivative Liabilities | |
| | Balance Sheet Location | Fair Value | Balance Sheet Location | Fair Value |
| (amounts in thousands) | | | | |
| Derivatives designated as cash flow hedges: | | | | |
| Interest rate swaps | Other assets | $ 0 | Other liabilities | $ 296 |
| Total | | $ 0 | | $ 296 |
| Derivatives not designated as hedging instruments: | | | | |
| Interest rate swaps | Other assets | $ 5,556 | Other liabilities | $ 5,831 |
| Credit contracts | Other assets | 129 | Other liabilities | 0 |
| Residential mortgage loan commitments | Other assets | 35 | Other liabilities | 0 |
| Total | | $ 5,720 | | $ 5,831 |

| | December 31, 2013 | | | |
|---|---|---|---|---|
| | Derivative Assets | | Derivative Liabilities | |
| | Balance Sheet Location | Fair Value | Balance Sheet Location | Fair Value |
| (amounts in thousands) | | | | |
| Derivatives not designated as hedging instruments: | | | | |
| Interest rate swaps | Other assets | $ 3,523 | Other liabilities | $ 3,537 |
| Residential mortgage loan commitments | Other assets | 240 | Other liabilities | 0 |
| Total | | $ 3,763 | | $ 3,537 |

**Effect of Derivative Instruments on Comprehensive Income**

The following tables present the effect of the Bancorp s derivative financial instruments on comprehensive income for the three and nine months ended September 30, 2014 and 2013.

| | Three Months Ended September 30, 2014 | |
|---|---|---|
| | Income Statement Location | Amount of Income (Loss) Recognized in Earnings |
| (amounts in thousands) | | |
| Derivatives not designated as hedging instruments: | | |
| Interest rate swaps | Other non-interest income | $ 47 |
| Credit contracts | Other non-interest income | (4) |
| Residential mortgage loan commitments | Mortgage loan and banking income | (19) |
| Total | | $ 24 |

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| | Three Months Ended September 30, 2013 | |
|---|---|---|
| | Income Statement Location | Amount of Income Recognized in Earnings |
| (amounts in thousands) | | |
| Derivatives not designated as hedging instruments: | | |
| Interest rate swaps | Other non-interest income | $ 38 |

| | Nine Months Ended September 30, 2014 | |
|---|---|---|
| | Income Statement Location | Amount of Loss Recognized in Earnings |
| (amounts in thousands) | | |
| Derivatives not designated as hedging instruments: | | |
| Interest rate swaps | Other non-interest income | $ 686 |
| Credit contracts | Other non-interest income | (139) |
| Residential mortgage loan commitments | Mortgage loan and banking income | (205) |
| Total | | $ 342 |

| | Nine Months Ended September 30, 2013 | |
|---|---|---|
| | Income Statement Location | Amount of Income Recognized in Earnings |
| (amounts in thousands) | | |
| Derivatives not designated | | |

| | | |
|---|---|---|
| as hedging instruments: | | |
| Interest rate swaps | Other non-interest income | $ 236 |

| | Three Months Ended September 30, 2014 | | |
|---|---|---|---|
| | Amount of Gain (Loss) Recognized in OCI on Derivatives (Effective Portion)(1) | Location of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) | Amount of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) |
| (amounts in thousands) | | | |
| Derivative in cash flow hedging relationships: | | | |
| Interest rate swaps | $ 426 | Interest expense | $ 0 |

| | Nine Months Ended September 30, 2014 | | |
|---|---|---|---|
| | Amount of Gain (Loss) Recognized in OCI on Derivatives (Effective Portion)(1) | Location of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) | Amount of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) |
| (amounts in thousands) | | | |
| Derivative in cash flow hedging relationships: | | | |
| Interest rate swaps | $ (196) | Interest expense | $ 0 |

(1) Net of taxes

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**Credit-risk-related Contingent Features**

By entering into derivative contracts, the Bank is exposed to credit risk. The credit risk associated with derivatives executed with Bank customers is the same as that involved in extending the related loans and is subject to the same standard credit policies. To mitigate the credit-risk exposure to major derivative dealer counterparties, the Bancorp only enters into agreements with those counterparties that maintain credit ratings of high quality.

Agreements with major derivative dealer counterparties contain provisions whereby default on any of the Bancorp s indebtedness would be considered a default on its derivative obligations. The Bancorp also has entered into agreements that contain provisions under which the counterparty could require the Bancorp to settle its obligations if the Bancorp fails to maintain its status as a well/adequately-capitalized institution. As of September 30, 2014, the fair value of derivatives in a net liability position (which includes accrued interest but excludes any adjustment for nonperformance-risk) related to these agreements was $6.1million. In addition, the Bancorp has minimum collateral posting thresholds with certain of these counterparties, and at September 30, 2014 had posted $7.0 million of cash as collateral. The Bancorp records cash posted as collateral as a reduction in the outstanding balance of cash and cash equivalents and an increase in the balance of other assets.

**Disclosures about Offsetting Assets and Liabilities**

The following tables present derivative instruments that are subject to enforceable master netting arrangements. The Bancorp s interest rate swaps with institutional counterparties are subject to master netting arrangements and are included in the table below. Interest rate swaps with commercial banking customers and residential mortgage loan commitments are not subject to master netting arrangements and are excluded from the table below. The Bancorp has not made a policy election to offset its derivative positions.

**Offsetting of Financial Assets and Derivative Assets**

**At September 30, 2014**

| (amounts in thousands) | Gross Amount of Recognized Assets | Gross Amounts Offset in the Consolidated Balance Sheet | Net Amounts of Assets Presented in the Consolidated Balance Sheet | Gross Amounts not Offset in the Consolidated Balance Sheet Financial Instrument | Cash Collateral Received | Net Amount |
|---|---|---|---|---|---|---|
| Description | | | | | | |
| Interest rate swap derivatives with institutional counterparties | $ 108 | $ 0 | $ 108 | $ 108 | $ 0 | $ 0 |

**Offsetting of Financial Liabilities and Derivative Liabilities**

**At September 30, 2014**

| (amounts in thousands) | Gross Amount of Recognized Liabilities | Gross Amounts Offset in the Consolidated Balance Sheet | Net Amounts of Liabilities Presented in the Consolidated Balance Sheet | Gross Amounts not Offset in the Consolidated Balance Sheet Financial Instruments | Cash Collateral Pledged | Net Amount |
|---|---|---|---|---|---|---|
| Description | | | | | | |
| Interest rate swap derivatives with institutional counterparties | $ 6,026 | $ 0 | $ 6,026 | $ 108 | $ 5,918 | $ 0 |

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**Offsetting of Financial Assets and Derivative Assets**

**At December 31, 2013**

| (amounts in thousands) | Gross Amount of Recognized Assets | Gross Amounts Offset in the Consolidated Balance Sheet | Net Amounts of Assets Presented in the Consolidated Balance Sheet | Gross Amounts not Offset in the Consolidated Balance Sheet Financial Instruments | Cash Collateral Received | Net Amount |
|---|---|---|---|---|---|---|
| Description | | | | | | |
| Interest rate swap derivatives with institutional counterparties | $ 392 | $ 0 | $ 392 | $ 392 | $ 0 | $ 0 |

**Offsetting of Financial Liabilities and Derivative Liabilities**

**At December 31, 2013**

| (amounts in thousands) | Gross Amount of Recognized Liabilities | Gross Amounts Offset in the Consolidated Balance Sheet | Net Amounts of Liabilities Presented in the Consolidated Balance Sheet | Gross Amounts not Offset in the Consolidated Balance Sheet Financial Instruments | Cash Collateral Pledged | Net Amount |
|---|---|---|---|---|---|---|
| Description | | | | | | |
| Interest rate swap derivatives with institutional counterparties | $ 3,191 | $ 0 | $ 3,191 | $ 392 | $ 2,799 | $ 0 |

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**ITEM 2. Management s Discussion and Analysis of Financial Condition and Results of Operations.**

**Cautionary Note Regarding Forward-Looking Statements**

This report and all attachments hereto as well as other written or oral communications made from time to time by Customers Bancorp may contain certain forward-looking information within the meaning of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended. These statements relate to future events or future predictions, including events or predictions relating to future financial performance, and are generally identifiable by the use of forward-looking terminology such as believes, expects, may, will, should, plan, in anticipates, strategies or the negative thereof or comparable terminology, or by discussion of strategy that involve risks and uncertainties. These forward-looking statements are only predictions and estimates regarding future events and circumstances and involve known and unknown risks, uncertainties and other factors, including the risks described under Risk Factors that may cause actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by such forward-looking statements. This information is based on various assumptions that may not prove to be correct. These forward-looking statements are subject to significant uncertainties and contingencies, many of which are beyond the control of the Bancorp and the Bank. Although the expectations reflected in the forward-looking statements are currently believed to be reasonable, future results, levels of activity, performance or achievements cannot be guaranteed. Accordingly, there can be no assurance that actual results will meet expectations or will not be materially lower than the results contemplated in this report and attachments hereto. You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this report or, in the case of documents referred to, the dates of those documents. Neither Customers Bancorp nor the Bank undertakes any obligation to release publicly or otherwise provide any revisions to these forward-looking statements to reflect events or circumstances after the date of this report or to reflect the occurrence of unanticipated events, except as may be required under applicable law.

Management s discussion and analysis represents an overview of the financial condition and results of operations, and highlights the significant changes in the financial condition and results of operations, as presented in the accompanying consolidated financial statements for Customers Bancorp, a financial holding company, and its wholly owned subsidiaries, including Customers Bank. This information is intended to facilitate your understanding and assessment of significant changes and trends related to Customers Bancorp s financial condition and results of operations as of and for the three and nine months ended September 30, 2014. All quarterly information in this Management s Discussion and Analysis is unaudited. You should read this section in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operation included in Customers Bancorp s filing on Form 10-K for the fiscal year ended December 31, 2013.

**Critical Accounting Policies**

We have adopted various accounting policies that govern the application of accounting principles generally accepted in the United States of America and that are consistent with general practices within the banking industry in the preparation of our financial statements. Our significant accounting policies are described in NOTE 3 SIGNIFICANT ACCOUNTING POLICIES AND BASIS OF PRESENTATION to our audited financial statements included in our 2013 Form 10-K and updated in this report on Form 10-Q for the quarterly period ended September 30, 2014.

Certain accounting policies involve significant judgments and assumptions by Customers Bancorp that have a material impact on the carrying value of certain assets and liabilities. We consider these accounting policies to be critical accounting policies. The judgment and assumptions used are based on historical experience and other factors, which are believed to be reasonable under the circumstances. Because of the nature of the judgments and assumptions

management makes, actual results could differ from these judgments and estimates, which could have a material impact on the carrying values of our assets and liabilities and our results of operations. There have been no material changes in our critical accounting policies, judgments and estimates, including assumptions or estimation techniques utilized, as compared to those disclosed in our 2013 Form 10-K.

**Third Quarter Events of Note**

Following a successful 2013 and first half of 2014, Customers Bancorp continued its strong performance through third quarter 2014. Most notably, total assets were $6.5 billion at September 30, 2014, an increase of $0.9 billion from June 30, 2014 and $2.4 billion from December 31, 2013. During third quarter 2014, the Bancorp achieved significant organic loan and deposit growth as loan balances increased $0.8 billion and deposits grew $0.6 billion. During third quarter 2014, multi-family loans increased $357 million, commercial loans (including commercial real estate) increased $256 million and warehouse loans increased $187 million. Asset quality remained high and capital ratios exceeded levels established for well-capitalized banks. Financial results for third quarter 2014 included strong earnings of $11.7 million, a record high, or $0.42 per diluted share. Return on average common equity continued to trend upwards, reaching 11.0% for third quarter 2014, and the efficiency ratio declined to 54.5%. During the quarter, Customers sold approximately $100 million of multi-family loans in a market-based transaction, which resulted in a gain on sale of $0.7 million.

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## Results of Operations

### *Third Quarter 2014 Compared to Third Quarter 2013*

Net income available to common shareholders increased $3.4 million (41.0%) to $11.7 million for the three months ended September 30, 2014, compared to $8.3 million for the three months ended September 30, 2013. The increased net income resulted from increased net interest income of $13.0 million, decreased income tax expense of $0.6 million and increased non-interest income of $0.4 million, partially offset by increased non-interest expense of $6.3 million, and increased provision for loan losses of $4.3 million.

Net interest income increased $13.0 million (47.9%) for the three months ended September 30, 2014 to $40.2 million, compared to $27.2 million for the three months ended September 30, 2013. This increase resulted principally from an increase in average loan balances of $2.0 billion, offset in part by a 31 basis point decrease in average yields on interest earning assets to 3.55% net of a 1 basis point decrease in the cost of funding. The reduced yields are primarily driven by a decrease in market interest rates on loans, payoffs on maturing higher yielding loans, and growth of multi-family loans, which have higher credit quality but yield less than the average yield on the current loan portfolio.

The provision for loan losses increased by $4.3 million to $5.0 million for the three months ended September 30, 2014, compared to $0.8 million for the same period in 2013. The increase in the provision for loan losses during third quarter 2014 was primarily driven by growth in the portfolio of loans held for investment and reduced estimated benefits from the FDIC loss sharing receivable.

Non-interest income increased $0.4 million during the three months ended September 30, 2014 to $5.1 million, compared to $4.7 million for the three months ended September 30, 2013. The increase in 2014 was primarily attributable to the gain on sale of loans (up $0.7 million), income from bank owned life insurance (up $0.4 million), mortgage loan and banking income (up $0.2 million), partially offset by a decrease in mortgage warehouse transactional fees (down $0.9 million).

Non-interest expense increased $6.3 million during the three months ended September 30, 2014 to $24.7 million, compared to $18.3 million during the three months ended September 30, 2013. Expenses increased in 2014 principally for salaries and employee benefits as staffing levels grew to support the growing business (up $3.1 million), assessment for FDIC insurance and other regulatory fees as the Bank grew and other costs were incurred (up $2.2 million), occupancy as the business expansion into new markets and increased activity in existing markets required additional facilities (up $0.6 million), professional services for loan workout, litigation, and other general regulatory matters (up $0.5 million), and technology, communication and bank operations to further support and build infrastructure (up $0.4 million), partially offset by decreased expenses associated with loan workout fees (down $0.5 million).

Income tax expense decreased $0.6 million in the three months ended September 30, 2014 to $3.9 million, compared to $4.5 million in the same period of 2013. The decrease in the income tax expense was primarily due to an adjustment that resulted from a return to provision and deferred tax analysis performed in the third quarter 2014.

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*Net Interest Income*

Net interest income (the difference between the interest earned on loans, investments and interest-earning deposits with banks, and interest paid on deposits, borrowed funds and subordinated debt) is the primary source of Customers Bancorp s earnings. The following table summarizes the Bancorp s net interest income and related spread and margin for the periods indicated.

| | Three Months Ended September 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2014 | | | 2013 | | |
| (amounts in thousands) | Average Balance | Interest Income or Expense | Average Yield or Cost (%) | Average Balance | Interest Income or Expense | Average Yield or Cost |
| **Assets** | | | | | | |
| Interest earning deposits | $ 244,013 | $ 154 | 0.25% | $ 230,992 | $ 148 | 0.26% |
| Investment securities, taxable (A) | 421,213 | 2,361 | 2.24 | 235,927 | 1,423 | 2.41 |
| Loans held for sale | 1,014,068 | 8,503 | 3.33 | 985,050 | 9,495 | 3.82 |
| Loans, taxable (B) | 3,950,977 | 39,446 | 3.96 | 1,982,117 | 22,363 | 4.48 |
| Loans, non-taxable (B) | 26,430 | 194 | 2.91 | 17,729 | 122 | 2.73 |
| Other interest-earning assets | 83,313 | 640 | 3.05 | 22,805 | 194 | 3.37 |
| **Total interest earning assets** | 5,740,014 | 51,298 | 3.55 | 3,474,620 | 33,745 | 3.86 |
| Non-interest earning assets | 238,223 | | | 158,661 | | |
| **Total assets** | $ 5,978,237 | | | $ 3,633,281 | | |
| **Liabilities** | | | | | | |
| Interest checking | $ 58,734 | $ 94 | 0.63% | $ 47,569 | $ 47 | 0.38% |
| Money market | 1,741,007 | 2,599 | 0.59 | 1,148,895 | 2,046 | 0.71 |
| Other savings | 42,117 | 43 | 0.40 | 32,576 | 39 | 0.47 |
| Certificates of deposit | 1,426,644 | 3,443 | 0.96 | 1,332,815 | 3,338 | 0.99 |
| Total interest bearing deposits | 3,268,502 | 6,179 | 0.75 | 2,561,855 | 5,470 | 0.85 |
| Borrowings | 1,674,576 | 4,905 | 1.17 | 244,149 | 1,077 | 1.76 |
| **Total interest-bearing liabilities** | 4,943,078 | 11,084 | 0.89 | 2,806,004 | 6,547 | 0.93 |
| Non-interest-bearing deposits | 596,497 | | | 439,276 | | |
| Total deposits & borrowings | 5,539,575 | | 0.79 | 3,245,280 | | 0.80 |
| Other non-interest bearing liabilities | 16,596 | | | 4,993 | | |
| **Total liabilities** | 5,556,171 | | | 3,250,273 | | |
| **Shareholders Equity** | 422,066 | | | 383,008 | | |

| | | | | |
|---|---|---|---|---|
| **Total liabilities and shareholders equity** | $ 5,978,237 | | $ 3,633,281 | |
| Net interest earnings | | 40,214 | | 27,198 |
| Tax-equivalent adjustment (C) | | 104 | | 66 |
| Net interest earnings | | $ 40,318 | | $ 27,264 |
| **Interest spread** | | 2.75% | | 3.05% |
| **Net interest margin** | | 2.78% | | 3.11% |
| **Net interest margin tax equivalent (C)** | | 2.79% | | 3.11% |

(A) For presentation in this table, average balances and the corresponding average rates for investment securities are based upon historical cost, adjusted for amortization of premiums and accretion of discounts.
(B) Includes non-accrual loans, the effect of which is to reduce the yield earned on loans, and deferred loan fees.
(C) Full tax-equivalent basis, using a 35% statutory tax rate to approximate interest income as a taxable asset.

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The following table presents the dollar amount of changes in interest income and interest expense for the major categories of interest-earning assets and interest-bearing liabilities. Information is provided for each category of interest-earning assets and interest-bearing liabilities with respect to (i) changes attributable to volume (i.e., changes in average balances multiplied by the prior-period average rate) and (ii) changes attributable to rate (i.e., changes in average rate multiplied by prior-period average balances). For purposes of this table, changes attributable to both rate and volume which cannot be segregated have been allocated proportionately to the change due to volume and the change due to rate.

| | Three Months Ended September 30, 2014 vs. 2013 | | |
|---|---|---|---|
| | Increase (Decrease) due to Change in | | |
| | Rate | Volume | Total |
| (amounts in thousands) | | | |
| **Interest income:** | | | |
| Interest earning deposits | $ (3) | $ 9 | $ 6 |
| Investment securities | (109) | 1,047 | 938 |
| Loans held for sale | (1,265) | 273 | (992) |
| Loans, taxable | (2,839) | 19,922 | 17,083 |
| Loans, non-taxable | 8 | 64 | 72 |
| Other interest-earning assets | (20) | 466 | 446 |
| **Total interest income** | (4,228) | 21,781 | 17,553 |
| **Interest expense:** | | | |
| Interest checking | 36 | 11 | 47 |
| Money market deposit accounts | (373) | 926 | 553 |
| Savings | (6) | 10 | 4 |
| Certificates of deposit | (124) | 229 | 105 |
| Total interest bearing deposits | (467) | 1,176 | 709 |
| Borrowings | (484) | 4,312 | 3,828 |
| **Total interest expense** | (951) | 5,488 | 4,537 |
| **Net interest income** | $ (3,277) | $ 16,293 | $ 13,016 |

Net interest income for the three months ended September 30, 2014 was $40.2 million, an increase of $13.0 million, or 47.9%, when compared to net interest income of $27.2 million for the three months ended September 30, 2013. This net increase was primarily the result of an increase of $2.3 billion in average interest-earning assets, offset by a decrease of 31 basis points in the average yield on interest-earning assets. As shown in the table above, both rate and volume changes within Loans, taxable had a significant effect on net interest income. Within Loans, taxable, changes in the following categories primarily were responsible for the net increase in loan volume:

- $1.2 billion increase in the average balance of multi-family loans due to growth of the multi-family lending business; and

- $579.0 million increase in the average balance of commercial loans primarily due to the growth of the commercial and industrial loan portfolio, including owner occupied commercial real estate loans.

These particular increases in loan volume were the result of concentrated efforts by Customers Bank s lending teams to execute an organic growth strategy.

Average interest-bearing liabilities for the three months ended September 30, 2014 increased by $2.1 billion when compared to average interest-bearing liabilities for the three months ended September 30, 2013. The related average cost of interest-bearing liabilities decreased 4 basis points; and the net impact of the increased volume and the decreased rate was a decrease of $4.5 million in net interest income. As shown in the table above, primarily volume changes within Borrowings had a significant effect on net interest income. Within Borrowings, changes in the following categories were responsible for the net increase in the volume of borrowings:

- $1.1 billion increase in the average balance of short-term FHLB advances; and

- $157.4 million increase in the average balance of subordinated and senior debt due to the issuances of $135.0 million in June 2014 and $63.3 million in July and August 2013.

The key measure of net interest income is net interest margin. Customers net interest margin (tax equivalent) decreased 32 basis points to 2.79% for the three months ended September 30, 2014 when compared to the net interest margin (tax equivalent) of 3.11% for the same period in 2013. The decrease resulted primarily from a decrease in the average yield on Loans, taxable from 4.48% to 3.96%, due to the maturity of higher-yielding loans and the growth of multi-family loan products, which have higher credit quality but yield less than the average yield on the third quarter 2013 loan portfolio.

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*Provision for Loan Losses*

Customers Bank has established an allowance for loan losses through a provision for loan losses charged as an expense on the consolidated statements of income. The loan portfolio is reviewed quarterly to evaluate the outstanding loans and to measure both the performance of the portfolio and the adequacy of the allowance for loan losses. At September 30, 2014, approximately 0.81% of the loan portfolio was covered under loss sharing agreements with the FDIC. Charge-offs incurred on the loans covered by the loss share agreements greater than the original estimated value are recorded as an increase to the provision for loan losses, and a corresponding receivable due from the FDIC is recorded as a reduction to the provision for loan losses for the portion anticipated to be recovered under the loss sharing agreements. Conversely, if the estimated cash flows on the covered loans increase, all or a portion of the previously recorded provision for loan losses will be reversed, and the corresponding receivable due from the FDIC will be written down as an increase to the provision for loan losses. The FDIC loss sharing receivable balance will be reduced through a charge to the provision for loan losses, with no offsetting reduction to the allowance for loan losses, as the FDIC loss sharing arrangements reach their contractual maturities and the estimated losses in the covered loans have not yet emerged or been realized in a final disposition event. The FDIC loss sharing arrangements for non-single family loans expire in third quarter 2015. The loss sharing arrangements for single family loans expire in third quarter 2020.

The provision for loan losses increased by $4.3 million to $5.0 million for the three months ended September 30, 2014, compared to $0.8 million for the same period in 2013. The increase in the 2014 provision was principally the result of growth in the portfolio of loans held for investment and a reduced benefit expected to be collected from the FDIC as the loss sharing arrangements for the non-single family loans approach their contractual maturity.

For more information about our provision and allowance for loan losses and our loss experience, see Credit Risk and Asset Quality herein.

*Non-Interest Income*

The table below presents the components of non-interest income for the three months ended September 30, 2014 and 2013.

| | Three Months Ended September 30, | |
|---|---|---|
| | 2014 | 2013 |
| (amounts in thousands) | | |
| Mortgage warehouse transactional fees | $ 2,154 | $ 3,090 |
| Bank-owned life insurance | 976 | 615 |
| Gain (loss) on sale of loans | 695 | (6) |
| Mortgage loan and banking income | 212 | 50 |
| Deposit fees | 192 | 198 |
| Other | 873 | 714 |
| Total non-interest income | $ 5,102 | $ 4,661 |

Non-interest income increased $0.4 million during the three months ended September 30, 2014 to $5.1 million, compared to $4.7 million for the three months ended September 30, 2013. The increase in 2014 was primarily attributable to the gain on sale of loans, which resulted from the sale of multi-family loans in a market-based

transaction (up $0.7 million), income from bank-owned life insurance (up $0.4 million) as a result of increased purchases during 2014, mortgage loan and banking income (up $0.2 million), partially offset by a decrease in mortgage warehouse transactional fees (down $0.9 million).

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*Non-Interest Expense*

The table below presents the components of non-interest expense for the three months ended September 30, 2014 and 2013.

| | Three Months Ended September 30, | |
|---|---|---|
| | 2014 | 2013 |
| (amounts in thousands) | | |
| Salaries and employee benefits | $ 12,070 | $ 8,963 |
| FDIC assessments, taxes and regulatory fees | 3,320 | 1,105 |
| Occupancy | 2,931 | 2,289 |
| Professional services | 1,671 | 1,191 |
| Technology, communications and bank operations | 1,485 | 1,121 |
| Other real estate owned | 603 | 401 |
| Loan workout | 388 | 928 |
| Advertising and promotion | 261 | 450 |
| Other | 1,950 | 1,899 |
| Total non-interest expense | $ 24,679 | $ 18,347 |

Non-interest expense was $24.7 million for the three months ended September 30, 2014, an increase of $6.3 million from non-interest expense of $18.3 million for the three months ended September 30, 2013.

Salaries and employee benefits, which represent the largest component of non-interest expense, increased $3.1 million (34.7%) to $12.1 million for the three months ended September 30, 2014. The primary reason for this increase was an increase in the number of employees from 356 full-time equivalents at September 30, 2013 to 400 full-time equivalents at September 30, 2014. This was directly related to the need for additional employees to support our organic growth and expansion into new markets. More specifically, the increased headcount is needed to support the growing multi-family, commercial real estate and commercial and industrial loan portfolios.

FDIC assessments, taxes and regulatory fees increased by $2.2 million, or 200.5%, to $3.3 million for the three months ended September 30, 2014 from $1.1 million for the three months ended September 30, 2013. The primary reasons for this increase were related to higher Pennsylvania bank shares tax expense that resulted from legislative changes to the tax calculation, growth of the Bank and increased deposit premiums and other regulatory and filing fees.

Occupancy expense increased by $0.6 million, or 28.0%, rising to $2.9 million for the three months ended September 30, 2014 from $2.3 million for the three months ended September 30, 2013. This increase was driven by the business expansion into new markets and increased activity in existing markets which required additional facilities.

Professional services expense increased by $0.5 million, or 40.3%, to $1.7 million for the three months ended September 30, 2014 from $1.2 million for the three months ended September 30, 2013. This increase was primarily attributable to higher legal and consulting expenses in 2014 related to loan workout, litigation and other general regulatory matters.

Technology, communication and bank operations increased by $0.4 million, or 32.5%, rising to $1.5 million for the three months ended September 30, 2014 from $1.1 million for the three months ended September 30, 2013. The primary reason for this increase was related to building the infrastructure to support growth through increased technology improvements and upgrades as well as the costs related to expanding technological platforms into new markets. This corresponds with our philosophy of high touch, high tech , whereby we provide an exceptional level of customer service supported by state-of-the-art technology.

Loan workout expense decreased $0.5 million, or 58.2%, falling to $0.4 million for the three months ended September 30, 2014 from $0.9 million for the three months ended September 30, 2013. Loan workout expenses fluctuate based on the level of non-performing loans and expenses incurred for delinquent loans.

*Income Taxes*

Income tax expense was $3.9 million and $4.5 million, respectively, for the three months ended September 30, 2014 and 2013. The decrease in 2014 was primarily due to an adjustment of $1.5 million that resulted from a return to provision and deferred tax analysis performed in the third quarter 2014. This adjustment resulted in an effective tax rate of 25% for the three months ended September 30, 2014, compared to an effective tax rate of 35% for the three months ended September 30, 2013.

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***Nine Months Ended September 30, 2014 Compared to Nine Months Ended September 30, 2013***

Customers Bancorp had net income available to common shareholders of $30.0 million for the nine months ended September 30, 2014, compared to $23.7 million for the nine months ended September 30, 2013, an increase of $6.4 million, or 26.8%. Diluted earnings per share were $1.08 for the nine months ended September 30, 2014 and $0.98 for the nine months ended September 30, 2013, an earnings increase of $0.10 per share.

*Net-Interest Income*

Net interest income (the difference between the interest earned on loans, investments and interest-earning deposits with other banks, and interest paid on deposits and borrowings) is the primary source of our earnings. The following table summarizes net interest income and the related spread and margin for the periods indicated:

| | Nine Months Ended September 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2014 | | | 2013 | | |
| (amounts in thousands) | Average Balance | Interest Income or Expense | Average Yield or Cost | Average Balance | Interest Income or Expense | Average Yield or Cost |
| **Assets** | | | | | | |
| Interest earning deposits | $ 214,215 | $ 403 | 0.25% | $ 194,903 | $ 370 | 0.25% |
| Investment securities, taxable (A) | 461,708 | 7,944 | 2.29 | 187,178 | 3,334 | 2.37 |
| Loans held for sale | 787,509 | 20,301 | 3.45 | 1,088,641 | 31,536 | 3.87 |
| Loans, taxable (B) | 3,433,885 | 102,677 | 4.00 | 1,688,317 | 57,489 | 4.55 |
| Loans, non-taxable (B) | 25,045 | 539 | 2.88 | 14,604 | 291 | 2.66 |
| Other interest-earning assets | 61,961 | 1,402 | 3.03 | 27,216 | 419 | 2.06 |
| **Total interest earning assets** | 4,984,323 | 133,266 | 3.57 | 3,200,859 | 93,439 | 3.90 |
| Non-interest earning assets | 220,389 | | | 126,331 | | |
| **Total assets** | $ 5,204,712 | | | $ 3,327,190 | | |
| **Liabilities** | | | | | | |
| Interest checking | $ 58,479 | $ 240 | 0.55% | $ 42,561 | $ 131 | 0.41% |
| Money market | 1,594,472 | 7,315 | 0.61 | 1,067,288 | 5,600 | 0.70 |
| Other savings | 41,920 | 133 | 0.42 | 29,652 | 109 | 0.49 |
| Certificates of deposit | 1,333,594 | 9,633 | 0.97 | 1,268,529 | 9,902 | 1.04 |
| Total interest bearing deposits | 3,028,465 | 17,321 | 0.76 | 2,408,030 | 15,742 | 0.87 |
| Borrowings | 1,136,675 | 9,008 | 1.06 | 258,021 | 1,757 | 0.91 |
| **Total interest-bearing liabilities** | 4,165,140 | 26,329 | 0.84 | 2,666,051 | 17,499 | 0.88 |
| Non-interest-bearing deposits | 615,956 | | | 321,935 | | |

| | | | | |
|---|---|---|---|---|
| Total deposits & borrowings | 4,781,096 | 0.74 | 2,987,986 | 0.78 |
| Other non-interest bearing liabilities | 14,963 | | 10,898 | |
| **Total liabilities** | 4,796,059 | | 2,998,884 | |
| **Shareholders equity** | 408,653 | | 328,306 | |
| **Total liabilities and shareholders equity** | $ 5,204,712 | | $ 3,327,190 | |
| Net interest earnings | | 106,937 | | 75,940 |
| Tax equivalent adjustment (C) | | 290 | | 157 |
| Net interest earnings | | $ 107,227 | | $ 76,097 |
| **Interest spread** | | 2.84% | | 3.12% |
| **Net interest margin** | | 2.87% | | 3.17% |
| **Net interest margin tax equivalent (C)** | | 2.88% | | 3.18% |

(A) For presentation in this table, balances and the corresponding average rates for investment securities are based upon historical cost, adjusted for amortization of premiums and accretion of discounts.
(B) Includes non-accrual loans, the effect of which is to reduce the yield earned on loans, and deferred loan fees.
(C) Full tax equivalent basis, using a 35% statutory tax rate to approximate interest income as a taxable asset.

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The following table presents the dollar amount of changes in interest income and interest expense for the major categories of interest-earning assets and interest-bearing liabilities. Information is provided for each category of interest-earning assets and interest-bearing liabilities with respect to (i) changes attributable to volume (i.e., changes in average balances multiplied by the prior-period average rate) and (ii) changes attributable to rate (i.e., changes in average rate multiplied by prior-period average balances). For purposes of this table, changes attributable to both rate and volume which cannot be segregated have been allocated proportionately to the change due to volume and the change due to rate.

| | Nine Months Ended September 30, 2014 vs. 2013 Increase (Decrease) due to Change in | | |
|---|---|---|---|
| | Rate | Volume | Total |
| (amounts in thousands) | | | |
| **Interest income:** | | | |
| Interest earning deposits | $ (4) | $ 37 | $ 33 |
| Investment securities | (116) | 4,726 | 4,610 |
| Loans held for sale | (3,199) | (8,036) | (11,235) |
| Loans, taxable | (7,773) | 52,961 | 45,188 |
| Loans, non-taxable | 25 | 223 | 248 |
| Other interest-earning assets | 265 | 718 | 983 |
| **Total interest income** | (10,802) | 50,629 | 39,827 |
| **Interest expense:** | | | |
| Interest checking | 51 | 58 | 109 |
| Money market deposit accounts | (773) | 2,488 | 1,715 |
| Savings | (17) | 41 | 24 |
| Certificates of deposit | (761) | 492 | (269) |
| Total interest bearing deposits | (1,500) | 3,079 | 1,579 |
| Borrowings | 332 | 6,919 | 7,251 |
| **Total interest expense** | (1,168) | 9,998 | 8,830 |
| **Net interest income** | $ (9,634) | $ 40,631 | $ 30,997 |

Net interest income for the nine months ended September 30, 2014 was $106.9 million, an increase of $31.0 million, or 40.8%, when compared to net interest income of $75.9 million for the nine months ended September 30, 2013. This net increase was primarily the result of an increase of $1.8 billion in average interest-earning assets, offset by a decrease of 33 basis points in the average yield on interest-earning assets. As shown in the table above, both rate and volume changes within Loans, taxable had a significant effect on net interest income. Within Loans, taxable, changes in the following categories primarily were responsible for the net increase in loan volume:

- $1.0 billion increase in the average balance of multi-family loans due to growth of the multi-family lending business; and

- $484.9 million increase in the average balance of commercial loans primarily due to the growth of the commercial and industrial loan portfolio, including owner occupied commercial real estate loans.

These particular increases in loan volume were the result of concentrated efforts by Customers Bank s lending teams to execute an organic growth strategy.

Average interest-bearing liabilities for the nine months ended September 30, 2014 increased by $1.5 billion when compared to average interest-bearing liabilities for the nine months ended September 30, 2013. The related average cost of interest-bearing liabilities decreased 4 basis points; and the net impact of the increased volume and the decreased rate was a decrease of $8.8 million in net interest income. As shown in the table above, primarily volume changes within Borrowings had a significant effect on net interest income. Within Borrowings, changes in the following categories were responsible for the net increase in the volume of borrowings:

- $728.3 million increase in the average balance of short-term FHLB advances; and

- $97.5 million increase in the average balance of subordinated and senior debt due to the issuances of $135.0 million in June 2014 and $63.3 million in July and August 2013.

The key measure of net interest income is net interest margin. Customers net interest margin (tax equivalent) decreased 30 basis points to 2.88% for the nine months ended September 30, 2014 when compared to the net interest margin (tax equivalent) of 3.18%

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for the same period in 2013. The decrease resulted primarily from a decrease in the average yield on Loans, taxable from 4.55% to 4.00%, due to the maturity of higher-yielding loans and the growth of multi-family loan products, which have higher credit quality but yield less than the average yield on the loan portfolio through the first nine months of 2013.

*Provision for Loan Losses*

Customers Bank has established an allowance for loan losses through a provision for loan losses charged as an expense on the consolidated statements of income. The loan portfolio is reviewed quarterly to evaluate the outstanding loans and to measure both the performance of the portfolio and the adequacy of the allowance for loan losses. At September 30, 2014, approximately 0.81% of the total loan portfolio (including loans held for sale) was covered under loss sharing agreements with the FDIC. Charge-offs incurred on the loans covered by the loss share agreements greater than the original estimated value are recorded as an increase to the provision for loan losses, and a corresponding receivable due from the FDIC is recorded as a reduction to the provision for loan losses for the portion anticipated to be recovered under the loss sharing agreements. Conversely, if the estimated cash flows on the covered loans increase, all or a portion of the previously recorded provision for loan losses will be reversed, and the corresponding receivable due from the FDIC will be written down as an increase to the provision for loan losses. The FDIC loss sharing receivable balance will be reduced through a charge to the provision for loan losses, with no offsetting reduction to the allowance for loan losses, as the FDIC loss sharing arrangements reach their contractual maturities and the estimated losses in the covered loans have not yet emerged or been realized in a final disposition event. The FDIC loss sharing arrangements for non-single family loans expire in third quarter 2015. The loss sharing arrangements for single family loans expire in third quarter 2020.

The provision for loan losses increased by $9.5 million to $12.3 million for the nine months ended September 30, 2014, compared to $2.7 million for the same period in 2013. The increase in the provision was primarily attributable to significant organic loan growth in the held-for-investment loan portfolio during the first nine months of 2014 and a reduced benefit expected to be collected from the FDIC as the loss sharing arrangements for the non-single family loans approach their contractual maturity.

*Non-Interest Income*

The chart below shows our results in the various components of non-interest income for the nine months ended September 30, 2014 and 2013.

| | Nine Months Ended September 30, | |
|---|---|---|
| | **2014** | **2013** |
| (amounts in thousands) | | |
| Mortgage warehouse transactional fees | $ 6,128 | $ 10,626 |
| Bank-owned life insurance | 2,646 | 1,658 |
| Gain on sale of loans | 1,266 | 402 |
| Mortgage loan and banking income | 2,175 | 50 |
| Deposit fees | 618 | 487 |
| Gain on sale of investment securities | 3,191 | 0 |
| Other | 3,298 | 1,784 |
| Total non-interest income | $ 19,322 | $ 15,007 |

Non-interest income was $19.3 million for the nine months ended September 30, 2014, an increase of $4.3 million from $15.0 million for the nine months ended September 30, 2013. This increase was primarily the result of gains realized on the sale of available-for-sale investment securities (up $3.2 million), increased mortgage loan and banking income, which includes a gain realized from the sale of mortgage loans acquired from Flagstar Bank (up $2.1 million), higher income from bank-owned life insurance (up $1.0 million) resulting from increased purchases during 2014, increased gains on the sale of loans (up $0.9 million) driven by larger gains realized from the sale of SBA loans of $0.2 million and a gain of $0.7 million realized from the sale of multi-family loans, and increased other income (up $1.5 million) mainly driven by management advisory fees of $1.3 million earned in conjunction with an equity investment in a foreign entity that was made during the third quarter of 2013 and increased fees earned by executing interest rate swaps with commercial banking customers. These increases were offset by a decrease of $4.5 million in mortgage warehouse transactional fees, which is consistent with the decline in our mortgage warehouse activity from 2013 and increased competition for this business reducing fees.

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*Non-Interest Expense*

The below chart shows ours results in the various components of non-interest expense for the nine months ended September 30, 2014 and 2013.

| | Nine Months Ended September 30, | |
|---|---|---|
| | 2014 | 2013 |
| (amounts in thousands) | | |
| Salaries and employee benefits | $ 33,012 | $ 24,868 |
| FDIC assessments, taxes and regulatory fees | 8,529 | 3,510 |
| Occupancy | 8,162 | 6,309 |
| Professional services | 5,834 | 3,149 |
| Technology, communication and bank operations | 4,666 | 3,023 |
| Other real estate owned | 1,845 | 962 |
| Loan workout | 1,306 | 1,674 |
| Advertising and promotion | 1,104 | 973 |
| Loss contingency | 0 | 2,000 |
| Other | 6,592 | 5,254 |
| Total non-interest expenses | $ 71,050 | $ 51,722 |

Non-interest expense was $71.1 million for the nine months ended September 30, 2014, an increase of $19.3 million when compared to $51.7 million for the same period in 2013.

Salaries and employee benefits, which represent the largest component of non-interest expense, increased by $8.1 million, or 32.8%, to $33.0 million for the nine months ended September 30, 2014. This increase was primarily driven by increased headcount as Customers recruited larger lending, support, risk management and compliance teams over the past year in support of a greater level of business activities in existing and expanding markets.

FDIC assessments, taxes and regulatory fees increased by $5.0 million, or 143.0% to $8.5 million for the nine months ended September 30, 2014 from $3.5 million for the nine months ended September 30, 2013. The primary reasons for this increase were related to higher Pennsylvania bank shares tax expense that resulted from legislative changes to the tax calculation, growth of the Bank and increased deposit premiums and other regulatory and filing fees.

Occupancy expense increased $1.9 million, or 29.4%, to $8.2 million for the nine months ended September 30, 2014 from $6.3 million for the same period in 2013. This increase was driven by the business expansion into new markets and increased activity in existing markets which required additional facilities.

Professional services expense increased $2.7 million, or 85.3%, to $5.8 million for the nine months ended September 30, 2014 when compared to $3.1 million for the same period in 2013. This increase was primarily attributable to legal and consulting expenses incurred in 2014 related to loan workout, litigation and other general regulatory matters.

Technology, communications, and bank operations expense increased $1.6 million, or 54.4%, to $4.7 million for the nine months ended September 30, 2014 from $3.0 million for the same period in 2013. The primary reason for this increase was related to building the infrastructure to support growth through increased technology improvements and

upgrades as well as the costs related to expanding technological platforms into new markets. This corresponds with our philosophy of high touch, high tech , whereby we provide an exceptional level of customer service supported by state-of-the-art technology.

In March 2013, a suspected fraud was discovered in the Bank s loans held-for-sale portfolio. Total loans involved in this fraud initially appeared to be $5.2 million. The Bank determined that an aggregate of $1.0 million of the loans were not involved in the fraud, and these loans were subsequently sold during 2013. In addition, the Bank recorded $1.5 million in cash from the alleged perpetrator in 2013. During 2013, a loss contingency expense of $2.0 million was provided, resulting in a net amount of $0.7 million classified in other assets as of September 30, 2014.

Other expense increased $1.3 million, or 25.5%, to $6.6 million for the nine months ended September 30, 2014 from $5.3 million for the same period in 2013. The Company experienced higher expenses in most categories due to the expansion of the franchise which contributed to the overall increase in other expenses.

*Income Taxes*

Income tax expense was $12.9 million and $12.8 million, respectively, for the nine months ended September 30, 2014 and 2013. The effective tax rate for the nine months ended September 30, 2014 and 2013 was approximately 30 percent and 35 percent, respectively. The decrease in the effective tax rate in 2014 was primarily due to an adjustment of $1.5 million that resulted from a return to provision and deferred tax analysis performed in the third quarter 2014.

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**Financial Condition**

*General*

Total assets were $6.5 billion at September 30, 2014. This represented a $2.4 billion, or 57.3%, increase from $4.2 billion at December 31, 2013. The major change in our financial position occurred as the result of organic growth in our loan portfolio, which increased by 73.6%, or $2.3 billion to $5.5 billion at September 30, 2014 from $3.1 billion at December 31, 2013.

The main driver of the increase in loans was primarily from the expansion of multi-family loans, which increased by $1.1 billion (103.7%) to $2.2 billion at September 30, 2014 from $1.1 billion at December 31, 2013. Additionally, commercial real estate and commercial and industrial loans increased by $549.3 million (50.5%) to $1.6 billion at September 30, 2014 from $1.1 billion at December 31, 2013.

Total liabilities were $6.1 billion at September 30, 2014. This represented a $2.3 billion, or 62.1%, increase from $3.8 billion at December 31, 2013. The increase in total liabilities was due to a higher level of deposits at September 30, 2014 compared to December 31, 2013. Total deposits grew by $1.3 billion (44.7%) to $4.3 billion at September 30, 2014 from $3.0 billion at December 31, 2013. Deposits are obtained primarily from within the Bank s geographic service area and through wholesale and broker networks. These broker networks provide low-cost funding alternatives to retail deposits and increase the diversity of the Bank s sources of funds. The increase in bank deposits was largely due to the seasonal inflow of student deposits and growth in money market deposit accounts, primarily brokered accounts.

The following table sets forth certain key condensed balance sheet data:

| | September 30, 2014 | December 31, 2013 |
|---|---|---|
| (amounts in thousands) | | |
| Cash and cash equivalents | $ 331,306 | $ 233,068 |
| Investment securities, available for sale | 409,303 | 497,573 |
| Loans held for sale, (includes $1,231,039 and $747,593, respectively, at fair value) | 1,395,720 | 747,593 |
| Loans receivable not covered under FDIC Loss Sharing Agreements | 4,065,672 | 2,398,353 |
| Loans receivable covered under FDIC Loss Sharing Agreements | 44,463 | 66,725 |
| Total loans receivable, net of the allowance for loan losses | 4,079,052 | 2,441,080 |
| Total assets | 6,532,435 | 4,153,173 |
| Total deposits | 4,284,140 | 2,959,922 |
| Federal funds purchased | 0 | 13,000 |
| FHLB advances | 1,594,500 | 706,500 |
| Other borrowings | 88,250 | 63,250 |
| Subordinated debt | 112,000 | 2,000 |
| Total liabilities | 6,106,636 | 3,766,550 |
| Total shareholders equity | 425,799 | 386,623 |

| | | |
|---|---|---|
| Total liabilities and shareholders equity | 6,532,435 | 4,153,173 |

*Cash and Cash Equivalents*

Cash and cash equivalents include cash and due from banks and interest-earning deposits. Cash and due from banks consists mainly of vault cash and cash items in the process of collection. These balances totaled $89.7 million at September 30, 2014. This represents a $29.0 million increase from $60.7 million at December 31, 2013. These balances vary from day to day, primarily due to variations in customers deposits with the Bank. Interest-earning deposits consist of cash deposited at other banks, primarily the Federal Reserve Bank of Philadelphia. Interest-earning deposits were $241.6 million and $172.4 million at September 30, 2014 and December 31, 2013, respectively.

*Investment Securities*

The investment securities portfolio is an important source of interest income and liquidity. At September 30, 2014, investments consisted of mortgage-backed securities (principally guaranteed by an agency of the United States government) and marketable equity securities. In addition to generating revenue, the investment portfolio is maintained to manage interest-rate risk, provide liquidity and collateral for borrowings, and diversify the credit risk of interest-earning assets. The portfolio is structured to maximize net interest income, given changes in the economic environment, liquidity position, and balance sheet mix.

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At September 30, 2014, our investment securities were $409.3 million compared to $497.6 million at December 31, 2013. The decrease was primarily the result of our sale of securities to strategically reduce interest rate risk by shortening the duration of the investment securities term.

Unrealized gains and losses on available-for-sale securities are included in other comprehensive income and reported as a separate component of shareholders equity, net of the related tax effect.

*Loans*

Existing lending relationships are primarily with small businesses and individual consumers primarily in Bucks, Berks, Chester, Montgomery, Delaware, and Philadelphia Counties, Pennsylvania; Camden and Mercer Counties, New Jersey; and Westchester County and New York City, New York; and the New England area. The loan portfolio is primarily comprised of loans to support mortgage banking companies funding needs, multi-family/commercial real estate, construction, and commercial and industrial loans.

Mortgage warehouse loans and certain residential and multi-family loans expected to be sold are classified as loans held for sale. Loans held for sale totaled $1.4 billion at September 30, 2014 and $0.7 billion at December 31, 2013. Loans held for sale are not included in the loan receivable amounts. The increase in loans held for sale was primarily driven by an increase in mortgage warehouse loans of $0.5 billion and the reclassification of $164.7 million of multi-family loans from held for investment to held for sale because the Company was actively marketing these loans and no longer had the intent to retain these loans in its portfolio. The mortgage warehouse product line provides financing to mortgage companies nationwide from the time of the home purchase or refinancing of a mortgage loan through the sale of the loan by the mortgage originator into the secondary market, either through a repurchase facility or the purchase of the underlying mortgages. As a mortgage warehouse lender, we provide a form of financing to mortgage bankers by purchasing for resale the underlying residential mortgages on a short-term basis under a master repurchase agreement. We are subject to the risks associated with such lending, including, but not limited to, the risks of fraud, bankruptcy and default of the mortgage banker or of the underlying residential borrower, any of which could result in credit losses. The mortgage warehouse lending employees monitor these mortgage originators by obtaining financial and other relevant information to reduce these risks during the lending period.

Loans receivable, net, increased by $1.6 billion to $4.1 billion at September 30, 2014 from $2.4 billion at December 31, 2013. The multi-family/commercial real estate loan balance increased due to the focus on this element of Customers organic growth strategy. Offsetting these increases in part was the loan runoff for purchased-credit-impaired and covered loans. The composition of loans receivable as of September 30, 2014 and December 31, 2013 was as follows:

| (amounts in thousands) | September 30, 2014 | December 31, 2013 |
|---|---|---|
| Construction | $ 6,755 | $ 14,627 |
| Commercial real estate/multi-family | 18,366 | 24,258 |
| Commercial and industrial | 3,520 | 5,814 |
| Residential real estate | 12,769 | 18,733 |
| Manufactured housing | 3,053 | 3,293 |
| | 44,463 | 66,725 |

| | | |
|---|---|---|
| Total loans receivable covered under FDIC loss sharing agreements (1) | | |
| Construction | 56,603 | 36,901 |
| Commercial real estate/multi-family | 3,153,980 | 1,835,186 |
| Commercial and industrial | 432,917 | 239,509 |
| Mortgage warehouse | 8 | 866 |
| Manufactured housing | 129,798 | 139,471 |
| Residential real estate | 290,621 | 145,188 |
| Consumer | 1,684 | 2,144 |
| Total loans receivable not covered under FDIC loss sharing agreements | 4,065,611 | 2,399,265 |
| Total loans receivable | 4,110,074 | 2,465,990 |
| Deferred (fees) costs, net (2) | 61 | (912) |
| Allowance for loan losses | (31,083) | (23,998) |
| Loans receivable, net | $ 4,079,052 | $ 2,441,080 |

(1) Loans that were acquired in two FDIC assisted transactions and are covered under loss sharing arrangements with the FDIC are referred to as covered loans throughout this Management s Discussion and Analysis.

(2) Includes $3.5 million and $0.6 million of amortized premiums on purchased loans at September 30, 2014 and December 31, 2013, respectively.

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*Credit Risk*

Customers Bancorp manages credit risk by maintaining diversification in its loan portfolio, by establishing and enforcing prudent underwriting standards, collection efforts and continuous and periodic loan classification reviews. Management also considers the effect of credit risk on financial performance by maintaining an adequate allowance for loan losses. Credit losses are charged when they are identified, and provisions are added, to the allowance for loan losses when and as appropriate, but at least quarterly. The allowance for loan losses is evaluated at least quarterly.

The provision for loan losses was $12.3 million and $2.7 million for the nine months ended September 30, 2014 and 2013, respectively. The allowance for loan losses maintained for loans receivable (excludes loans held for sale) was $31.1 million, or 0.8% of non-covered loans receivable, at September 30, 2014, $26.8 million, or 1.3% of non-covered loans receivable, at September 30, 2013, and $24.0 million, or 1.0% of non-covered loans receivable, at December 31, 2013. The coverage ratio declined largely due to the decrease in non-performing loans as a result of net-charge-offs ($3.2 million for the twelve months ended September 30, 2014), transfers to other real estate owned, sustained performance improvements that led to lower reserve factors for commercial, multi-family and residential mortgage loans, and the growth of the multi-family loan portfolio which draws only a 40 basis point reserve level based on its historical payment experience. Net charge-offs were $1.8 million for the nine months ended September 30, 2014, a decrease of $3.7 million compared to the same period in 2013. The Bank had approximately $44.5 million in loans that were covered under loss share arrangements with the FDIC as of September 30, 2014 compared to $66.7 million as of December 31, 2013. The Bank considers the covered loans in estimating the allowance for loan losses and considers recovery of estimated credit losses from the FDIC in the FDIC indemnification asset.

The chart below depicts changes in Customers Bancorp s allowance for loan losses for the periods indicated.

**Analysis of the Allowance for Loan Losses**

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 |
| (amounts in thousands) | | | | |
| **Balance at the beginning of the period** | $ 28,186 | $ 28,142 | $ 23,998 | $ 25,837 |
| **Loan charge-offs** | | | | |
| Construction | 284 | 0 | 284 | 1,470 |
| Commercial real estate | 278 | 851 | 1,438 | 2,742 |
| Commercial and industrial | 91 | 1,311 | 536 | 1,407 |
| Residential real estate | 139 | 116 | 442 | 315 |
| Consumer and other | 0 | 16 | 33 | 16 |
| Total Charge-offs | 792 | 2,294 | 2,733 | 5,950 |
| **Loan recoveries** | | | | |
| Construction | 4 | 0 | 7 | 0 |
| Commercial real estate | 369 | 186 | 395 | 246 |
| Commercial and industrial | 67 | 16 | 292 | 181 |
| Residential real estate | 23 | 0 | 265 | 7 |
| Consumer and other | 4 | 0 | 6 | 9 |

| | | | | |
|---|---|---|---|---|
| Total Recoveries | 467 | 202 | 965 | 443 |
| **Total net charge-offs** | 325 | 2,092 | 1,768 | 5,507 |
| **Provision for loan losses** | 3,222 | 750 | 8,853 | 6,470 |
| **Balance at the end of the period** | $ 31,083 | $ 26,800 | $ 31,083 | $ 26,800 |

The allowance for loan losses is based on a periodic evaluation of the loan portfolio and is maintained at a level that management considers adequate to absorb potential losses. All commercial loans are assigned credit risk ratings, based upon an assessment of the borrower, the structure of the transaction and the available collateral and/or guarantees. All loans are monitored regularly by the responsible officer, and the risk ratings are adjusted when considered appropriate. The risk assessment allows management to identify problem loans timely. Management considers a variety of factors, and recognizes the inherent risk of loss that always exists in the lending process. Management uses a disciplined methodology to estimate the appropriate level of allowance for loan losses. See Asset Quality for further discussion of the allowance for loan losses.

Customers methodology includes an evaluation of loss potential from individual problem credits (potentially impaired loans), as well as a general reserve for the portfolio considering anticipated specific and general economic factors that may positively or adversely

affect collectability. This assessment includes a review of changes in the composition and volume of the loan portfolio, overall portfolio quality and past loss experience, review of specific problem loans, current economic conditions that may affect borrowers ability to repay, and other factors that may warrant consideration in estimating the reserve. In addition, the Bancorp s internal auditors, loan review, and various regulatory agencies periodically review the adequacy of the allowance as an integral part of their work responsibilities or examination process. Customers Bancorp may be asked to recognize additions or reductions to the allowance for loan losses based on their judgments of information available at the time of their examination.

Nearly 90% of the Bank s commercial real estate, commercial and residential construction, consumer residential and commercial and industrial loan types have real estate as collateral (collectively, the real estate portfolio ). The Bank s lien position on the real estate collateral will vary on a loan-by-loan basis and will change as a result of changes in the value of the collateral. Current appraisals providing current value estimates of the property are received when the Bank s credit group determines that the facts and circumstances have significantly changed since the date of the last appraisal, including that real estate values may have deteriorated. The credit committee and loan officers review loans that are fifteen or more days delinquent and all non-accrual loans on a periodic basis. In addition, loans where the loan officers have identified a borrower of interest are discussed to determine if additional analysis is necessary to apply the risk rating criteria properly. The risk ratings for the real estate loan portfolio are determined based upon the current information available, including but not limited to discussions with the borrower, updated financial information, economic conditions within the geographic area and other factors that may affect the cash flow of the loan. On a quarterly basis, if necessary, the collateral values or discounted cash flow models are used to determine the estimated fair value of the underlying collateral for the quantification of a specific reserve for impaired loans. Appraisals used within this evaluation process do not typically age more than two years before a new appraisal is obtained. For loans where real estate is not the primary source of collateral, updated financial information is obtained, including accounts receivable and inventory aging reports and relevant supplemental financial data to determine the fair value of the underlying collateral.

These evaluations, however, are inherently subjective as they require material estimates, including, among other estimates, the amounts and timing of expected future cash flows on impaired loans, estimated losses in the loan portfolio, and general amounts for historical loss experience, economic conditions, uncertainties in estimating losses and inherent risks in the various credit portfolios, all of which may be susceptible to significant change. Pursuant to ASC 450 *Contingencies* and ASC 310-40 *Troubled Debt Restructurings by Creditors,* impaired loans, consisting of non-accrual and restructured loans, are considered in the methodology for determining the allowance for credit losses. Impaired loans are generally evaluated based on the expected future cash flows or the fair value of the underlying collateral (less estimated costs to sell) if principal repayment is expected to come from the sale or operation of such collateral.

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*Asset Quality*

Customers divides its loan portfolio into two categories to analyze and understand loan activity and performance: loans that were originated and loans that were acquired. Customers further divides originated loans into two categories: those originated prior to the current underwriting standards in 2009 ( Legacy ) and those originated subject to those standards post 2009 ( Total Originated Loans ), and purchased loans into two categories: those purchased credit impaired, and those not acquired credit impaired. Management believes that this additional information provides for a better understanding of the risk in the portfolio and the various types of reserves that are available to absorb loan losses that may arise in future periods. Credit losses from originated loans are absorbed by the allowance for loan losses. Credit losses from acquired loans are absorbed by the allowance for loan losses and cash reserves, as described below. The schedule below includes both loans held for sale and loans held for investment.

**Asset Quality at September 30, 2014**

| Loan Type (amounts in thousands) | Total Loans | PCI Loans (1) | Current | 30-90 Days | Greater than 90 Days and Accruing | Non-accrual/ NPL (a) | OREO (b) | NPA (a)+(b) | NPL to Loan Type (%) | NPA to Loans + OREO (%) |
|---|---|---|---|---|---|---|---|---|---|---|
| ***Legacy Originated Loans*** | | | | | | | | | | |
| Loans | $ 57,615 | $ 0 | $ 51,655 | $ 782 | $ 0 | $ 5,178 | $ 6,464 | $ 11,642 | 8.99 | 18.17 |
| TDRs | 1,661 | 0 | 1,004 | 0 | 0 | 657 | 0 | 657 | 39.55 | 39.55 |
| ***Total Legacy Loans*** | 59,276 | 0 | 52,659 | 782 | 0 | 5,835 | 6,464 | 12,299 | 9.84 | 18.71 |
| ***Originated Loans*** | | | | | | | | | | |
| Warehouse Repo | 34,533 | 0 | 34,533 | 0 | 0 | 0 | 0 | 0 | 0.00 | 0.00 |
| Manufactured Housing | 4,382 | 0 | 4,296 | 25 | 0 | 61 | 0 | 61 | 1.39 | 1.39 |
| Commercial | 1,401,490 | 0 | 1,399,680 | 146 | 0 | 1,664 | 335 | 1,999 | 0.12 | 0.14 |
| Multi-family | 1,993,431 | 0 | 1,993,431 | 0 | 0 | 0 | 0 | 0 | 0.00 | 0.00 |
| Consumer/Mortgage | 121,811 | 0 | 121,811 | 0 | 0 | 0 | 0 | 0 | 0.00 | 0.00 |
| CRA | 35,863 | 0 | 35,602 | 110 | 0 | 151 | 0 | 151 | 0.42 | 0.42 |
| TDRs | 557 | 0 | 557 | 0 | 0 | 0 | 0 | 0 | 0.00 | 0.00 |
| ***Total Originated Loans*** | 3,592,067 | 0 | 3,589,910 | 281 | 0 | 1,876 | 335 | 2,211 | 0.05 | 0.06 |
| ***Acquired Loans*** | | | | | | | | | | |
| Berkshire | 9,250 | 0 | 7,802 | 98 | 0 | 1,350 | 425 | 1,775 | 14.59 | 18.35 |
| FDIC Covered | 31,412 | 0 | 27,333 | 18 | 0 | 4,061 | 10,208 | 14,269 | 12.93 | 34.28 |
| FDIC Non-covered | 9 | 0 | 9 | 0 | 0 | 0 | 0 | 0 | 0.00 | 0.00 |
| Manufactured Housing 2010 | 70,004 | 0 | 65,408 | 4,596 | 0 | 0 | 0 | 0 | 0.00 | 0.00 |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Manufactured Housing 2011 | 0 | 0 | 0 | 0 | 0 | 0 | 323 | 323 | 0.00 | 100.0 |
| Manufactured Housing 2012 | 48,729 | 0 | 42,710 | 1,937 | 4,082 | 0 | 0 | 0 | 0.00 | 0.00 |
| Flagstar (Commercial) | 126,742 | 0 | 126,742 | 0 | 0 | 0 | 0 | 0 | 0.00 | 0.00 |
| Flagstar (Residential) | 109,294 | 0 | 109,294 | 0 | 0 | 0 | 0 | 0 | 0.00 | 0.00 |
| TDRs | 3,258 | 0 | 2,332 | 93 | 0 | 833 | 0 | 833 | 25.57 | 25.57 |
| ***Total Acquired Loans*** | 398,698 | 0 | 381,630 | 6,742 | 4,082 | 6,244 | 10,956 | 17,200 | 1.57 | 4.20 |
| ***Acquired PCI Loans*** | | | | | | | | | | |
| Berkshire | 43,571 | 43,571 | 39,235 | 79 | 4,257 | 0 | 0 | 0 | 0.00 | 0.00 |
| FDIC Covered | 12,515 | 12,515 | 4,175 | 28 | 8,312 | 0 | 0 | 0 | 0.00 | 0.00 |
| Manufactured Housing 2011 | 4,257 | 4,257 | 2,197 | 328 | 1,732 | 0 | 0 | 0 | 0.00 | 0.00 |
| ***Total Acquired PCI Loans*** | 60,343 | 60,343 | 45,607 | 435 | 14,301 | 0 | 0 | 0 | 0.00 | 0.00 |
| Unamortized fees, expenses, premiums and discounts | (249) | 0 | (249) | 0 | 0 | 0 | 0 | 0 | | |
| ***Total Loans Held for Investment*** | 4,110,135 | 60,343 | 4,069,557 | 8,240 | 18,383 | 13,955 | 17,755 | 31,710 | 0.34 | 0.77 |
| ***Total Loans Held for Sale*** | 1,395,720 | 0 | 1,395,720 | 0 | 0 | 0 | 0 | 0 | | |
| ***Total Portfolio*** | $ 5,505,855 | $ 60,343 | $ 5,465,277 | $ 8,240 | $ 18,383 | $ 13,955 | $ 17,755 | $ 31,710 | 0.25 | 0.57 |

(1) Purchased-credit-impaired ( PCI ) loans aggregated into a pool are accounted for as a single asset with a single composite interest rate and an aggregate expectation of cash flows, and the past due status of the pools, or that of the individual loans within the pools, is not meaningful. Because of the credit impaired nature of the loans, the loans are recorded at a discount reflecting estimated future cash flows and the Bank recognizes interest income on each pool of loans reflecting the estimated yield and passage of time. Such loans are considered to be performing. Purchased-credit-impaired loans that are not in pools accrete interest when the timing and amount of their expected cash flows are reasonably estimable, and are reported as performing loans.

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**Asset Quality at September 30, 2014 (continued)**

| Loan Type (amounts in thousands) | Total Loans | NPL | ALL | Cash Reserve | Total Credit Reserves | Reserves to Loans (%) | Reserves to NPLs (%) |
|---|---|---|---|---|---|---|---|
| ***Legacy Originated Loans*** | | | | | | | |
| Loans | $ 57,615 | $ 5,178 | $ 2,943 | $ 0 | $ 2,943 | 5.11 | 56.83 |
| TDRs | 1,661 | 657 | 88 | 0 | 88 | 5.30 | 13.39 |
| ***Total Legacy Originated Loans*** | 59,276 | 5,835 | 3,031 | 0 | 3,031 | 5.11 | 51.94 |
| ***Originated Loans*** | | | | | | | |
| Warehouse Repo | 34,533 | 0 | 259 | 0 | 259 | 0.75 | 0.00 |
| Manufactured Housing | 4,382 | 61 | 88 | 0 | 88 | 2.01 | 0.00 |
| Commercial | 1,401,490 | 1,664 | 10,213 | 0 | 10,213 | 0.73 | 613.76 |
| Multi-family | 1,993,431 | 0 | 7,974 | 0 | 7,974 | 0.40 | 0.00 |
| Consumer/Mortgage | 121,811 | 0 | 433 | 0 | 433 | 0.36 | 0.00 |
| CRA | 35,863 | 151 | 242 | 0 | 242 | 0.67 | 0.00 |
| TDRs | 557 | 0 | 0 | 0 | 0 | 0.00 | 0.00 |
| ***Total Originated Loans*** | 3,592,067 | 1,876 | 19,209 | 0 | 19,209 | 0.53 | 1023.88 |
| ***Acquired Loans*** | | | | | | | |
| Berkshire | 9,250 | 1,350 | 342 | 0 | 342 | 3.70 | 25.33 |
| FDIC Covered | 31,412 | 4,061 | 529 | 0 | 529 | 1.68 | 13.00 |
| FDIC Non-covered | 9 | 0 | 0 | 0 | 0 | 0.00 | 0.00 |
| Manufactured Housing 2010 | 70,004 | 0 | 0 | 3,308 | 3,308 | 4.73 | 0.00 |
| Manufactured Housing 2011 | 0 | 0 | 0 | 0 | 0 | 0.00 | 0.00 |
| Manufactured Housing 2012 | 48,729 | 0 | 0 | 0 | 0 | 0.00 | 0.00 |
| Flagstar (Commercial) | 126,742 | 0 | 0 | 0 | 0 | 0.00 | 0.00 |
| Flagstar (Residential) | 109,294 | 0 | 0 | 0 | 0 | 0.00 | 0.00 |
| TDRs | 3,258 | 833 | 145 | 0 | 145 | 4.45 | 17.41 |
| ***Total Acquired Loans*** | 398,698 | 6,244 | 1,016 | 3,308 | 4,324 | 1.08 | 69.24 |
| ***Acquired PCI Loans*** | | | | | | | |
| Berkshire | 43,571 | 0 | 5,416 | 0 | 5,416 | 12.44 | 0.00 |
| FDIC Covered | 12,515 | 0 | 2,178 | 0 | 2,178 | 17.36 | 0.00 |
| Manufactured Housing 2011 | 4,257 | 0 | 233 | 0 | 233 | 5.47 | 0.00 |
| ***Total Acquired PCI Loans*** | 60,343 | 0 | 7,827 | 0 | 7,827 | 12.97 | 0.00 |
| Unamortized fees, expenses, premiums and discounts | (249) | 0 | 0 | 0 | 0 | | |
| ***Total Loans Held for Investment*** | 4,110,135 | 13,955 | 31,083 | 3,308 | 34,391 | 0.84 | 246.44 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| ***Total Loans Held for Sale*** | 1,395,720 | 0 | 0 | 0 | 0 | | |
| ***Total Portfolio*** | $ 5,505,855 | $ 13,955 | $ 31,083 | $ 3,308 | $ 34,391 | 0.62 | 246.44 |

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*Originated Loans*

Originated loans (excluding held-for-sale loans) totaled $3.7 billion, or 66.3%, of total loans at September 30, 2014, compared to $2.1 billion, or 64.2%, at December 31, 2013. Of the total originated loans at September 30, 2014, $3.6 billion, or 98.4%, were originated post 2009, when the new management team adopted new underwriting standards that management believes better limits risks of loss. Only $1.9 million, or 0.05%, of the post 2009 loans were non-performing at September 30, 2014. Of the total originated loans at December 31, 2013, $2.0 billion, or 96.3%, were originated post 2009. Only $0.5 million, or 0.03%, of the post 2009 loans were non-performing at December 31, 2013. The post 2009 originated loans were supported by an allowance for loan losses of $19.2 million (0.53% of post 2009 originated loans) and $10.7 million (0.54% of post 2009 originated loans), respectively, at September 30, 2014 and December 31, 2013.

Legacy loans declined $16.8 million to $59.3 million at September 30, 2014, compared to $76.0 million at December 31, 2013. Non-performing Legacy loans also declined from $10.2 million at December 31, 2013 to $5.8 million at September 30, 2014 as Customers continued to workout the losses in this portfolio. The Legacy originated loans were supported by an allowance for loan losses of $3.0 million (5.11% of Legacy loans) and $2.4 million (3.21% of Legacy loans), respectively, at September 30, 2014 and December 31, 2013.

*Acquired Loans*

At September 30, 2014, Customers Bank reported $0.5 billion of acquired loans, which was 8.3% of total loans, compared to $0.4 billion, or 12.6%, of total loans at December 31, 2013. Non-performing acquired loans totaled $6.2 million at September 30, 2014 and $8.5 million at December 31, 2013. When loans are acquired, they are recorded on the balance sheet at fair value. Acquired loans include purchased portfolios, FDIC failed-bank acquisitions, and unassisted acquisitions. Of the manufactured housing loans purchased from Tammac prior to 2012, $70.0 million were supported by a $3.3 million cash reserve at September 30, 2014, compared to $74.7 million supported by a cash reserve of $3.1 million at December 31, 2013. The cash reserve was created as part of the purchase transaction to absorb losses and is maintained in a demand deposit account at the Bank. All current losses and delinquent interest are absorbed by this reserve. For the manufactured housing loans purchased in 2012, Tammac has an obligation to pay the Bank the full payoff amount of the defaulted loan, including any principal, unpaid interest, or advances on the loans, once the borrower vacates the property. At September 30, 2014, $48.7 million of these loans were outstanding, compared to $53.5 million at December 31, 2013.

Many of the acquired loans were purchased at a discount. The price paid considered management s judgment as to the credit and interest rate risk inherent in the portfolio at the time of purchase. Every quarter, management reassesses the risk and adjusts the cash flow forecast to incorporate changes in the credit outlook. Generally, a decrease in forecasted cash flows for a purchased loan will result in a provision for loan losses, and absent charge-offs, an increase in the allowance for loan losses. Acquired loans have a significantly higher percentage of non-performing loans than loans originated after September 2009. Management acquired these loans with the expectation that non-performing loan levels would be elevated, and therefore incorporated that expectation into the price paid. There is a Special Assets Group that focuses on workouts for these acquired non-performing assets. Total acquired loans were supported by reserves (allowance for loan losses and cash reserves) of $12.2 million (2.65% of total acquired loans) and $13.9 million (3.43% of total acquired loans), respectively, at September 30, 2014 and December 31, 2013.

*Held-for-Sale Loans*

At September 30, 2014, loans held for sale were $1.4 billion, or 25.4%, of the total loan portfolio, compared to $0.7 billion, or 23.3% of the total loan portfolio at December 31, 2013. The loans held-for-sale portfolio at September 30,

2014 included $1.2 billion of loans to mortgage banking businesses, $164.7 million of multi-family loans and $4.1 million of residential mortgage loans, compared to $740.7 million of loans to mortgage banking businesses and $6.9 million of residential mortgages loans at December 31, 2013. Held-for-sale loans are carried on our balance sheet at either fair value (due to the election of the fair value option) or the lower of cost of fair value. An allowance for loan losses is not recorded on loans that are held for sale.

The Bank manages its credit risk through the diversification of the loan portfolio and the application of policies and procedures designed to foster sound credit standards and monitoring practices. While various degrees of credit risk are associated with substantially all investing activities, the lending function carries the greatest degree of potential loss. At September 30, 2014 and December 31, 2013, non-performing loans to total loans were 0.25% and 0.60%, respectively. Total reserves to non-performing loans were 246.4% and 152.9%, respectively, at September 30, 2014 and December 2013.

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*Deposits*

Customers Bank offers a variety of deposit accounts, including checking, savings, money market deposit accounts ( MMDA ) and time deposits. Deposits are generally obtained primarily from our geographic service area. Customers also acquires deposits nationwide through deposit brokers, listing services and other relationships. Total deposits grew to $4.3 billion at September 30, 2014, an increase of $1.3 billion, or 44.7%, from $3.0 billion at December 31, 2013. Demand deposits were $770.7 million at September 30, 2014, compared to $536.1 million at December 31, 2013, an increase of $234.5 million, or 43.7%. These amounts were comprised primarily of non-interest bearing demand deposits. Savings, including MMDA totaled $2.0 billion at September 30, 2014, an increase of $732.7 million or 56.4%, primarily attributed to the increase in brokered savings accounts. Time deposits were $1.5 billion at September 30, 2014, an increase of $357.0 million or 31.7%. We experienced growth in retail deposits due primarily to exceptional sales behaviors, despite lower interest rates in 2014.

The components of deposits were as follows at the dates indicated:

| (amounts in thousands) | September 30, 2014 | December 31, 2013 |
|---|---|---|
| Demand | $ 770,664 | $ 536,116 |
| Savings, including MMDA | 2,031,182 | 1,298,468 |
| Time, $100,000 and over | 783,346 | 797,322 |
| Time, other | 698,948 | 328,016 |
| Total deposits | $ 4,284,140 | $ 2,959,922 |

*Borrowings*

On June 26, 2014, Customers Bancorp, Inc. closed a private placement transaction in which it issued $25 million of 4.625% senior notes due 2019, and Customers Bank closed a private placement transaction in which it issued $110 million of fixed-to-floating-rate subordinated notes due 2029. The aggregate net proceeds from the sale of the notes totaled $133.1 million.

The senior notes bear interest at a rate of 4.625%, and interest will be paid semi-annually in arrears in June and December. The subordinated notes will bear interest at an annual fixed rate of 6.125% until June 26, 2024, and interest will be paid semiannually. From June 26, 2024, the subordinated notes will bear an annual interest rate equal to three-month LIBOR plus 344.3 basis points until maturity on June 26, 2029. Customers Bank has the ability to call the subordinated notes, in whole or in part, at a redemption price equal to 100 percent of the principal balance at certain times on or after June 26, 2024.

The subordinated notes qualify as Tier 2 capital for regulatory capital purposes.

During the nine months ended September 30, 2014, Customers Bank borrowed $275 million of long-term FHLB advances. On May 13, 2014, $100 million was issued at a fixed rate of 1.04% with a maturity date of May 15, 2017. On May 20, 2014, there were two additional issuances of $50 million, at fixed rates of 0.54 % and 1.44%, maturing on May 20, 2016 and May 21, 2018, respectively. On September 9, 2014, $75 million was issued at a fixed rate of 1.30% with a maturity date of September 11, 2017.

*Capital Adequacy and Shareholders Equity*

Shareholders equity increased by $39.2 million to $425.8 million at September 30, 2014, from $386.6 million at December 31, 2013. Net income was $30.0 million for the nine months ended September 30, 2014. In addition, the recognition of stock-based compensation of $3.1 million and improvements in the fair values of available-for-sale securities of $5.3 million, offset in part by unrealized fair value losses on derivatives designated in cash flow hedge relationships, increased equity. Lastly, 47,095 shares of voting common stock were issued during the nine months ended September 30, 2014 to directors who were entitled to receive these as compensation for their service as a director of the Bancorp or the Bank, and 34,414 shares were issued under other share-based-compensation arrangements which resulted in a $0.9 million aggregate increase in shareholders equity.

We are subject to various regulatory capital requirements that are monitored by federal banking agencies. Failure to meet minimum capital requirements can lead to supervisory actions by regulators; any supervisory action could have a direct material effect on our financial statements. At September 30, 2014, we met all capital adequacy requirements to which we were subject and were well capitalized.

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The capital ratios for the Bank and the Bancorp at September 30, 2014 and December 31, 2013 were as follows:

| | Actual | | For Capital Adequacy Purposes | | To Be Well Capitalized Under Prompt Corrective Action Provisions | |
|---|---|---|---|---|---|---|
| (Dollars in thousands) | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| **As of September 30, 2014:** | | | | | | |
| **Total capital (to risk weighted assets)** | | | | | | |
| Customers Bancorp, Inc. | $ 563,506 | 11.22% | $ 401,910 | 8.0% | N/A | N/A |
| Customers Bank | $ 589,714 | 11.81% | $ 399,448 | 8.0% | $ 499,310 | 10.0% |
| **Tier 1 capital (to risk weighted assets)** | | | | | | |
| Customers Bancorp, Inc. | $ 422,423 | 8.41% | $ 200,955 | 4.0% | N/A | N/A |
| Customers Bank | $ 448,631 | 8.99% | $ 199,724 | 4.0% | $ 299,586 | 6.0% |
| **Tier 1 capital (to average assets)** | | | | | | |
| Customers Bancorp, Inc. | $ 422,423 | 7.07% | $ 239,016 | 4.0% | N/A | N/A |
| Customers Bank | $ 448,631 | 7.55% | $ 237,820 | 4.0% | $ 297,275 | 5.0% |
| **As of December 31, 2013:** | | | | | | |
| **Total capital (to risk weighted assets)** | | | | | | |
| Customers Bancorp, Inc. | $ 411,527 | 13.21% | $ 249,196 | 8.0% | N/A | N/A |
| Customers Bank | $ 435,432 | 14.11% | $ 246,936 | 8.0% | $ 308,670 | 10.0% |
| **Tier 1 capital (to risk weighted assets)** | | | | | | |
| Customers Bancorp, Inc. | $ 387,529 | 12.44% | $ 124,598 | 4.0% | N/A | N/A |
| Customers Bank | $ 411,434 | 13.33% | $ 123,468 | 4.0% | $ 185,202 | 6.0% |
| **Tier 1 capital (to average assets)** | | | | | | |
| Customers Bancorp, Inc. | $ 387,529 | 10.11% | $ 153,310 | 4.0% | N/A | N/A |
| Customers Bank | $ 411,434 | 10.81% | $ 152,191 | 4.0% | $ 190,239 | 5.0% |

**Liquidity and Capital Resources**

Liquidity for a financial institution is a measure of that institution s ability to meet depositors needs for funds, to satisfy or fund loan commitments, and for other operating purposes. Ensuring adequate liquidity is an objective of the asset/liability management process. Customers Bancorp coordinates its management of liquidity with its interest rate sensitivity and capital position, and strives to maintain a strong liquidity position.

The Bank s investment portfolio provides periodic cash flows through regular maturities and amortization, and can be used as collateral to secure additional liquidity funding. Our principal sources of funds are proceeds from stock issuance, deposits, debt issuance, principal and interest payments on loans, and other funds from operations. Borrowing arrangements are maintained with the Federal Home Loan Bank and the Federal Reserve Bank of Philadelphia to meet short-term liquidity needs. As of September 30, 2014, our borrowing capacity with the Federal Home Loan Bank was $2.9 billion of which $1.3 billion was utilized in short-term borrowings. As of September 30, 2014, our borrowing capacity with the Federal Reserve Bank of Philadelphia was $64.3 million.

Net cash flows used in operating activities were $445.6 million for the nine months ended September 30, 2014, compared to net cash flows provided by operating activities of $588.0 million for the nine months ended September 30, 2013. For the nine months ended September 30, 2014, originations of loans held for sale exceeded proceeds received from the sale of loans by $481.3 million. For the nine months ended September 30, 2013, proceeds

received from the sale of loans exceeded originations of loans held for sale by $519.3 million.

Investing activities used net cash flows of $1.8 billion for the nine months ended September 30, 2014, compared to $1.2 billion for the nine months ended September 30, 2013. Net cash used to originate loans totaled $1.6 billion for the nine months ended September 30, 2014, compared to $639.0 million for the nine months ended September 30, 2013. Net cash used to purchase loans was $308.2 million in the nine months ended September 30, 2014, compared to $155.3 million for the nine months ended September 30, 2013.

Financing activities provided an aggregate of $2.3 billion for the nine months ended September 30, 2014: increases in deposits provided $1.3 billion, net proceeds from short-term borrowed funds provided $610.0 million, net proceeds from long-term FHLB advances provided $265.0 million, and net proceeds from issuances of privately placed long-term subordinated and senior debt provided $133.1 million. Financing activities provided an aggregate of $656.5 million for the nine months ended September 30, 2013 driven by a net increase in deposits of $802.6 million, decreased cash from short-term borrowed funds of $339.0 million, net proceeds of $97.5 million from the issuance of stock and net proceeds of $60.3 million from long-term borrowed funds. These financing activities provided sufficient cash flows to support the Bancorp s investing and operating activities.

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Overall, based on our core deposit base and available sources of borrowed funds, management believes that the Bancorp has adequate resources to meet its short-term and long-term cash requirements within the foreseeable future.

**Other Information**

*Regulatory Matters and Pending Legislation*

In 2008, the U.S. financial system and broader economy faced the most severe financial crisis since the Great Depression. The crisis threatened the stability of the financial system and contributed to the failure of numerous financial institutions, including some large, complex financial institutions. In response to the crisis, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), which became law on July 21, 2010. The act includes numerous reforms to strengthen oversight of financial services firms and consolidate certain consumer protection responsibilities within the Bureau of Consumer Financial Protection, commonly known as the Consumer Financial Protection Bureau (CFPB). Although the Dodd-Frank Act exempts small institutions, such as community banks and credit unions, from several of its provisions, and authorizes federal regulators to provide small institutions with relief from certain regulations, it also contains provisions that will impose additional restrictions and compliance costs on these institutions. Determining which provisions will affect us is difficult, because the impact may depend on how agencies implement certain provisions through their rules, and many of the rules needed to implement the act have not been finalized.

On September 12, 2010, the Basel Committee on Banking Supervision announced an agreement to a strengthened set of capital requirements for internationally active banking organizations in the United States and around the world, known as Basel III. Basel III narrows the definition of what is included in regulatory capital, introduces requirements for minimum Tier 1 common capital, increases requirements for minimum Tier 1 capital and total risk-based capital, and changes risk-weighting of certain assets. On July 2, 2013, the Federal Reserve adopted a final rule regarding new capital requirements pursuant to Basel III. These rules, which are currently scheduled to become effective on January 1, 2015 for community banks, and fully phased in by January 1, 2019, will increase the required amount of regulatory capital to meet the regulatory capital standards and may, if capital levels are not sufficient, lead to limitations on the dividend payments and compensation. We continue to evaluate the impact the new capital requirements may have on our business and will manage our business accordingly.

**Effect of Government Monetary Policies**

Our earnings are and will be affected by domestic economic conditions and the monetary and fiscal policies of the United States government and its agencies. An important function of the Federal Reserve Board is to regulate the money supply and interest rates. Among the instruments used to implement those objectives are open market operations in United States government securities and changes in reserve requirements against member bank deposits. These instruments are used in varying combinations to influence overall growth and distribution of bank loans, investments, and deposits, and their use may also affect rates charged on loans or paid for deposits.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

At September 30, 2014, there have been no material changes in the information disclosed under Quantitative and Qualitative Disclosures About Market Risk included within Customers Bancorp s 2013 Form 10-K.

**Item 4. Controls and Procedures**

As of the end of the period covered by this report, Customers Bancorp carried out an evaluation, under the supervision and with the participation of Customers Bancorp s management, including Customers Bancorp s Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of Customers Bancorp s disclosure controls and procedures as defined and in the Exchange Act Rules 13a-15(e) and 15d-15(e). Based upon the evaluation, the Chief Executive Officer and Chief Financial Officer concluded that Customers Bancorp s disclosure controls and procedures were effective at September 30, 2014.

During the quarter ended September 30, 2014, there have been no changes in the Bancorp s internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the Bancorp s internal control over financial reporting.

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## Part II. OTHER INFORMATION

### Item 1. Legal Proceedings

There have been no material changes to the legal proceedings disclosed within our 2013 Form 10-K.

### Item 1A. Risk Factors

In addition to the other information set forth in this Quarterly Report, you should carefully consider the factors discussed in Risk Factors included within the 2013 Form 10-K and in our subsequently filed quarterly reports on Form 10-Q for the periods ended March 31, 2014 and June 30, 2014. The risks described therein are not the only risks facing us. Additional risks and uncertainties not currently known to us or that we currently believe to be immaterial also may materially adversely affect our business, financial condition and/or operating results. See Item 2 Management s Discussion and Analysis of Financial Condition and Results of Operations Cautionary Note Regarding Forward-Looking Statements.

### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

On November 26, 2013, the Bancorp s Board of Directors authorized a stock repurchase plan in which the Bancorp could acquire up to 5% of its current outstanding shares at prices not to exceed a 20% premium over the then current book value. The repurchase program has no expiration date but may be suspended, modified or discontinued at any time, and the Bancorp has no obligation to repurchase any amount of its common stock under the program.

During the three and nine months ended September 30, 2014, the Bancorp did not repurchase any of its shares. The maximum number of shares available to be purchased under the plan is 750,551 shares.

### Item 3. Defaults Upon Senior Securities

None.

### Item 4. Mine Safety Disclosures

Not applicable.

### Item 5. Other Information

None

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**Item 6. Exhibits**

| Exhibit No. | Description |
|---|---|
| 3.1 | Amended and Restated Articles of Incorporation of Customers Bancorp, incorporated by reference to Exhibit 3.1 to the Customers Bancorp s Form 8-K filed with the SEC on April 30, 2012 |
| 3.2 | Amended and Restated Bylaws of Customers Bancorp, incorporated by reference to Exhibit 3.2 to the Customers Bancorp s Form 8-K filed with the SEC on April 30, 2012 |
| 3.3 | Articles of Amendment to the Amended and Restated Articles of Incorporation of Customers Bancorp, incorporated by reference to Exhibit 3.1 to the Customers Bancorp Form 8-K filed with the SEC on July 2, 2012 |
| 4.1 | Indenture, dated as of July 30, 2013, by and between Customers Bancorp, Inc., as Issuer, and Wilmington Trust, National Association, as Trustee, incorporated by reference to Exhibit 4.1 to the Customers Bancorp 8-K filed with the SEC on July 31, 2013 |
| 4.2 | First Supplemental Indenture, dated as of July 30, 2013, by and between Customers Bancorp, Inc., as Issuer, and Wilmington Trust, National Association, as Trustee, incorporated by reference to Exhibit 4.2 to the Customers Bancorp 8-K filed with the SEC on July 31, 2013 |
| 4.3 | 6.375% Global Note in aggregate principal amount of $55,000,000, incorporated by reference to Exhibit 4.3 to the Customers Bancorp 8-K filed with the SEC on July 31, 2013 |
| 4.4 | Amendment to First Supplemental Indenture, dated August 27, 2013, by and between Customers Bancorp, Inc. and Wilmington Trust Company, National Association, as trustee, incorporated by reference to Exhibit 4.1 to the Customers Bancorp 8-K filed with the SEC on August 29, 2013. |
| 4.5 | 6.375% Global Note in aggregate principal amount of $8,250,000, incorporated by reference to Exhibit 4.2 to the Customers Bancorp 8-K filed with the SEC on August 29, 2013 |
| 4.6 | Form of Note Subscription Agreement (including form of Subordinated Note Certificate and Senior Note Certificate), incorporated by reference to Exhibit 10.1 to the Customers Bancorp 8-K filed with the SEC on June 26, 2014 |
| 10.1 | Amended and Restated 2014 Employee Stock Purchase Plan, incorporated by reference to Exhibit 4.4 to the Customers Bancorp Form S-8 Registration statement filed August 8, 2014 |
| 31.1 | Certification of the Chief Executive Officer Pursuant to Exchange Act Rule 13a-14(a) or Rule15d-14(a) |
| 31.2 | Certification of the Chief Financial Officer Pursuant to Exchange Act Rule 13a-14(a) or Rule15d-14(a) |
| 32.1 | Certification of the Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of Sarbanes-Oxley Act of 2002 |
| 32.2 | Certification of the Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of Sarbanes-Oxley Act of 2002 |
| 101 | The Exhibits filed as part of this report are as follows: |
| 101.INS | XBRL Instance Document. |

| | |
|---|---|
| 101.SCH | XBRL Taxonomy Extension Schema Document. |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document. |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document. |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document. |
| 101.DEF | XBRL Taxonomy Extension Definitions Linkbase Document. |

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## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**Customers Bancorp, Inc.**

November 7, 2014

By: /s/ Jay S. Sidhu
Name: Jay S. Sidhu
Title: Chairman and Chief Executive Officer

(Principal Executive Officer)

**Customers Bancorp, Inc.**

November 7, 2014

By: /s/ Robert E. Wahlman
Name: Robert E. Wahlman
Title: Chief Financial Officer

(Principal Financial Officer)

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