



**DISCOUNT BANCORP, INC. AND SUBSIDIARIES**

Consolidated Financial Statements

December 31, 2011 and 2010

(With Independent Auditors' Report Thereon)

**DISCOUNT BANCORP, INC. AND SUBSIDIARIES**

Consolidated Financial Statements

December 31, 2011 and 2010

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KPMG LLP  
345 Park Avenue  
New York, NY 10154

## Independent Auditors' Report

The Board of Directors and Stockholder  
Discount Bancorp, Inc.:

We have audited the accompanying consolidated balance sheets of Discount Bancorp, Inc. and subsidiaries (the Company) as of December 31, 2011 and 2010, and the related consolidated statements of income, changes in stockholder's equity and comprehensive income, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statement based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Discount Bancorp, Inc. and subsidiaries as of December 31, 2011 and 2010, and the results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

**KPMG LLP**

March 26, 2012

**DISCOUNT BANCORP, INC. AND SUBSIDIARIES**

Consolidated Balance Sheets

December 31, 2011 and 2010

(Dollars in thousands)

| <b>Assets</b>  | <b>2011</b>         | <b>2010</b>      |
|--|---------------------|------------------|
| Cash   | \$ 64,979           | 40,982           |
| Due from banks   | 103,435             | 86,602           |
| Cash and cash equivalents  | <u>168,414</u>      | <u>127,584</u>   |
| Interest-bearing deposits with banks   | 440,083             | 342,246          |
| Trading account assets, at fair value  | 103,898             | 15,815           |
| Available-for-sale securities, at fair value   | 3,781,989           | 3,337,232        |
| Held-to-maturity securities (fair value of \$866,679 and<br>\$1,218,385, respectively) | 830,520             | 1,220,859        |
| Federal Home Loan Bank of New York stock, at cost                                      | 27,334              | 34,651           |
| Loans held for sale  | 700                 | 2,755            |
| Loans, net of unearned income and deferred fees  | 3,824,746           | 3,920,959        |
| Less allowance for loan losses   | <u>(73,792)</u>     | <u>(62,558)</u>  |
| Loans, net   | 3,750,954           | 3,858,401        |
| Unrealized gain on derivatives   | 16,514              | 16,997           |
| Premises and equipment, net  | 33,391              | 30,646           |
| Accrued interest   | 39,969              | 39,065           |
| Accounts receivable  | 12,453              | 15,178           |
| Bank-owned life insurance, net   | 163,979             | 163,778          |
| Customers' liability under acceptances   | 8,025               | 7,553            |
| Deferred tax asset, net  | 75,544              | 59,055           |
| Other assets   | <u>33,737</u>       | <u>47,401</u>    |
| Total assets   | <u>\$ 9,487,504</u> | <u>9,319,216</u> |

See accompanying notes to consolidated financial statements.

**DISCOUNT BANCORP, INC. AND SUBSIDIARIES**

## Consolidated Balance Sheets

December 31, 2011 and 2010

(Dollars in thousands, except par value)

| <b>Liabilities and Stockholder's Equity</b>   | <b>2011</b>  | <b>2010</b> |
|---|--------------|-------------|
| Deposits:   |              |             |
| Domestic offices:   |              |             |
| Noninterest-bearing   | \$ 597,060   | 489,974     |
| Interest bearing  | 4,259,165    | 4,118,719   |
| Foreign offices:  |              |             |
| Noninterest bearing   | 35,968       | 42,899      |
| Interest bearing  | 1,714,017    | 1,460,523   |
| Total deposits  | 6,606,210    | 6,112,115   |
| Securities sold under agreements to repurchase  | 1,747,599    | 2,029,942   |
| Federal Home Loan Bank of New York (FHLB) and other<br>borrowed funds                             | 148,425      | 204,053     |
| Unrealized loss on derivatives  | 14,100       | 14,912      |
| Acceptances outstanding   | 8,025        | 7,553       |
| Accounts payable, accrued expenses, and other liabilities   | 99,866       | 108,638     |
| Subordinated capital note payable to Parent   | 75,000       | 75,000      |
| Total liabilities   | 8,699,225    | 8,552,213   |
| Commitments and contingencies (note 19)   |              |             |
| Stockholder's equity:   |              |             |
| Common stock, par value \$100. Authorized 100,000 shares;<br>issued and outstanding 50,000 shares | 5,000        | 5,000       |
| Surplus   | 94,652       | 94,652      |
| Retained earnings   | 730,811      | 685,025     |
| Accumulated other comprehensive loss, net of tax  | (42,184)     | (17,674)    |
| Total stockholder's equity  | 788,279      | 767,003     |
| Total liabilities and stockholder's equity  | \$ 9,487,504 | 9,319,216   |

See accompanying notes to consolidated financial statements.

**DISCOUNT BANCORP, INC. AND SUBSIDIARIES**

Consolidated Statements of Income

Years ended December 31, 2011 and 2010

(Dollars in thousands)

|   | <u>2011</u>      | <u>2010</u>    |
|---|------------------|----------------|
| Interest and dividend income:   |                  |                |
| Loans   | \$ 158,995       | 159,368        |
| Investment securities   | 149,005          | 161,672        |
| Deposits with banks   | 4,881            | 3,875          |
| Dividends on securities   | 1,543            | 2,182          |
| Total interest and dividend income  | <u>314,424</u>   | <u>327,097</u> |
| Interest expense:   |                  |                |
| Deposits  | 39,295           | 38,511         |
| Securities sold under repurchase agreements and borrowed funds                                  | 82,246           | 91,023         |
| Total interest expense  | <u>121,541</u>   | <u>129,534</u> |
| Net interest and dividend income  | 192,883          | 197,563        |
| Less provision for loan losses  | <u>40,857</u>    | <u>45,125</u>  |
| Net interest income, after provision for loan losses  | <u>152,026</u>   | <u>152,438</u> |
| Noninterest income (loss):  |                  |                |
| Commissions and service fees  | 20,352           | 22,030         |
| Loan and deposit fees   | 21,710           | 24,114         |
| Trust and safekeeping fees  | 3,290            | 3,702          |
| Gains on securities, net  | 20,433           | 25,228         |
| Loss on other-than temporary impairment (OTTI) write-down<br>of securities (all credit related) | —                | (12,732)       |
| Gains on foreign exchange, net  | 4,421            | 3,197          |
| Gain from trading account assets, net   | 606              | 2,166          |
| Other   | 8,665            | 8,023          |
| Total noninterest income  | <u>79,477</u>    | <u>75,728</u>  |
| Noninterest expense:  |                  |                |
| Salaries and employee benefits  | 95,691           | 88,718         |
| Occupancy and equipment   | 22,547           | 23,096         |
| Professional fees   | 5,902            | 8,176          |
| Operating costs for representative offices  | 8,453            | 6,326          |
| Other   | 38,955           | 37,821         |
| Total noninterest expense   | <u>171,548</u>   | <u>164,137</u> |
| Income before income tax expense  | 59,955           | 64,029         |
| Income tax expense  | <u>14,169</u>    | <u>12,720</u>  |
| Net income  | <u>\$ 45,786</u> | <u>51,309</u>  |

See accompanying notes to consolidated financial statements.

**DISCOUNT BANCORP, INC. AND SUBSIDIARIES**

Consolidated Statements of Changes in Stockholder's Equity and Comprehensive Income

Years ended December 31, 2011 and 2010

(Dollars in thousands)

|   | <b>Number of<br/>common<br/>shares issued<br/>and<br/>outstanding</b> | <b>Common<br/>stock</b> | <b>Surplus</b> | <b>Retained<br/>earnings</b> | <b>Accumulated<br/>other<br/>comprehensive<br/>loss</b> | <b>Comprehensive<br/>(loss)/income</b> | <b>Total</b> |
|---|---|-------------------------|----------------|------------------------------|---|--|--------------|
| Balance, December 31, 2009  | 50,000  | \$ 5,000                | 94,652         | 633,716                      | (23,481)  |  | 709,887      |
| Comprehensive income:   |   |                         |                |                              |   |  |              |
| Net unrealized gain on securities, net of taxes   | —   | —                       | —              | —                            | 17,832  | \$ 17,832                              | 17,832       |
| Other-than-temporary impairments (OTTI) on<br>available-for-sale securities, net of taxes | —   | —                       | —              | —                            | 799   | 799                                    | 799          |
| Realized gains on available-for-sale securities,<br>net of taxes                          | —   | —                       | —              | —                            | (11,205)  | (11,205)                               | (11,205)     |
| Net unrealized gain on securities transferred from<br>AFS to HTM, net of taxes            | —   | —                       | —              | —                            | 1,102   | 1,102                                  | 1,102        |
| Net amortization of gain on securities transferred<br>from AFS to HTM, net of taxes       | —   | —                       | —              | —                            | (1,003)   | (1,003)                                | (1,003)      |
| Funded status of pension and post retirement<br>benefits, net of taxes                    | —   | —                       | —              | —                            | (1,718)   | (1,718)                                | (1,718)      |
| Net income  | —   | —                       | —              | 51,309                       | —   | 51,309                                 | 51,309       |
| Comprehensive income  |   |                         |                |                              |   | \$ 57,116                              |              |
| Balance, December 31, 2010  | 50,000  | 5,000                   | 94,652         | 685,025                      | (17,674)  |  | 767,003      |
| Comprehensive income:   |   |                         |                |                              |   |  |              |
| Net unrealized loss on securities, net of taxes   | —   | —                       | —              | —                            | (7,669)   | \$ (7,669)                             | (7,669)      |
| Realized gains on available-for-sale securities,<br>net of taxes                          | —   | —                       | —              | —                            | (8,867)   | (8,867)                                | (8,867)      |
| Net amortization of gain on securities transferred<br>from AFS to HTM, net of taxes       | —   | —                       | —              | —                            | (372)   | (372)                                  | (372)        |
| Net unrealized loss on cash flow hedge<br>net of taxes                                    | —   | —                       | —              | —                            | (2,226)   | (2,226)                                | (2,226)      |
| Funded status of pension and post retirement<br>benefits, net of taxes                    | —   | —                       | —              | —                            | (5,376)   | (5,376)                                | (5,376)      |
| Net income  | —   | —                       | —              | 45,786                       | —   | 45,786                                 | 45,786       |
| Comprehensive income  |   |                         |                |                              |   | \$ 21,276                              |              |
| Balance, December 31, 2011  | 50,000  | \$ 5,000                | 94,652         | 730,811                      | (42,184)  |  | 788,279      |

See accompanying notes to consolidated financial statements.

**DISCOUNT BANCORP, INC. AND SUBSIDIARIES**

Consolidated Statements of Cash Flows

Year ended December 31, 2011 and 2010

(Dollars in thousands)

|  | <u>2011</u>       | <u>2010</u>       |
|--|-------------------|-------------------|
| Cash flows from operating activities:  |                   |                   |
| Net income   | \$ 45,786         | 51,309            |
| Adjustments to reconcile net income to net cash provided (used) by operating activities: |                   |                   |
| Provision for loan losses  | 40,857            | 45,125            |
| Depreciation and amortization of premises and equipment                                  | 6,540             | 6,675             |
| (Gains) on securities, net   | (20,433)          | (25,228)          |
| Other-than-temporary impairment write-down of securities                                 | —                 | 12,732            |
| (Income) from bank-owned and corporate-owned life insurance, net                         | (5,927)           | (6,253)           |
| Deferred income tax benefit  | (266)             | (9,248)           |
| Amortization of securities, net  | 29,159            | 31,433            |
| Changes in:  |                   |                   |
| Accrued interest receivable  | (904)             | (1,029)           |
| Accounts receivable  | (2,716)           | (5,234)           |
| Accrued interest payable   | 3,687             | (1,633)           |
| Trading account assets   | (88,083)          | (9,639)           |
| Other  | 14,979            | 28,619            |
| Proceeds from sales of loans held-for sale   | 116,009           | 15,085            |
| Net cash provided by operating activities  | <u>138,688</u>    | <u>132,714</u>    |
| Cash flows from investing activities:  |                   |                   |
| Purchases of held-to-maturity securities   | (79,832)          | (621,097)         |
| Proceeds from the sales of held-to-maturity securities                                   | 46,467            | —                 |
| Proceeds from the maturities of held-to-maturity securities                              | 420,859           | 445,003           |
| Purchases of available-for-sale securities   | (2,954,149)       | (2,658,924)       |
| Proceeds from the sales of available-for-sale securities                                 | 1,161,569         | 1,182,291         |
| Proceeds from the maturities of available-for-sale securities                            | 1,287,424         | 1,715,394         |
| Proceeds from sales of other assets  | 3,294             | —                 |
| Proceeds from bank-owned life insurance  | 11,300            | 6,001             |
| Purchase of premises and equipment   | (9,285)           | (4,979)           |
| Changes in:  |                   |                   |
| Interest-bearing deposits with banks   | (97,837)          | 343,618           |
| Loans  | (51,109)          | (430,015)         |
| Federal Home Loan Bank Stock   | 7,317             | 4,751             |
| Net cash (used) in investing activities  | <u>(253,982)</u>  | <u>(17,957)</u>   |
| Cash flows from financing activities:  |                   |                   |
| Changes in:  |                   |                   |
| Deposits   | 494,095           | (95,955)          |
| Securities sold under repurchase agreements  | (282,343)         | 10,175            |
| Repayments of FHLB advances  | (50,312)          | (60,808)          |
| Other funds borrowed   | (5,316)           | (1,458)           |
| Net cash provided by (used) in financing activities                                      | <u>156,124</u>    | <u>(148,046)</u>  |
| Net increase (decrease) in cash and cash equivalents                                     | 40,830            | (33,289)          |
| Cash and cash equivalents at beginning of year   | <u>127,584</u>    | <u>160,873</u>    |
| Cash and cash equivalents at end of year   | \$ <u>168,414</u> | \$ <u>127,584</u> |
| Supplemental disclosure of cash flow information:  |                   |                   |
| Cash paid during the period for:   |                   |                   |
| Interest   | \$ 117,854        | 131,167           |
| Income taxes   | 10,979            | 11,328            |
| Supplemental disclosure of noncash investing activities:                                 |                   |                   |
| Transfer of securities from available-for-sale to held-to-maturity                       | \$ —              | 568,472           |
| Transfer of loans to loans held-for-sale   | 115,694           | 17,460            |
| Transfer of loans held-for-sale to other assets  | 2,755             | —                 |

See accompanying notes to consolidated financial statements.

## DISCOUNT BANCORP, INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

December 31, 2011 and 2010

#### (1) General

Discount Bancorp, Inc. (Discount), a wholly owned subsidiary of Israel Discount Bank Limited, Tel Aviv (IDBL), is a Delaware bank holding company. The consolidated financial statements of Discount include the following wholly owned bank subsidiaries: Israel Discount Bank of New York (the Bank), a New York State chartered bank, and Discount Bank (Latin America), Montevideo, Uruguay (DBLA), a bank regulated in Uruguay, and the following principal nonbank subsidiaries: IDBNY Realty LLC, IDBNY Realty (Delaware), Inc., IDB Leasing, Inc., IDB Capital Corp., a broker-dealer regulated by the Financial Industry Regulatory Authority (FINRA) and the U.S. Securities and Exchange Commission, and DB Properties, Inc. (collectively, the Company).

The annual audited financial statements and the Independent Auditors Report over management's assertion on Effectiveness of Internal Controls over Financial Reporting as of December 31, 2011, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) can be found on the Company's website at [www.idbbank.com](http://www.idbbank.com).

#### (2) Significant Accounting Policies

##### (a) *Basis of Presentation*

The consolidated financial statements include the accounts of Discount Bancorp, Inc. and subsidiaries after elimination of intercompany balances and transactions. The Company translates its foreign-currency-denominated assets, liabilities, and off-balance sheet foreign currency transactions at the U.S. dollar spot rate of exchange at the balance sheet date. Certain reclassifications and adjustments have been made to the prior year amounts to conform to the current year presentation.

The consolidated financial statements have been prepared by management and in the opinion of management, include all adjustments consisting of normal recurring accruals, necessary for a fair presentation of the Company's financial position and results of operations as of the date and period presented.

##### (b) *Cash and Cash Equivalents*

For presentation in the Consolidated Balance Sheets and Consolidated Statements of Cash Flows, cash and cash equivalents include cash, non-interest bearing deposits with banks and Federal funds sold.

##### (c) *Securities – Trading Account, Available-for-Sale, and Held-to-Maturity Assets*

The Company designates an investment in securities as trading, available-for-sale, or held-to-maturity at the time of acquisition.

Trading securities are debt securities held principally for the purpose of selling them in the near term. These securities are recorded at fair value with unrealized gains and losses being recognized in gains from trading account assets, net in the Consolidated Statements of Income.

Available-for-sale (AFS) securities are investments that the Company intends to hold for an indefinite period of time. Such securities include those which will be used as part of the Company's

## DISCOUNT BANCORP, INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

December 31, 2011 and 2010

asset/liability management strategy or securities that may be sold in response to changes in interest rates, changes in prepayment analyses, the need to increase liquidity, or similar factors. Available-for-sale securities are recorded at fair value with unrealized gains and losses excluded from net income and reported as a separate component of Stockholder's equity in Accumulated other comprehensive loss, net of tax (AOCI). Gains or losses on dispositions are recognized by the specific identification method and are included in gains on securities, net in the Consolidated Statements of Income.

Held-to-maturity (HTM) securities are investments that the Company has the positive intent and the ability to hold to their scheduled maturity. These securities are carried at cost, adjusted for the amortization of premiums or accretion of discounts and impairment charges while in HTM.

Purchase premiums and discounts are recognized as interest income using the level yield method over the term of the securities. Amortization of premiums and accretion of discounts on mortgage backed securities are based on the estimated cash flows of the mortgage backed securities, periodically adjusted for changes in estimated lives, on a level yield basis.

Fair value is determined by quoted market prices, where available, or by independent pricing services. If listed prices or quotes are not available or if it is deemed that other methods are more appropriate in light of current market conditions then fair value is based upon pricing models that primarily use market-based or independently sourced market parameters as inputs, including, but not limited to, yield curves, interest rates, equity or debt prices for similar securities, and credit curves. In addition to market information, models also incorporate transaction details, such as maturity and cash flow assumptions.

The Company reviews its Available-for-sale and Held-to-maturity investment securities quarterly to determine whether an impairment that is considered to be other-than-temporary (OTTI) has occurred. If a decline in fair value is judged by the Company to be other-than-temporary, and if there are significant credit concerns regarding a particular security and it is expected that the Company will not recover its amortized cost, the security is written down from its original cost basis to reflect the adjusted fair value and a new cost basis is established. Management's assessment also addresses the impact of the length of time an investment has been in an unrealized loss position. In general, the longer the length of time that a security has been in an unrealized loss position and the greater the magnitude of the unrealized loss, the more likely it is that the security is OTTI. Factors that management considers in its reviews for OTTI are the financial condition and near-term prospects of the issuer, recent events specific to the issuer or the issuer's industry, adverse or positive changes in fair value and ratings announced by one or more rating agencies, trends and volatility in earnings, whether the issuer of the debt security has remained current on principal and interest payments, whether the decline in fair value appears to be issuer specific or, alternatively, a reflection of general market conditions, and current analyst evaluations and other key measures, and if relevant, cash flow models based on the specific structure of the security to determine if there are adverse changes in cash flows.

If at any quarter-end date there is a security that management intends to sell or if a decision to sell has not been made but management concludes that it is more likely than not that it will be required to sell such a security before recovery of the amortized cost basis of the security then an OTTI

## DISCOUNT BANCORP, INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

December 31, 2011 and 2010

write-down to fair value would be recorded in earnings. If it is not more likely than not that the Company will have to sell the security prior to recovery of amortized cost then an OTTI loss equal to the credit loss component would be recorded in earnings with the remaining difference to fair value recorded in AOCI. A credit loss is deemed to exist when full repayment of principal and interest according to the contractual terms of the security is no longer probable, and it is determined based on one of following measures: the present value of expected future cash flows discounted at the security's effective interest rate; or the fair value of the collateral if the security is collateral dependent.

**(d) *Federal Home Loan Bank of New York Stock***

The Bank is a member of the Federal Home Loan Bank of New York ("FHLB") and is required to maintain an investment in capital stock of the FHLB. Based on redemption provisions, the stock has no quoted market value and is carried at cost. Management evaluates the ultimate recoverability of the cost basis of the stock for impairment on a quarterly basis.

**(e) *Loans***

Loans are reported at their outstanding principal amounts, net of unearned income and deferred fees. Interest is credited to income, on the accrual method of accounting, based on principal amounts outstanding at agreed-upon interest rates. Unearned income on loans is credited to income by use of the effective-interest method. Deferred fees are amortized to interest income, using a method, which approximates the interest method, over the life of the loan as an adjustment to yield.

A loan is placed on nonaccrual status when management has determined that the borrower may be unable to meet contractual principal or interest obligations, or when payments are 90 days or more past due. Accrual of interest ceases and, in general, uncollected past-due interest (including interest applicable to prior years, if any) is reversed and charged against current interest income. For loans carried on a nonaccrual basis, including impaired loans, interest income is recognized only to the extent it is received in cash, except where there is doubt with regard to the ultimate collection of the loan principal. In those circumstances where the collection of loan principal is in doubt, cash received, whether designated as principal or interest, is applied first to reduce loan principal. A nonaccrual loan may only be returned to current accrual interest status when both the loan principal and interest are current and future principal and interest payments are reasonably assured.

**(f) *Troubled Debt Restructurings***

A loan is accounted for as a troubled debt restructuring if the Company, for economic or legal reasons related to a borrower's financial condition, grants a significant concession to the borrower that it would not otherwise consider. A troubled debt restructuring may involve the receipt of assets from the debtor in partial or full satisfaction of the loan, a modification of terms such as a reduction of the stated interest rate or face amount of the loan, a reduction of accrued interest, an extension of the maturity date at a stated interest rate lower than the current market rate for a new loan with similar risk, or some combination of these concessions. Troubled debt restructurings generally remain on nonaccrual status until there is a sustained period of payment performance, which is usually six months for a loan with monthly amortizations, and there is reasonable assurance that the payments will continue.

## DISCOUNT BANCORP, INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

December 31, 2011 and 2010

**(g) Allowance for Loan Losses**

The allowance for loan losses is established through provisions for loan losses charged to earnings. Losses on loans are charged to the allowance for loan losses when management believes that the collection of principal is unlikely. Recoveries of loans previously charged-off are credited to the allowance when realized.

Management's evaluation process, which is further described in section (g) of footnote 6, is subject to review by the regulators and takes into consideration such factors as the Company's past loan experience, changes in the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans and collateral values, and current economic conditions that may affect the borrowers' ability to pay. Future adjustments to the allowance for loan losses may be necessary based on changes in economic conditions, real estate values, real estate trends, changes in collateral values, further information obtained regarding known problem loans, results of regulatory examinations, the identification of additional problem loans, and other factors.

As further described in section (f) of footnote 6, the Company considers a loan to be impaired when, based on current information and events, it is probable that it will be unable to collect all principal and interest contractually due.

**(h) Derivative Contracts and Foreign Exchange**

The Company enters into forward exchange contracts to hedge certain firm commitments denominated in foreign currencies. The purpose of these foreign currency hedging transactions is to protect the Company from the risk that the eventual dollar cash flows from foreign denominated securities will be adversely affected by changes in the currency exchange rate.

The Company's derivative contracts are recorded at fair value in the Consolidated Balance Sheets. Unrealized gains and losses on derivatives categorized as cash flow hedges are recorded as a component of accumulated other comprehensive loss, net of tax and are reclassified into earnings in the same period or periods during which the hedged transactions affect earnings.

The Company may enter into interest rate swap agreements to effectively manage its interest rate risk and cross currency swaps to manage its exposure to foreign exchange positions. The interest rate swap agreements utilized by the Company modify its exposure to fixed interest rate risk by converting fixed-rate available-for-sale securities to a floating rate. The swap agreements provide for the payment of fixed-rate interest payments in exchange for floating rate interest payments, over the life of the agreement, without the notional amounts being exchanged.

In the event of an early termination of an interest rate or cross currency swap agreement, the Company may sell the available-for-sale security being economically hedged to mitigate the asset exposure to changes in foreign exchange or interest rates. The gain or loss on the sales of derivative contracts would be included in gain from trading account assets, net while the securities gains (if sold) would be included, in gains on securities, net, in the Consolidated Statements of Income.

Foreign exchange trading positions, including spot and forward purchase and sale contracts, are revalued daily at prevailing market rates and all profits or losses are included in gains from trading

## DISCOUNT BANCORP, INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

December 31, 2011 and 2010

account assets, net, in the Consolidated Statements of Income. DBLA is a retail bank in Uruguay and buys and sells foreign exchange on behalf of its retail customers. Income earned for conducting this business is recorded in gains on foreign exchange, net in the Consolidated Statements of Income.

In addition, the Company holds derivative instrument contracts that are used as an economic hedge against certain deposits. Gains and losses resulting from these contracts are included in gains from trading account assets, net, in the Consolidated Statements of Income.

**(i) *Securities Sold under Agreements to Repurchase***

Securities sold under agreements to repurchase (Repos) are accounted for as financings and as such the obligations to repurchase securities sold are reflected as liabilities in the Consolidated Balance Sheets. The securities collateralizing the Repos remain in the respective asset account on the balance sheet, although the securities are delivered to the counterparty to the agreement. In certain cases, the counterparties may have sold or re-pledged the securities to other parties in the normal course of business. However, the counterparty has agreed to resell to the Company the same securities at the maturity of the agreement.

**(j) *Premises and Equipment, Net***

Premises and equipment are stated at cost less accumulated depreciation and amortization. Depreciation is computed by the straight-line and accelerated methods based upon useful lives from 3 to 30 years. Amortization of leasehold improvements is computed by the straight-line method over the shorter time period of either the useful life of the improvement or the remaining life of the lease. The cost of maintenance and repairs on premises and equipment is charged to occupancy and equipment expense in the Consolidated Statements of Income.

**(k) *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use***

The Company purchases internal-use computer software from third parties. External costs related to maintenance are expensed, while costs incurred under agreements related to upgrades and enhancements are capitalized and amortized.

**(l) *Pension and Other Benefit Plans***

The Bank sponsors a noncontributory defined benefit pension plan covering substantially all full time employees of the Bank who were hired prior to January 1, 2011. The Plan is funded annually, as is required, based on computations prepared by an independent actuarial consultant. In addition, the Bank maintains a Supplemental Executive Retirement Plan (SERP), Restoration Plans and a Deferred Compensation Plan, which are designed to provide payments to its participants upon their retirement or leaving the Bank. The Company recognizes in its balance sheet the funded status of the pension and other postretirement benefits with the offset to accumulated other comprehensive loss. In recognizing the Plan's funded status, the Company recognizes actuarial gains and losses, prior service cost, and any remaining transition amounts.

The Bank maintains a contributory Savings and Investment Plan (401(k)). Contributions are made by employees on a discretionary basis, subject to the applicable limitations of U.S. tax laws. The Bank matches contributions up to the lesser of 3% of employee compensation or \$7,350 for 2011 and

## DISCOUNT BANCORP, INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

December 31, 2011 and 2010

2010. The Bank also maintains a non-contributory defined contribution plan covering substantially all full time employees who were hired on or after January 1, 2011. The Bank contributes a percentage of eligible compensation ranging from three to five percent depending on years of service.

**(m) Use of Estimates**

The preparation of consolidated financial statements, in conformity with U.S. generally accepted accounting principles (GAAP), requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and revenues and expenses for the period covered by the financial statements. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, measurements of other-than-temporary impairment of securities, the valuation of deferred tax assets, the valuation of investment securities, and actuarial determined liabilities.

**(n) Income Tax**

Income tax expense consists of income taxes that are currently payable and deferred income taxes. Deferred income tax expense (benefit) is determined by recognizing deferred tax assets and liabilities for future tax consequences, attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using enacted tax rates. The Company assesses the deferred tax assets and establishes a valuation allowance where realization of a deferred tax asset is not considered to be "more likely than not." In evaluating the need for a future valuation allowance, the Company generally considers the expectation of future taxable income, as well as its ability to carry back net operating losses in accordance with prevailing rules from the Internal Revenue Service.

The Company estimates income taxes payables based on the amounts it expects to owe the various tax authorities (i.e., federal, state, and local). Income tax represents the net estimated amount due to, or to be received from, such taxing authorities. In estimating income taxes, management assesses the relative merits and risks of the appropriate tax treatments of transactions, taking into account statutory, judicial, and regulatory guidance in the context of the Company's tax position. In this process, management also relies on tax opinions, recent audits, and historical experience. Although the Company uses available information to record income taxes, underlying estimates and assumptions can change over time as a result of unanticipated events or circumstances such as changes in tax laws and judicial guidance influencing its overall tax position.

**(o) Off-Balance Sheet Credit Related Financial Instruments**

In the ordinary course of business, the Company has entered into commitments to extend credit, including commitments under commercial letters of credit, and standby letters of credit. Such instruments are recorded when they are funded.

**(p) Bank-Owned Life Insurance**

All of the Bank-owned life insurance contracts at December 31, 2011 and December 31, 2010 are part of the general account liability of the various insurance companies. The market risks associated

## DISCOUNT BANCORP, INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

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with the general accounts are recorded by the insurance companies. In accordance with GAAP, the Bank-owned life insurance contracts are carried at their contract value and are classified as noninterest earning assets. Increases in the contract value are recorded as noninterest income in the consolidated statement of income, and insurance proceeds received are recorded as a reduction of the contract value.

### (3) Trading Account Assets, at Fair Value

Trading account assets are carried at fair value, and their balances are as follows:

|  | <u>2011</u>            | <u>2010</u>   |
|--|------------------------|---------------|
|  | (Dollars in thousands) |               |
| Foreign government securities  | \$ 89,663              | —             |
| Corporate bonds, notes, and debentures   | 105                    | 3,678         |
| U.S. government sponsored enterprise mortgage-backed<br>pass-through securities      | 828                    | 1,106         |
| U.S. government agency mortgage-backed pass-through securities                       | 10                     | 11            |
| Other mortgage backed securities:<br>U.S. government agency and sponsored enterprise | <u>13,292</u>          | <u>11,020</u> |
|  | <u>\$ 103,898</u>      | <u>15,815</u> |

**DISCOUNT BANCORP, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2011 and 2010

**(4) Securities – Available-for-Sale and Held-to-Maturity**

The amortized cost, fair value, and gross unrealized gains and losses of available-for-sale and held-to-maturity securities are as follows:

|   | <b>December 31, 2011</b>  |                                       |  |                   |
|---|---------------------------|---------------------------------------|--|-------------------|
|   | <b>Amortized<br/>cost</b> | <b>Gross<br/>unrealized<br/>gains</b> | <b>Gross<br/>unrealized<br/>losses</b> | <b>Fair value</b> |
|   | (Dollars in thousands)    |                                       |  |                   |
| Available-for-sale securities:                  |                           |                                       |  |                   |
| Debt securities:                                |                           |                                       |  |                   |
| U.S. Treasury securities                        | \$ 102,957                | 7                                     | 2                                      | 102,962           |
| U.S. government sponsored enterprise            | 43,402                    | 112                                   | 34                                     | 43,480            |
| Foreign government securities                   | 86,117                    | 270                                   | 73                                     | 86,314            |
| Mortgage backed pass-through securities:        |                           |                                       |  |                   |
| U.S. government agency                          | 58,625                    | 2,063                                 | —                                      | 60,688            |
| U.S. government sponsored enterprise            | 852,025                   | 19,992                                | 171                                    | 871,846           |
| Other mortgage backed securities:               |                           |                                       |  |                   |
| U.S. government agency and sponsored enterprise | 2,142,990                 | 20,184                                | 7,147                                  | 2,156,027         |
| Corporate bonds, notes, and debentures:         |                           |                                       |  |                   |
| U.S. corporate securities                       | 348,392                   | 154                                   | 69,732                                 | 278,814           |
| Foreign corporate securities                    | 185,072                   | 118                                   | 8,988                                  | 176,202           |
| Total debt securities                           | 3,819,580                 | 42,900                                | 86,147                                 | 3,776,333         |
| Mutual funds and equity securities              | 5,550                     | 122                                   | 16                                     | 5,656             |
| Total   | \$ 3,825,130              | 43,022                                | 86,163                                 | 3,781,989         |

**DISCOUNT BANCORP, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2011 and 2010

|  | <b>December 31, 2011</b>  |                                       |  |                   |
|--|---------------------------|---------------------------------------|--|-------------------|
|  | <b>Amortized<br/>cost</b> | <b>Gross<br/>unrealized<br/>gains</b> | <b>Gross<br/>unrealized<br/>losses</b> | <b>Fair value</b> |
|  | (Dollars in thousands)    |                                       |  |                   |
| Held-to-maturity securities:                       |                           |                                       |  |                   |
| U.S. government sponsored<br>enterprise            | \$ 126,257                | 265                                   | (93)                                   | 126,429           |
| Mortgage backed pass-through securities:           |                           |                                       |  |                   |
| U.S. government agency                             | 26,032                    | 1,556                                 | —                                      | 27,588            |
| U.S. government sponsored<br>enterprise            | 26,647                    | 1,326                                 | —                                      | 27,973            |
| Other mortgage backed securities:                  |                           |                                       |  |                   |
| U.S. government agency and<br>sponsored enterprise | 200,900                   | 5,773                                 | —                                      | 206,673           |
| Commercial mortgage<br>backed securities           | 14,687                    | 1,212                                 | —                                      | 15,899            |
| States and political subdivisions                  | 428,289                   | 25,172                                | (128)                                  | 453,333           |
| Foreign government securities                      | 7,708                     | 1,076                                 | —                                      | 8,784             |
| <b>Total</b>                                       | <b>\$ 830,520</b>         | <b>36,380</b>                         | <b>(221)</b>                           | <b>866,679</b>    |

**DISCOUNT BANCORP, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2011 and 2010

|  | <b>December 31, 2010</b>  |                                       |  | <b>Fair value</b> |
|--|---------------------------|---------------------------------------|--|-------------------|
|  | <b>Amortized<br/>cost</b> | <b>Gross<br/>unrealized<br/>gains</b> | <b>Gross<br/>unrealized<br/>losses</b> |                   |
|  |                           | (Dollars in thousands)                |  |                   |
| Available-for-sale securities:                     |                           |                                       |  |                   |
| Debt securities:                                   |                           |                                       |  |                   |
| U.S. Treasury securities                           | \$ 222,712                | 445                                   | 2,219                                  | 220,938           |
| U.S. government sponsored<br>enterprise            | 56,914                    | 139                                   | 187                                    | 56,866            |
| Foreign government securities                      | 76,538                    | 459                                   | 14                                     | 76,983            |
| Mortgage backed pass-through securities:           |                           |                                       |  |                   |
| U.S. government agency                             | 28,229                    | 1,305                                 | —                                      | 29,534            |
| U.S. government sponsored<br>enterprise            | 735,904                   | 26,151                                | 890                                    | 761,165           |
| Other mortgage backed securities:                  |                           |                                       |  |                   |
| U.S. government agency and<br>sponsored enterprise | 1,710,475                 | 21,291                                | 3,977                                  | 1,727,789         |
| Residential mortgage backed<br>securities          | 500                       | —                                     | —                                      | 500               |
| Structured financial products                      | 3,485                     | —                                     | —                                      | 3,485             |
| Corporate bonds, notes, and<br>debentures:         |                           |                                       |  |                   |
| U.S. corporate securities                          | 390,856                   | 2,207                                 | 57,709                                 | 335,354           |
| Foreign corporate securities                       | 122,350                   | 316                                   | 3,776                                  | 118,890           |
| Total debt securities                              | 3,347,963                 | 52,313                                | 68,772                                 | 3,331,504         |
| Mutual funds and equity securities                 | 5,527                     | 293                                   | 92                                     | 5,728             |
| Total  | \$ 3,353,490              | 52,606                                | 68,864                                 | 3,337,232         |

**DISCOUNT BANCORP, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2011 and 2010

|   | <b>December 31, 2010</b>  |                                       |  |                   |
|---|---------------------------|---------------------------------------|--|-------------------|
|   | <b>Amortized<br/>cost</b> | <b>Gross<br/>unrealized<br/>gains</b> | <b>Gross<br/>unrealized<br/>losses</b> | <b>Fair value</b> |
|   | (Dollars in thousands)    |                                       |  |                   |
| Held-to-maturity securities:                    |                           |                                       |  |                   |
| U.S. government sponsored enterprise            | \$ 372,335                | 165                                   | 12,460                                 | 360,040           |
| Mortgage backed pass-through securities:        |                           |                                       |  |                   |
| U.S. government agency                          | 30,696                    | 622                                   | —                                      | 31,318            |
| U.S. government sponsored enterprise            | 36,075                    | 850                                   | —                                      | 36,925            |
| Other mortgage backed securities:               |                           |                                       |  |                   |
| U.S. government agency and sponsored enterprise | 274,803                   | 4,618                                 | 218                                    | 279,203           |
| Commercial mortgage backed securities           | 19,290                    | 2,099                                 | —                                      | 21,389            |
| Residential mortgage backed securities          | 41,804                    | 174                                   | —                                      | 41,978            |
| States and political subdivisions               | 434,095                   | 4,502                                 | 4,341                                  | 434,256           |
| Foreign government securities                   | 11,761                    | 1,515                                 | —                                      | 13,276            |
| Total   | \$ <u>1,220,859</u>       | <u>14,545</u>                         | <u>17,019</u>                          | <u>1,218,385</u>  |

In March 2010, in connection with IDBL's implementation of Basel II, the Company transferred certain U.S. government and U.S. government agency mortgage backed securities as well as its portfolio of commercial mortgage backed securities from available for sale to held-to-maturity. The securities were transferred at fair value with the difference between amortized cost and fair value recorded in Accumulated other comprehensive loss, net of tax (AOCI). The fair value of the securities transferred was \$568 million with a net unrealized gain of approximately \$2.0 million recorded in AOCI. The net unrealized gain recorded in AOCI will be amortized as an adjustment of yield over the remaining contractual life of the underlying securities.

**DISCOUNT BANCORP, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

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The maturity table of mortgage-backed securities reflects the contractual final maturity date of principal balances outstanding at December 31, 2011 and 2010. Actual maturities of debt securities may differ, since certain obligations provide the issuer with the right to prepay or call the obligation prior to maturity.

| <b>December 31, 2011</b>                                       |                                   |                   |  |                   |                                      |                   |
|--|-----------------------------------|-------------------|--|-------------------|--------------------------------------|-------------------|
| <b>Contractual maturities of available-for-sale securities</b> |                                   |                   |  |                   |                                      |                   |
|  | <b>U.S. Treasury securities</b>   |                   | <b>U.S. government sponsored enterprise securities</b> |                   | <b>Foreign government securities</b> |                   |
|  | <b>Amortized cost</b>             | <b>Fair value</b> | <b>Amortized cost</b>                                  | <b>Fair value</b> | <b>Amortized cost</b>                | <b>Fair value</b> |
|  | (Dollars in thousands)            |                   |  |                   |                                      |                   |
| Available-for-sale:  |                                   |                   |  |                   |                                      |                   |
| Due within 1 year  | \$ 102,957                        | 102,962           | —  | —                 | 74,879                               | 74,892            |
| After 1 year but within 5 years                                | —                                 | —                 | 43,402   | 43,480            | 10,635                               | 10,660            |
| After 5 years but within 10 years                              | —                                 | —                 | —  | —                 | 560                                  | 690               |
| After 10 years   | —                                 | —                 | —  | —                 | 43                                   | 72                |
| Total  | <u>\$ 102,957</u>                 | <u>102,962</u>    | <u>43,402</u>  | <u>43,480</u>     | <u>86,117</u>                        | <u>86,314</u>     |
|  | <b>Mortgage backed securities</b> |                   | <b>Corporate bonds, notes, and debentures</b>          |                   | <b>Total</b>                         |                   |
|  | <b>Amortized cost</b>             | <b>Fair value</b> | <b>Amortized cost</b>                                  | <b>Fair value</b> | <b>Amortized cost</b>                | <b>Fair value</b> |
|  | (Dollars in thousands)            |                   |  |                   |                                      |                   |
| Available-for-sale:  |                                   |                   |  |                   |                                      |                   |
| Due within 1 year  | \$ —                              | —                 | 29,260   | 29,255            | 207,096                              | 207,109           |
| After 1 year but within 5 years                                | 3,284                             | 3,472             | 109,016  | 105,928           | 166,337                              | 163,540           |
| After 5 years but within 10 years                              | 37,899                            | 39,738            | 144,849  | 135,911           | 183,308                              | 176,339           |
| After 10 years   | <u>3,012,457</u>                  | <u>3,045,351</u>  | <u>250,339</u>   | <u>183,922</u>    | <u>3,262,839</u>                     | <u>3,229,345</u>  |
| Total debt securities  | 3,053,640                         | 3,088,561         | 533,464  | 455,016           | 3,819,580                            | 3,776,333         |
| Mutual funds and equity securities                             |                                   |                   |  |                   | 5,550                                | 5,656             |
| Total securities   | <u>\$ 3,053,640</u>               | <u>3,088,561</u>  | <u>533,464</u>   | <u>455,016</u>    | <u>3,825,130</u>                     | <u>3,781,989</u>  |

**DISCOUNT BANCORP, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2011 and 2010

| December 31, 2010                                       |                            |            |   |            |                               |            |
|---|----------------------------|------------|---|------------|-------------------------------|------------|
| Contractual maturities of available-for-sale securities |                            |            |   |            |                               |            |
|   | U.S. Treasury securities   |            | U.S. government sponsored enterprise securities |            | Foreign government securities |            |
|   | Amortized cost             | Fair value | Amortized cost                                  | Fair value | Amortized cost                | Fair value |
| (Dollars in thousands)                                  |                            |            |   |            |                               |            |
| Available-for-sale:                                     |                            |            |   |            |                               |            |
| Due within 1 year                                       | \$ 103,007                 | 103,028    | 5,008   | 5,035      | 67,098                        | 67,354     |
| After 1 year but within 5 years                         | —                          | —          | 51,906  | 51,831     | 8,828                         | 8,921      |
| After 5 years but within 10 years                       | 119,705                    | 117,910    | —   | —          | 570                           | 645        |
| After 10 years  | —                          | —          | —   | —          | 42                            | 63         |
| Total   | \$ 222,712                 | 220,938    | 56,914  | 56,866     | 76,538                        | 76,983     |
|   | Mortgage backed securities |            | Corporate bonds, notes, and debentures          |            | Total                         |            |
|   | Amortized cost             | Fair value | Amortized cost                                  | Fair value | Amortized cost                | Fair value |
| (Dollars in thousands)                                  |                            |            |   |            |                               |            |
| Available-for-sale:                                     |                            |            |   |            |                               |            |
| Due within 1 year                                       | \$ 571                     | 598        | 69,822  | 70,202     | 245,506                       | 246,217    |
| After 1 year but within 5 years                         | 5,990                      | 6,224      | 109,690   | 109,429    | 176,414                       | 176,405    |
| After 5 years but within 10 years                       | 57,881                     | 59,973     | 75,500  | 74,270     | 253,656                       | 252,798    |
| After 10 years  | 2,410,666                  | 2,452,193  | 261,679   | 203,828    | 2,672,387                     | 2,656,084  |
| Total debt securities                                   | 2,475,108                  | 2,518,988  | 516,691   | 457,729    | 3,347,963                     | 3,331,504  |
| Mutual funds and equity securities                      | —                          | —          | —   | —          | 5,527                         | 5,728      |
| Total securities  | \$ 2,475,108               | 2,518,988  | 516,691   | 457,729    | 3,353,490                     | 3,337,232  |

**DISCOUNT BANCORP, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2011 and 2010

| <b>December 31, 2011</b>                                     |  |                       |                                       |                       |  |                       |
|--|--|-----------------------|---------------------------------------|-----------------------|--|-----------------------|
| <b>Contractual maturities of held-to-maturity securities</b> |  |                       |                                       |                       |  |                       |
|  | <b>U.S. government sponsored<br/>enterprise securities</b> |                       | <b>Mortgage backed<br/>securities</b> |                       | <b>States and political<br/>subdivisions</b> |                       |
|  | <b>Amortized<br/>cost</b>                                  | <b>Fair<br/>value</b> | <b>Amortized<br/>cost</b>             | <b>Fair<br/>value</b> | <b>Amortized<br/>cost</b>                    | <b>Fair<br/>value</b> |
| (Dollars in thousands)                                       |  |                       |                                       |                       |  |                       |
| Held-to-maturity:  |  |                       |                                       |                       |  |                       |
| Due within 1 year  | \$ —   | —                     | —                                     | —                     | 6,488  | 6,532                 |
| After 1 year but within 5 years                              | 489  | 513                   | —                                     | —                     | 18,156                                       | 18,348                |
| After 5 years but within 10 years                            | 44,963   | 45,159                | —                                     | —                     | 17,041                                       | 18,967                |
| After 10 years   | 80,805   | 80,757                | 268,266                               | 278,133               | 386,604                                      | 409,486               |
| Total  | \$ 126,257   | 126,429               | 268,266                               | 278,133               | 428,289                                      | 453,333               |
| <b>Foreign government securities</b>                         |  |                       |                                       |                       |  |                       |
| <b>Total debt securities</b>                                 |  |                       |                                       |                       |  |                       |
|  | <b>Amortized<br/>cost</b>                                  | <b>Fair<br/>value</b> | <b>Amortized<br/>cost</b>             | <b>Fair<br/>value</b> |  |                       |
| (Dollars in thousands)                                       |  |                       |                                       |                       |  |                       |
| Held-to-maturity:  |  |                       |                                       |                       |  |                       |
| Due within 1 year  | \$ —   | —                     | 6,488                                 | 6,532                 |  |                       |
| After 1 year but within 5 years                              | 6,115  | 6,727                 | 24,760                                | 25,588                |  |                       |
| After 5 years but within 10 years                            | 1,327  | 1,640                 | 63,331                                | 65,766                |  |                       |
| After 10 years   | 266  | 417                   | 735,941                               | 768,793               |  |                       |
| Total  | \$ 7,708   | 8,784                 | 830,520                               | 866,679               |  |                       |

**DISCOUNT BANCORP, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2011 and 2010

| December 31, 2010                                     |  |                       |                               |               |                                      |               |
|---|--|-----------------------|-------------------------------|---------------|--------------------------------------|---------------|
| Contractual maturities of held-to-maturity securities |  |                       |                               |               |                                      |               |
|   | U.S. government sponsored<br>enterprise securities |                       | Mortgage backed<br>securities |               | States and political<br>subdivisions |               |
|   | Amortized<br>cost                                  | Fair<br>value         | Amortized<br>cost             | Fair<br>value | Amortized<br>cost                    | Fair<br>value |
| (Dollars in thousands)                                |  |                       |                               |               |                                      |               |
| Held-to-maturity:                                     |  |                       |                               |               |                                      |               |
| Due within 1 year                                     | \$ —   | —                     | —                             | —             | 7,473                                | 7,528         |
| After 1 year but within 5 years                       | —  | —                     | —                             | —             | 27,393                               | 27,501        |
| After 5 years but within 10 years                     | 40,283   | 38,518                | —                             | —             | 9,366                                | 9,507         |
| After 10 years  | 332,052  | 321,522               | 402,668                       | 410,813       | 389,863                              | 389,720       |
| Total   | \$ 372,335   | 360,040               | 402,668                       | 410,813       | 434,095                              | 434,256       |
| Foreign government securities                         |  |                       |                               |               |                                      |               |
| Foreign government securities                         |  | Total debt securities |                               |               |                                      |               |
|   | Amortized<br>cost                                  | Fair<br>value         | Amortized<br>cost             | Fair<br>value |                                      |               |
| (Dollars in thousands)                                |  |                       |                               |               |                                      |               |
| Held-to-maturity:                                     |  |                       |                               |               |                                      |               |
| Due within 1 year                                     | \$ 4,128   | 4,314                 | 11,601                        | 11,842        |                                      |               |
| After 1 year but within 5 years                       | 5,993  | 6,917                 | 33,386                        | 34,418        |                                      |               |
| After 5 years but within 10 years                     | 1,375  | 1,680                 | 51,024                        | 49,705        |                                      |               |
| After 10 years  | 265  | 365                   | 1,124,848                     | 1,122,420     |                                      |               |
| Total   | \$ 11,761  | 13,276                | 1,220,859                     | 1,218,385     |                                      |               |

Gross realized gains and losses on available-for-sale securities are presented in gains on securities, net in the Consolidated Statements of Income for the years ended December 31, 2011 and 2010 as follows:

|                          | 2011                   | 2010    |
|--------------------------|------------------------|---------|
|                          | (Dollars in thousands) |         |
| Gross gains              | \$ 17,588              | 21,542  |
| Gross losses             | (2,451)                | (1,879) |
| Gains on options written | 5,296                  | 5,565   |
| Gains on securities, net | \$ 20,433              | 25,228  |

Gains on options written included in gains on securities, net above represent option premium income related to options written on available-for-sale securities as further described in Note 21.

**DISCOUNT BANCORP, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2011 and 2010

For securities where fair value is less than amortized cost, the aggregate fair value and unrealized losses are as follows:

|   | <b>December 31, 2011</b>  |                          |                      |                          |
|---|---------------------------|--------------------------|----------------------|--------------------------|
|   | <b>Less than one year</b> |                          | <b>Over one year</b> |                          |
|   | <b>Fair value</b>         | <b>Unrealized losses</b> | <b>Fair value</b>    | <b>Unrealized losses</b> |
|   | (Dollars in thousands)    |                          |                      |                          |
| Available-for-sale securities:                  |                           |                          |                      |                          |
| Debt securities:                                |                           |                          |                      |                          |
| U.S. Treasury securities                        | \$ 49,989                 | 2                        | —                    | —                        |
| U.S. government sponsored enterprise            | 10,016                    | 34                       | —                    | —                        |
| Foreign government securities                   | 51,661                    | 73                       | —                    | —                        |
| Mortgage backed pass-through securities:        |                           |                          |                      |                          |
| U.S. government sponsored enterprise            | 33,969                    | 171                      | —                    | —                        |
| Other mortgage backed securities:               |                           |                          |                      |                          |
| U.S. government agency and sponsored enterprise | 683,464                   | 4,662                    | 101,410              | 2,485                    |
| Corporate bonds, notes, and debentures:         |                           |                          |                      |                          |
| U.S. corporate securities                       | 72,208                    | 7,182                    | 165,089              | 62,550                   |
| Foreign corporate securities                    | 98,234                    | 2,992                    | 39,008               | 5,996                    |
| Mutual funds and equity securities              | 2,507                     | 16                       | —                    | —                        |
|   | <u>\$ 1,002,048</u>       | <u>15,132</u>            | <u>305,507</u>       | <u>71,031</u>            |
| Held-to-maturity:                               |                           |                          |                      |                          |
| U.S. government sponsored enterprise            | \$ 3,039                  | 93                       | —                    | —                        |
| States and political subdivisions               | 13,896                    | 89                       | 8,743                | 39                       |
|   | <u>\$ 16,935</u>          | <u>182</u>               | <u>8,743</u>         | <u>39</u>                |

**DISCOUNT BANCORP, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2011 and 2010

|   | <b>December 31, 2010</b>  |                          |                      |                          |
|---|---------------------------|--------------------------|----------------------|--------------------------|
|   | <b>Less than one year</b> |                          | <b>Over one year</b> |                          |
|   | <b>Fair value</b>         | <b>Unrealized losses</b> | <b>Fair value</b>    | <b>Unrealized losses</b> |
|   | (Dollars in thousands)    |                          |                      |                          |
| Available-for-sale securities:                  |                           |                          |                      |                          |
| Debt securities:                                |                           |                          |                      |                          |
| U.S. Treasury securities                        | \$ 80,726                 | 2,219                    | —                    | —                        |
| U.S. government sponsored enterprise            | 26,044                    | 187                      | —                    | —                        |
| Foreign government securities                   | 14,130                    | 14                       | —                    | —                        |
| Mortgage backed pass-through securities:        |                           |                          |                      |                          |
| U.S. government sponsored enterprise            | 70,727                    | 890                      | —                    | —                        |
| Other mortgage backed securities:               |                           |                          |                      |                          |
| U.S. government agency and sponsored enterprise | 469,620                   | 3,837                    | 8,909                | 140                      |
| Corporate bonds, notes, and debentures:         |                           |                          |                      |                          |
| U.S. corporate securities                       | 37,258                    | 539                      | 203,126              | 57,170                   |
| Foreign corporate securities                    | 88,323                    | 2,151                    | 5,382                | 1,625                    |
| Mutual funds and equity securities              | —                         | —                        | 2,408                | 92                       |
|   | <u>\$ 786,828</u>         | <u>9,837</u>             | <u>219,825</u>       | <u>59,027</u>            |
| Held-to-maturity:                               |                           |                          |                      |                          |
| U.S. government sponsored enterprise            | \$ 331,129                | 12,460                   | —                    | —                        |
| Other mortgage backed securities:               |                           |                          |                      |                          |
| U.S. government agency and sponsored enterprise | 50,491                    | 218                      | —                    | —                        |
| Commercial mortgage backed securities           | 4,988                     | —                        | —                    | —                        |
| States and political subdivisions               | 243,899                   | 4,340                    | 400                  | 1                        |
|   | <u>\$ 630,507</u>         | <u>17,018</u>            | <u>400</u>           | <u>1</u>                 |

The majority of the unrealized losses at December 31, 2011 and December 31, 2010 relate to investment grade securities and are attributable to several factors, including changes in market interest rates subsequent to purchase, widening in market credit spreads for similar type securities, the impacts of inactive and illiquid markets, and changes in security ratings. As of December 31, 2011, none of the securities in the above table are past due with principal or interest payments.

The Company reviews its Available-for-sale and Held-to-maturity investment securities quarterly to determine whether an impairment that is considered to be other-than-temporary (OTTI) has occurred. If a decline in fair value is judged by the Company to be other-than-temporary, and if there are significant credit concerns regarding a particular security and it is expected that the Company will not recover its

## DISCOUNT BANCORP, INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

December 31, 2011 and 2010

amortized cost, the security is written down from its original cost basis to reflect the adjusted fair value and a new cost basis is established. Any OTTI loss will be segregated between credit and noncredit components (with the credit component recorded in income and the noncredit component recorded in AOCI) unless the Company intends to sell the security or it is more likely than not that it will have to sell the security before recovery of its amortized cost in which case the entire difference between amortized cost and fair value will be recognized in earnings.

As a result of the Company's ongoing valuation review of its investment securities portfolio the Company did not record any OTTI write-downs for the year ended December 31, 2011. For the year ended December 31, 2010 the Company recorded \$12.7 million in OTTI write-downs. A total of \$11.3 million in write-downs were for eight private label residential mortgage-backed securities (RMBS) in HTM. The Company also recorded a \$0.5 million write-down related to one RMBS security in AFS. Lastly, the Company recorded \$0.9 million in write-downs for two trust preferred collateralized debt obligations held in AFS. At December 31, 2010 the Company intended to sell all eleven of the securities deemed OTTI and the securities were written down to fair value at December 31, 2010. All eleven securities were sold in February 2011. The sale resulted in a gain of approximately \$1 million which is recorded in gain on securities, net for the year ended December 31, 2011. In addition, on July 13, 2011 the Company sold two commercial mortgage backed securities (CMBS) held in HTM. Management determined that there had been significant deterioration in issuer creditworthiness as a result of deteriorating collateral performance for these two securities and therefore the sale met the relevant accounting criteria for sale of HTM securities. Despite the significant credit deterioration, a gain was realized on the sale of the two CMBS securities of approximately \$385,000 in July which is included in gain on securities, net for the year ended December 31, 2011.

The unrealized losses on the Company's mortgage backed securities, which are primarily U.S. government agency or U.S. government sponsored enterprise issued securities were primarily caused by movements in market interest rates and spread volatility, rather than credit risk. Also, unrealized losses on the Company's U.S. government sponsored enterprise debt securities were also caused by movements in market interest rates and spread volatility. The Company purchased these investments either at a premium, par or at a discount relative to their face amount, and the contractual cash flows of these investments are guaranteed by an agency of the U.S. government or a U.S. government sponsored enterprise. Accordingly, it is expected that the securities would not be settled at a price that is less than the amortized cost of the Company's investment.

The Company's unrealized losses in corporate bonds relate primarily to investments in various financial institutions, with the majority being single bank issued trust preferred securities. The unrealized losses were primarily caused by market interest rate volatility and a significant widening of interest rate spreads across market sectors relating to the continued illiquidity and uncertainty in the financial markets. These securities were purchased based on an individual assessment of the institutions issuing such securities. This assessment included, but was not limited to, a review of credit ratings (if any), as well as an underwriting process designed to determine the institutions' creditworthiness.

The Company has minimal European sovereign debt exposure. Total exposure to European sovereigns included in foreign government securities in the AFS portfolio is comprised of two bonds to investment grade countries with a fair value of approximately \$4.6 million at December 31, 2011.

## DISCOUNT BANCORP, INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

December 31, 2011 and 2010

The Company has determined that as of December 31, 2011 that all of the unrealized losses on available-for-sale and held-to-maturity securities are temporary. The Company has the ability and intent to hold securities with unrealized losses until a market price recovery (which for debt securities may not be until maturity) and currently intends to hold all temporarily impaired securities to full recovery. Future reviews for OTTI will consider the particular facts and circumstances during the respective reporting period. There remains significant market and economic uncertainties that could result in further declines in the fair value of securities in our portfolio in the future. There continues to be considerable challenges facing the U.S. and global economies and a prolonged economic downturn could have implications and impact any recovery in security valuations. In spite of numerous market interventions and programs implemented by U.S. and global governments and regulators there continues to be a lack of liquidity and capital market flows to facilitate an improvement in many securities markets. Therefore, there is still a risk that there may be additional other than temporary impairment write-downs in the future.

The carrying value of pledged assets under repurchase agreements and other borrowing arrangements at December 31, 2011 and 2010 is shown in the following tables:

|   | December 31, 2011      |                             |                               | Total     |
|---|------------------------|-----------------------------|-------------------------------|-----------|
|   | Loans                  | Held-to-maturity securities | Available-for-sale securities |           |
|   | (Dollars in thousands) |                             |                               |           |
| Pledged assets for securities sold under repurchase agreements: |                        |                             |                               |           |
| U.S. government agency and sponsored enterprise                 | \$ —                   | 103,674                     | —                             | 103,674   |
| U.S. government agency MBS                                      | —                      | 104,574                     | 170,663                       | 275,237   |
| U.S. government sponsored enterprise MBS                        | —                      | 56,742                      | 1,624,565                     | 1,681,307 |
| Commercial MBS  | —                      | 7,020                       | —                             | 7,020     |
|   |                        |                             |                               |           |
| Total repurchase agreements                                     | —                      | 272,010                     | 1,795,228                     | 2,067,238 |
| Other pledged assets:   |                        |                             |                               |           |
| Federal Reserve Bank and Federal Home Loan Bank                 | 1,458,406              | 46,911                      | 202,412                       | 1,707,729 |
|   |                        |                             |                               |           |
| Total pledged   | \$ 1,458,406           | 318,921                     | 1,997,640                     | 3,774,967 |

**DISCOUNT BANCORP, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2011 and 2010

|   | <b>December 31, 2010</b> |                                    |                                      |                  |
|---|--------------------------|------------------------------------|--------------------------------------|------------------|
|   | <b>Loans</b>             | <b>Held-to-maturity securities</b> | <b>Available-for-sale securities</b> | <b>Total</b>     |
|   | (Dollars in thousands)   |                                    |                                      |                  |
| Pledged assets for securities sold under repurchase agreements: |                          |                                    |                                      |                  |
| U.S. government agency and sponsored enterprise                 | \$ —                     | 300,886                            | 117,910                              | 418,796          |
| U.S. government agency MBS                                      | —                        | 108,014                            | 194,380                              | 302,394          |
| U.S. government sponsored enterprise MBS                        | —                        | 82,139                             | 1,528,803                            | 1,610,942        |
| Commercial MBS  | —                        | 7,515                              | —                                    | 7,515            |
| Total repurchase agreements                                     | —                        | 498,554                            | 1,841,093                            | 2,339,647        |
| Other pledged assets:   |                          |                                    |                                      |                  |
| Federal Reserve Bank and Federal Home Loan Bank                 | 1,598,707                | 44,682                             | 242,755                              | 1,886,144        |
| Total pledged   | <u>\$ 1,598,707</u>      | <u>543,236</u>                     | <u>2,083,848</u>                     | <u>4,225,791</u> |

As of December 31, 2011, the carrying value of securities sold under repurchase agreements over the repurchase liability exceeded 10% of stockholder's equity with the following counterparties:

|               | <b>Amount at risk</b>  | <b>Weighted Average maturity of repurchase agreements</b> |
|---------------|------------------------|---|
|               | (Dollars in thousands) |   |
| Citibank      | \$ 37,946              | 4.0 years   |
| Barclays Bank | 25,566                 | 7.3 years   |

In addition, loans and securities have been pledged pursuant to a blanket security agreement with the Federal Home Loan Bank (FHLB) (see note 11).

**(5) Loans Held for Sale**

As part of its workout strategy, the Company designates for sale certain nonperforming loans deemed impaired and reports them as loans held-for-sale on the Consolidated Balance Sheets. The loans are reported at the lower of cost or fair value. At the time of transfer, the excess of the loan carrying value over

**DISCOUNT BANCORP, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

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the fair value of the asset is charged to the allowance for loan losses. Subsequent net unrealized losses, if any, will be recognized in a valuation allowance by a charge to income.

In June, 2010, the Company designated for sale \$17.5 million of certain non-performing commercial real estate loans. During the third and fourth quarter of 2010, \$14.7 million of these loans were sold. As of December 31, 2010 the balance of loans held for sale was \$2.8 million, comprising one loan which was transferred to other real estate owned (ORE) in the first quarter of 2011 subsequent to the foreclosure of the loan's guaranteeing property. During 2011, \$111 million of loans were designated for sale and immediately sold. An additional \$4.3 million of loans were designated held for sale in 2011. A total of \$2.8 million were sold and a valuation allowance for the remaining loans was established in the amount of \$0.8 million. As a result, the balance of loans held for sale as of December 31, 2011 was \$0.7 million.

**(6) Loans, Net of Unearned Income**

**(a) Loans**

Loans by portfolio segment are summarized below:

|  | <b>December 31</b>     |                  |
|--|------------------------|------------------|
|  | <b>2011</b>            | <b>2010</b>      |
|  | (Dollars in thousands) |                  |
| Domestic:  |                        |                  |
| Commercial and industrial                                | \$ 2,101,653           | 2,096,280        |
| Commercial real estate                                   | 937,269                | 945,640          |
| Other  | 231,911                | 375,512          |
| Total domestic, gross                                    | <u>3,270,833</u>       | <u>3,417,432</u> |
| Less unearned income and deferred fees                   | 7,560                  | 7,994            |
| Total domestic   | <u>3,263,273</u>       | <u>3,409,438</u> |
| Foreign:   |                        |                  |
| Commercial and industrial                                | 316,359                | 282,608          |
| Commercial real estate                                   | 21,695                 | 2,659            |
| Other  | 223,710                | 226,740          |
| Total foreign, gross                                     | <u>561,764</u>         | <u>512,007</u>   |
| Less unearned income and deferred fees                   | 291                    | 486              |
| Total foreign  | <u>561,473</u>         | <u>511,521</u>   |
| Total loans, net of unearned income<br>and deferred fees | <u>\$ 3,824,746</u>    | <u>3,920,959</u> |

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Commercial and industrial loans include corporate lending and asset based lending loans, whereas other loans include the following categories:

- Loans to depository institutions and acceptances of other banks
- Loans to finance agricultural production and other loans to farmers
- Loans to individuals for household, family, and other personal expenditures
- Loans to foreign governments and official institutions
- Loans to nondepository financial institutions and other loans
- Lease financing receivables

**(b) Foreign Loans**

Foreign loans outstanding by country at December 31, 2011 and 2010 are as follows:

|  | <b>December 31</b>     |                |
|--|------------------------|----------------|
|  | <b>2011</b>            | <b>2010</b>    |
|  | (Dollars in thousands) |                |
| Europe/Asia:                           |                        |                |
| Turkey                                 | \$ —                   | 10,000         |
| Kazakhstan                             | 154                    | 308            |
| All other European and Asian countries | 13,414                 | 17,822         |
| Total Europe/Asia                      | <u>13,568</u>          | <u>28,130</u>  |
| Latin America/Caribbean:               |                        |                |
| Uruguay                                | 124,626                | 104,041        |
| Peru                                   | 102,364                | 113,355        |
| Mexico                                 | 61,144                 | 64,721         |
| Brazil                                 | 86,852                 | 97,252         |
| British West Indies                    | 6,608                  | 9,033          |
| Argentina                              | 18,725                 | 16,471         |
| Panama                                 | 20,817                 | 11,941         |
| Colombia                               | 10,963                 | 2,376          |
| Costa Rica                             | 12,007                 | 11,474         |
| Guatemala                              | 10,080                 | 12,080         |
| Chile                                  | 67,619                 | 33,629         |
| Venezuela                              | 3,109                  | 2,769          |
| All other Latin American countries     | 52                     | 451            |
| Total Latin America/Caribbean          | <u>524,966</u>         | <u>479,593</u> |
| Canada                                 | 20,478                 | 2,571          |
| Israel                                 | 2,752                  | 1,713          |
| Total foreign loans, gross             | <u>\$ 561,764</u>      | <u>512,007</u> |

## DISCOUNT BANCORP, INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

December 31, 2011 and 2010

The Company is subject to numerous risks inherent in its portfolio of foreign loans. These risks include, among others, risk of loss from various unfavorable political, economic, legal or other developments, including social or political instability, changes in governmental policies or policies of central banks, expropriation, nationalization, confiscation of assets, price controls, capital controls and changes in legislation. Further, various countries in which the Company has extended these loans have experienced severe economic disruptions, including extreme currency fluctuations, high inflation, or low or negative growth, among other negative conditions. Thus, there can be no assurance that the Company will not suffer losses in the future arising from unfavorable economic, political, legal or other international events.

At December 31, 2011 and 2010, the Company believes that it has properly accounted for these risks in its allowance for loan losses.

**(c) *Credit Quality Indicators***

As part of its Credit and Risk Management processes, the Company has developed a Credit Risk Rating System (the System), which provides a systematic methodology for uniformly analyzing risk. The System is a two-phase analytical process, where phase one determines the Borrower Risk Rating (BRR), and phase two determines the Transaction Risk Adjustment (TRA) for the primary transaction factors. As a result, a TRA may be made to the BRR to arrive at the credit facility's Combined Credit Risk Rating (CCRR).

The Company's Credit Risk Rating process reviews critical risk factors associated with an obligor's potential for default by evaluating such risk factors as the borrower's financial condition, cash flow and debt capacity. This analysis of the BRR helps determine the borrower's financial capacity to repay the credit facility within the credit's established terms and conditions. However, there are transaction elements such as collateral, secured and unsecured guarantees, tenor, and loan structure that may positively or negatively influence the debt's repayment or sources of repayment. The influence of the more important transaction risk elements is determined and considered in terms of appropriate limited adjustments (TRA) that establish the credit facility's CCRR.

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The System uses a 10-category CCRR scale with a 1-rating reflecting the best possible risk and a 10-rating reflecting the worst (loss). In order to accommodate the Company’s regulatory policies and guidelines, the four worst rating categories, which are referred to as “Criticized and Classified” categories (7 through 10), correspond directly to the regulatory classifications of Special Mention=7, Substandard=8, Doubtful =9, and Loss=10. Following is a chart that summarizes the Company’s 10-point scale, matching the CCRR to external ratings and bank regulatory scale:

| <u>CCRR</u> | <u>External<br/>Debt Rating<br/>Equivalent</u> | <u>Regulatory<br/>Rating</u> |
|-------------|--|------------------------------|
| 1           | AAA  | Pass                         |
| 2           | AA   | Pass                         |
| 3           | A  | Pass                         |
| 4           | BBB  | Pass                         |
| 5           | BB   | Pass                         |
| 6           | B  | Pass                         |
| 6W          | B-   | Pass                         |
| 7           | CCC  | Special Mention              |
| 8           | CC   | Substandard                  |
| 9           | C  | Doubtful                     |
| 10          | D  | Loss                         |

The composition of the Company’s loan portfolio by CCRR as of December 31, 2011 and 2010 was as follows:

|                       | <u>December 31, 2011</u>     |                                   |                                |                |                  |
|-----------------------|------------------------------|-----------------------------------|--------------------------------|----------------|------------------|
|                       | <u>Corporate<br/>lending</u> | <u>Commercial<br/>real estate</u> | <u>Asset based<br/>lending</u> | <u>Other</u>   | <u>Total</u>     |
|                       | (Dollars in thousands)       |                                   |                                |                |                  |
| Pass                  | \$ 1,613,311                 | 906,086                           | 687,363                        | 450,124        | 3,656,884        |
| Special mention       | 21,008                       | 26,534                            | 23,186                         | 3,770          | 74,498           |
| Substandard           | 43,194                       | 25,435                            | 8,639                          | 1,727          | 78,995           |
| Doubtful              | 6,567                        | 909                               | 14,744                         | —              | 22,220           |
| Total loans,<br>gross | \$ <u>1,684,080</u>          | <u>958,964</u>                    | <u>733,932</u>                 | <u>455,621</u> | <u>3,832,597</u> |

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|                       | <b>December 31, 2010</b>     |                                   |                                |                |                  |
|-----------------------|------------------------------|-----------------------------------|--------------------------------|----------------|------------------|
|                       | <b>Corporate<br/>lending</b> | <b>Commercial<br/>real estate</b> | <b>Asset based<br/>lending</b> | <b>Other</b>   | <b>Total</b>     |
|                       | (Dollars in thousands)       |                                   |                                |                |                  |
| Pass                  | \$ 1,742,066                 | 909,905                           | 695,377                        | 421,792        | 3,769,140        |
| Special mention       | 12,917                       | 18,364                            | 9,883                          | 7,737          | 48,901           |
| Substandard           | 35,049                       | 20,030                            | 27,536                         | 2,517          | 85,132           |
| Doubtful              | 14,684                       | —                                 | 11,522                         | 60             | 26,266           |
| Total loans,<br>gross | <u>\$ 1,804,716</u>          | <u>948,299</u>                    | <u>744,318</u>                 | <u>432,106</u> | <u>3,929,439</u> |

Total loans, gross excludes unearned income and deferred fees of \$7.9 million and \$8.5 million as of December 31, 2011 and 2010, respectively.

**(d) Past Due and Nonaccrual Loans**

Following is a breakdown of the Company's loan portfolio by aging and payment activity as of December 31, 2011 and 2010:

|                        | <b>December 31, 2011</b>  |  |                                |  |                  |                    |
|------------------------|---|--|--------------------------------|--|------------------|--------------------|
|                        | <b>Past due 30<br/>through 89<br/>days and still<br/>accruing</b> | <b>Past due 90<br/>days or more<br/>and still<br/>accruing</b> | <b>Nonaccrual</b>              | <b>Total past<br/>due and<br/>nonaccrual</b> | <b>Current</b>   | <b>Total loans</b> |
|                        | (Dollars in thousands)  |  |                                |  |                  |                    |
| Corporate lending      | \$ 230  | —  | 33,876                         | 34,106                                       | 1,649,974        | 1,684,080          |
| Commercial real estate | 3,173   | —  | 24,844                         | 28,017                                       | 930,947          | 958,964            |
| Asset based lending    | —   | —  | 15,397                         | 15,397                                       | 718,535          | 733,932            |
| Other                  | 2,871   | —  | 1,727                          | 4,598  | 451,023          | 455,621            |
| Total loans, gross     | <u>\$ 6,274</u>   | <u>—</u>   | <u>75,844</u>                  | <u>82,118</u>                                | <u>3,750,479</u> | <u>3,832,597</u>   |
|                        | (Dollars in thousands)  |  |                                |  |                  |                    |
|                        | <b>Corporate<br/>lending</b>                                      | <b>Commercial<br/>real estate</b>                              | <b>Asset based<br/>lending</b> | <b>Other</b>                                 | <b>Total</b>     |                    |
| Performing             | \$ 1,650,204  | 934,120  | 718,535                        | 453,894                                      | 3,756,753        |                    |
| Nonaccrual             | 33,876  | 24,844   | 15,397                         | 1,727  | 75,844           |                    |
| Total loans, gross     | <u>\$ 1,684,080</u>   | <u>958,964</u>   | <u>733,932</u>                 | <u>455,621</u>                               | <u>3,832,597</u> |                    |

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|                        |    | <b>December 31, 2010</b>  |  |                                |  |                  |                    |
|------------------------|----|---|--|--------------------------------|--|------------------|--------------------|
|                        |    | <b>Past due 30<br/>through 89<br/>days and still<br/>accruing</b> | <b>Past due 90<br/>days or more<br/>and still<br/>accruing</b> | <b>Nonaccrual</b>              | <b>Total past<br/>due and<br/>nonaccrual</b> | <b>Current</b>   | <b>Total loans</b> |
|                        |    | (Dollars in thousands)  |  |                                |  |                  |                    |
| Corporate lending      | \$ | 399   | —  | 18,264                         | 18,663                                       | 1,786,053        | 1,804,716          |
| Commercial real estate |    | 2,714   | —  | 16,516                         | 19,230                                       | 929,069          | 948,299            |
| Asset based lending    |    | —   | —  | 23,816                         | 23,816                                       | 720,502          | 744,318            |
| Other                  |    | 923   | —  | 540                            | 1,463  | 430,643          | 432,106            |
| Total loans, gross     | \$ | <u>4,036</u>  | <u>—</u>   | <u>59,136</u>                  | <u>63,172</u>                                | <u>3,866,267</u> | <u>3,929,439</u>   |
|                        |    | <b>Corporate<br/>lending</b>                                      | <b>Commercial<br/>real estate</b>                              | <b>Asset based<br/>lending</b> | <b>Other</b>                                 | <b>Total</b>     |                    |
|                        |    | (Dollars in thousands)  |  |                                |  |                  |                    |
| Performing             | \$ | 1,786,452   | 931,783  | 720,502                        | 431,566                                      | 3,870,303        |                    |
| Nonaccrual             |    | 18,264  | 16,516   | 23,816                         | 540  | 59,136           |                    |
| Total loans, gross     | \$ | <u>1,804,716</u>  | <u>948,299</u>   | <u>744,318</u>                 | <u>432,106</u>                               | <u>3,929,439</u> |                    |

The Company uses payment activity as a means of identifying and reporting problem and potentially problem loans. All credit facilities are normally placed on nonaccrual status when there is a payment default on interest or principal for more than 90 days or an event where a borrower fails to cure a principal payment default and the loan is not well secured. In addition, if it is apparent that full collection of interest and principal is in doubt, the loan is placed on nonaccrual status, before the passage of the 90-day period.

Changes in total nonaccrual loans for the twelve-month period ended December 31, 2011 and 2010 are shown below:

|                                     |    | <b>Twelve months ended</b>   |                              |
|-------------------------------------|----|------------------------------|------------------------------|
|                                     |    | <b>December 31,<br/>2011</b> | <b>December 31,<br/>2010</b> |
|                                     |    | (Dollars in<br>thousands)    | (Dollars in<br>thousands)    |
| Balance at beginning of period      | \$ | 59,136                       | 95,501                       |
| Additions:                          |    |                              |                              |
| Placement on nonaccrual             |    | 87,442                       | 73,519                       |
| Reductions:                         |    |                              |                              |
| Charge-offs                         |    | (36,215)                     | (51,339)                     |
| Payments received                   |    | (26,822)                     | (29,957)                     |
| Transfer to Loans Held-for-Sale     |    | (4,285)                      | (17,460)                     |
| Reinstatement to performing status  |    | (3,412)                      | (8,500)                      |
| Transfer to Other Real Estate Owned |    | —                            | (2,628)                      |
|                                     |    | <u>(70,734)</u>              | <u>(109,884)</u>             |
| Balance at end of period            | \$ | <u>75,844</u>                | <u>59,136</u>                |

## DISCOUNT BANCORP, INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

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As shown above, during the year ended December 31, 2011, the balance of nonaccrual loans increased \$16.7 million or 28.3% to \$75.8 million from \$59.1 million as of December 31, 2010. Approximately 36.3% or \$31.7 million of the \$87.4 million of loans placed on nonaccrual status are commercial real estate loans, whereas corporate lending and asset based lending loans combined accounted for \$52.6 million or 60.2%, and other loans represented \$3.1 million or 3.5% of the increase. Charge-offs of nonaccrual loans were recorded during the year ended December 31, 2011 in the amount of \$36.2 million, which comprise \$12.9 million of commercial real estate loans, \$22.5 million of corporate lending and asset based lending loans, and \$.8 million of write downs in other loans.

Included in total payments received in the amount of \$26.8 million, are proceeds from the sale of notes in the amount of \$12.6 million, most of which took place during the second quarter of 2011. Additionally, in June and December 2010, the Company acquired a parcel of land and vacant warehouses, respectively, through foreclosure and classified them as other real estate owned (ORE). The related loans were recorded as loans held for sale prior to the foreclosure and transfer to ORE. ORE is recorded at the lower of the fair value of the asset acquired less estimated costs to sell or cost. At the time of foreclosure/acquisition, the excess, if any, of the loan over the fair value of the asset, less estimated selling costs, is charged to the allowance for loan losses. Any subsequent write-downs will be charged to other expense. The balance of ORE at December 31, 2011 was approximately \$1.1 million and is included in other assets.

As indicated in note 5 above, during the second quarter of 2010, the Company transferred certain real estate loans with a total balance of \$17.5 million to the category "Loans held for sale". Also as indicated in note 5 above during the first quarter of 2011, \$4.3 million of loans were transferred to loans held for sale. Loans with a book balance of \$3.4 million and \$8.5 million were placed on accrual status in 2011 and 2010, respectively due to improved performance.

**(e) *Troubled Debt Restructurings***

Troubled debt restructured loans (TDRs) are loans that the Company, for economic or legal reasons related to the borrower's financial condition, has granted a significant concession to the borrower that it would not otherwise consider. TDRs can be classified as either accrual or nonaccrual loans. Included in nonaccrual loans are TDRs of \$44.2 million as of December 31, 2011, whereas TDRs which continue to accrue had a balance of \$2.2 million as of the same date.

**(f) *Impaired Loans***

A loan is impaired when, based on current information and events, it is probable that a creditor will be unable to collect all amounts due (principal and interest) according to the contractual terms of the loan agreement. In this context, the range of probability that must be considered in the impairment analysis is as follows: i) Probable, the future event or events are likely to occur; ii) Reasonably possible, the chance of the future event or events occurring is more than remote but less than likely; and iii) Remote, the chance of the future event or events occurring is slight.

These loans are further examined to ascertain the amount of probable loss, if any, that may be indicated based on the facts and circumstances regarding the borrower's prospects for repayment, considering the Company's collection strategy, the borrower's financial condition, and the prospects

**DISCOUNT BANCORP, INC. AND SUBSIDIARIES**

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for repayment from other sources such as collateral and guarantors. For those loans that are considered impaired, the specific reserve will be the difference between the net present value on each credit extension, using one of the following measurements: net present value of expected future cash flows discounted at the loan's effective interest rate, or fair value of collateral less costs to sell, and the recorded investment in the loan. The Company's portfolio is typically highly collateral reliant, thus the majority of the impairment assessments are completed using the fair value of collateral approach, however for those "cash flow" structured loans which typically result in a large deficiency under the fair value of collateral approach, a discounted cash flow alternative is followed.

The balance of impaired loans as of December 31, 2011 and 2010 was \$59.7 and \$56.1 million, respectively, as follows:

|                                     | <b>December 31, 2011</b>       |   |                              |  |   |
|-------------------------------------|--------------------------------|---|------------------------------|--|---|
|                                     | <b>Recorded<br/>investment</b> | <b>Unpaid<br/>principal<br/>balance</b> | <b>Related<br/>allowance</b> | <b>Average<br/>recorded<br/>investment</b> | <b>Interest<br/>income<br/>recognized</b> |
|                                     | (Dollars in thousands)         |   |                              |  |   |
| With no related allowance recorded: |                                |   |                              |  |   |
| Corporate lending                   | \$ 691                         | 700                                     | —                            | 781  | 9   |
| Commercial real estate              | 1,900                          | 4,823                                   | —                            | 2,695                                      | 13  |
| Asset based lending                 | 902                            | 3,802                                   | —                            | 1,869                                      | 165                                       |
|                                     | <u>\$ 3,493</u>                | <u>9,325</u>                            | <u>—</u>                     | <u>5,345</u>                               | <u>187</u>                                |
| With an allowance recorded:         |                                |   |                              |  |   |
| Corporate lending                   | \$ 18,793                      | 29,813                                  | 4,207                        | 23,613                                     | 1,582                                     |
| Commercial real estate              | 22,944                         | 30,269                                  | 2,479                        | 23,991                                     | 619                                       |
| Asset based lending                 | 14,495                         | 18,737                                  | 9,627                        | 16,668                                     | 754                                       |
|                                     | <u>\$ 56,232</u>               | <u>78,819</u>                           | <u>16,313</u>                | <u>64,272</u>                              | <u>2,955</u>                              |
| Total:                              |                                |   |                              |  |   |
| Corporate lending                   | \$ 19,484                      | 30,513                                  | 4,207                        | 24,394                                     | 1,591                                     |
| Commercial real estate              | 24,844                         | 35,092                                  | 2,479                        | 26,686                                     | 632                                       |
| Asset based lending                 | 15,397                         | 22,539                                  | 9,627                        | 18,537                                     | 919                                       |
|                                     | <u>\$ 59,725</u>               | <u>88,144</u>                           | <u>16,313</u>                | <u>69,617</u>                              | <u>3,142</u>                              |

**DISCOUNT BANCORP, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

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|                                     | December 31, 2010          |                                 |                          |                                    |                                   |
|-------------------------------------|----------------------------|---------------------------------|--------------------------|------------------------------------|-----------------------------------|
|                                     | <u>Recorded investment</u> | <u>Unpaid principal balance</u> | <u>Related allowance</u> | <u>Average recorded investment</u> | <u>Interest income recognized</u> |
|                                     | (Dollars in thousands)     |                                 |                          |                                    |                                   |
| With no related allowance recorded: |                            |                                 |                          |                                    |                                   |
| Corporate lending                   | \$ —                       | —                               | —                        | —                                  | —                                 |
| Commercial real estate              | 5,912                      | 13,243                          | —                        | 8,673                              | 400                               |
| Asset based lending                 | 2,107                      | 6,603                           | —                        | 7,160                              | 96                                |
|                                     | <u>\$ 8,019</u>            | <u>19,846</u>                   | <u>—</u>                 | <u>15,833</u>                      | <u>496</u>                        |
| With an allowance recorded:         |                            |                                 |                          |                                    |                                   |
| Corporate lending                   | \$ 17,639                  | 32,166                          | 1,684                    | 25,410                             | 1,166                             |
| Commercial real estate              | 10,244                     | 14,938                          | 970                      | 12,181                             | 557                               |
| Asset based lending                 | 20,177                     | 27,553                          | 6,560                    | 21,812                             | 384                               |
|                                     | <u>\$ 48,060</u>           | <u>74,657</u>                   | <u>9,214</u>             | <u>59,403</u>                      | <u>2,107</u>                      |
| Total:                              |                            |                                 |                          |                                    |                                   |
| Corporate lending                   | \$ 17,639                  | 32,166                          | 1,684                    | 25,410                             | 1,166                             |
| Commercial real estate              | 16,156                     | 28,181                          | 970                      | 20,854                             | 957                               |
| Asset based lending                 | 22,284                     | 34,156                          | 6,560                    | 28,972                             | 480                               |
|                                     | <u><u>\$ 56,079</u></u>    | <u><u>94,503</u></u>            | <u><u>9,214</u></u>      | <u><u>75,236</u></u>               | <u><u>2,603</u></u>               |

The average recorded investment in the tables above represent period end averages for the twelve months ended December 31, 2011 and December 31, 2010, respectively.

**(g) Allowance for Loan Losses**

The allowance for loan losses is an amount that management believes is necessary to absorb probable losses on existing loans, based on evaluations of their collectability. Management's evaluation process is performed quarterly and comprises the calculation of a general allowance for both pass rated loans and nonimpaired criticized and classified loans, calculated separately, as well as a specific reserve on impaired loans. Following is a detailed description of the process:

i. *General allowance*

The general allowance results from the multiplication of the Company's total loan balance as of the date of measurement by a factor resulting from the historical loss ratio of the various loan portfolios adjusted for a variety of portfolio and environmental factors listed below:

- Changes in lending policies and procedures
- Changes in economic and business conditions
- Changes in the nature and volume of the portfolio
- Changes in lending management and other relevant staff
- Changes in past due, nonaccrual and adversely classified or graded loans
- Changes in the institution's loan review system
- Changes in the value of underlying collateral for collateral-dependent loans

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- Changes in concentrations of credit
- Effect of other external factors

Management reviews these factors quarterly, assigning certain basis points to each one of them by loan category based on judgment.

ii. *Specific reserve and general allowance for nonimpaired criticized and classified loans*

For those loans that are considered impaired, the specific reserve will be the difference between the loan's net present value, using one of the following measurements: net present value of expected future cash flows discounted at the loan's effective interest rate, or fair value of collateral less costs to sell, and the recorded investment in the loan. The Company's loan portfolio is typically highly collateral reliant, thus the majority of the impairment assessments are completed using the discounted collateral approach; however, for those "cash flow" structured loans which typically result in a large deficiency under the discounted collateral approach, a discounted cash flow or enterprise value alternatives will be followed.

In addition to the general allowance on non-criticized loans, an additional general allowance is established for nonimpaired criticized and classified loans as follows:

- Minimum allowance for nonimpaired CCRR 7 rated loans = 3 times the rolling average of the past five quarters' effective general allowance expressed as a percent of the Company's pass rated portfolio
- Maximum allowance for nonimpaired CCRR 7 rated loans = 2 times the rolling average of the past five quarters' effective specific reserve percentage for 7 rated nonimpaired loans
- Minimum allowance for nonimpaired CCRR 8 rated loans = 10 times the rolling average of the past five quarters' effective general allowance expressed as a percent of the Company's pass rated portfolio
- Maximum allowance for nonimpaired CCRR 8 rated loans = 2 times the rolling average of the past five quarters' effective specific reserve percentage for 7 rated nonimpaired loans

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Following are the changes in the allowance for loan losses by portfolio category for the twelve-month period ended December 31, 2011:

|  | <u>Corporate<br/>lending</u> | <u>Commercial<br/>real estate</u> | <u>Asset based<br/>lending</u> | <u>Other</u>   | <u>Total</u>     |
|--|------------------------------|-----------------------------------|--------------------------------|----------------|------------------|
|  | (Dollars in thousands)       |                                   |                                |                |                  |
| Balances as of   |                              |                                   |                                |                |                  |
| December 31, 2010  | \$ 26,630                    | 18,885                            | 12,159                         | 4,884          | 62,558           |
| Additions:   |                              |                                   |                                |                |                  |
| Provision for loan losses                                      | 14,750                       | 9,181                             | 13,285                         | 3,641          | 40,857           |
| Reclassification   | (744)                        | —                                 | —                              | —              | (744)            |
| Charge-offs and recoveries:                                    |                              |                                   |                                |                |                  |
| Charge-offs  | (19,006)                     | (12,774)                          | (3,671)                        | (846)          | (36,297)         |
| Recoveries   | 3,990                        | 2,364                             | 833                            | 231            | 7,418            |
| Net charge-offs  | <u>(15,016)</u>              | <u>(10,410)</u>                   | <u>(2,838)</u>                 | <u>(615)</u>   | <u>(28,879)</u>  |
| Balances as of   |                              |                                   |                                |                |                  |
| December 31, 2011  | \$ <u>25,620</u>             | <u>17,656</u>                     | <u>22,606</u>                  | <u>7,910</u>   | <u>73,792</u>    |
| Evaluated for impairment:                                      |                              |                                   |                                |                |                  |
| Individually   | \$ 4,208                     | 2,479                             | 9,627                          | —              | 16,314           |
| Nonimpaired criticized<br>and classified<br>general allocation | 4,951                        | 1,269                             | 1,742                          | 1,417          | 9,379            |
| Collectively-general<br>allocation                             | <u>16,461</u>                | <u>13,908</u>                     | <u>11,237</u>                  | <u>6,493</u>   | <u>48,099</u>    |
|  | \$ <u>25,620</u>             | <u>17,656</u>                     | <u>22,606</u>                  | <u>7,910</u>   | <u>73,792</u>    |
| Loans, gross:  |                              |                                   |                                |                |                  |
| Ending balance   | \$ 1,684,080                 | 958,964                           | 733,932                        | 455,621        | 3,832,597        |
| Evaluated for impairment:                                      |                              |                                   |                                |                |                  |
| Individually   | \$ 19,484                    | 24,844                            | 15,397                         | —              | 59,725           |
| Nonimpaired criticized<br>and classified<br>general allocation | 51,285                       | 28,034                            | 31,172                         | 5,497          | 115,988          |
| Collectively-general<br>allocation                             | <u>1,613,311</u>             | <u>906,086</u>                    | <u>687,363</u>                 | <u>450,124</u> | <u>3,656,884</u> |
|  | \$ <u>1,684,080</u>          | <u>958,964</u>                    | <u>733,932</u>                 | <u>455,621</u> | <u>3,832,597</u> |

**(h) Transfers and Servicing of Financial Assets**

As of December 31, 2011 and 2010, the Company has sold loans for which it continues to provide servicing totaling approximately \$3.9 million and \$6.6 million, respectively. The fair value of the servicing asset was not material at December 31, 2011 or 2010.

**DISCOUNT BANCORP, INC. AND SUBSIDIARIES**

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**(7) Premises and Equipment, Net**

Premises and equipment, net, was as follows:

|  | <b>December 31</b>     |             |
|--|------------------------|-------------|
|  | <b>2011</b>            | <b>2010</b> |
|  | (Dollars in thousands) |             |
| Furniture, fixtures, and equipment             | \$ 40,997              | 34,831      |
| Leasehold improvements                         | 10,409                 | 7,809       |
| Land and buildings                             | 8,831                  | 8,374       |
| Total  | 60,237                 | 51,014      |
| Less accumulated depreciation and amortization | 26,846                 | 20,368      |
| Premises and equipment, net                    | \$ 33,391              | 30,646      |

Depreciation and amortization expense which is included in occupancy and equipment, in the Consolidated Statements of Income, amounted to \$6.5 million and \$6.7 million, respectively, for the years ended December 31, 2011 and 2010.

**(8) Other Assets**

Following is a break down of the items included in other assets:

|                                     | <b>December 31</b>     |             |
|-------------------------------------|------------------------|-------------|
|                                     | <b>2011</b>            | <b>2010</b> |
|                                     | (Dollars in thousands) |             |
| Prepaid expenses                    | \$ 18,943              | 25,146      |
| Income taxes                        | 893                    | 4,044       |
| Investments in limited partnerships | 5,444                  | 5,754       |
| Premiums paid on options            | 5,637                  | 7,452       |
| Funded status – SERP                | —                      | 679         |
| Other real estate owned             | 1,100                  | 2,628       |
| Other                               | 1,720                  | 1,698       |
| Total other assets                  | \$ 33,737              | 47,401      |

During the fourth quarter of 2009, the FDIC required insured institutions to prepay estimated quarterly risk-based assessments for the fourth quarter of 2009 through the fourth quarter of 2012. The estimated assessments include an assumed annual assessment base increase of 5%. Prepaid expenses include prepaid FDIC assessments of \$13.8 million and \$20.0 million at December 31, 2011 and 2010, respectively.

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Notes to Consolidated Financial Statements

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**(9) Deposits**

|                        | <b>December 31, 2011</b> |                |             |              |
|------------------------|--------------------------|----------------|-------------|--------------|
|                        | <b>Demand</b>            | <b>Savings</b> | <b>Time</b> | <b>Total</b> |
|                        | (Dollars in thousands)   |                |             |              |
| Domestic offices:      |                          |                |             |              |
| Noninterest-bearing    | \$ 597,060               | —              | —           | 597,060      |
| Interest-bearing       | 190,265                  | 1,986,171      | 2,082,729   | 4,259,165    |
| Total domestic offices | 787,325                  | 1,986,171      | 2,082,729   | 4,856,225    |
| Foreign offices:       |                          |                |             |              |
| Noninterest-bearing    | 35,968                   | —              | —           | 35,968       |
| Interest-bearing       | 663,175                  | 518,804        | 532,038     | 1,714,017    |
| Total foreign offices  | 699,143                  | 518,804        | 532,038     | 1,749,985    |
| Total deposits         | \$ 1,486,468             | 2,504,975      | 2,614,767   | 6,606,210    |
|                        |                          |                |             |              |
|                        | <b>December 31, 2010</b> |                |             |              |
|                        | <b>Demand</b>            | <b>Savings</b> | <b>Time</b> | <b>Total</b> |
|                        | (Dollars in thousands)   |                |             |              |
| Domestic offices:      |                          |                |             |              |
| Noninterest-bearing    | \$ 489,974               | —              | —           | 489,974      |
| Interest-bearing       | 190,098                  | 1,855,961      | 2,072,660   | 4,118,719    |
| Total domestic offices | 680,072                  | 1,855,961      | 2,072,660   | 4,608,693    |
| Foreign offices:       |                          |                |             |              |
| Noninterest-bearing    | 42,899                   | —              | —           | 42,899       |
| Interest-bearing       | 486,410                  | 456,893        | 517,220     | 1,460,523    |
| Total foreign offices  | 529,309                  | 456,893        | 517,220     | 1,503,422    |
| Total deposits         | \$ 1,209,381             | 2,312,854      | 2,589,880   | 6,112,115    |

Time deposits in domestic and foreign offices with balances of \$100,000 or more amounted to approximately \$2.3 billion and \$2.2 billion, as of December 31, 2011 and 2010, respectively. The majority of these deposits were from foreign sources.

**DISCOUNT BANCORP, INC. AND SUBSIDIARIES**

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Scheduled maturities of time deposits are as follows:

|                                   | <b>December 31</b>     |                  |
|-----------------------------------|------------------------|------------------|
|                                   | <b>2011</b>            | <b>2010</b>      |
|                                   | (Dollars in thousands) |                  |
| Less than one year                | \$ 1,817,353           | 1,997,166        |
| Over one year but less than three | 513,571                | 448,949          |
| Over three years                  | 283,843                | 143,765          |
| Total                             | <u>\$ 2,614,767</u>    | <u>2,589,880</u> |

**DISCOUNT BANCORP, INC. AND SUBSIDIARIES**

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Deposits by customer home country/region were as follows:

|                          | <b>December 31</b>     |                  |
|--------------------------|------------------------|------------------|
|                          | <b>2011</b>            | <b>2010</b>      |
|                          | (Dollars in thousands) |                  |
| Latin America/Caribbean: |                        |                  |
| Argentina                | \$ 1,237,302           | 1,312,929        |
| Uruguay                  | 822,275                | 740,070          |
| Venezuela                | 277,241                | 290,213          |
| Brazil                   | 219,123                | 263,761          |
| Mexico                   | 199,160                | 234,499          |
| Chile                    | 127,075                | 147,787          |
| Peru                     | 167,561                | 167,467          |
| Colombia                 | 32,032                 | 33,118           |
| Bolivia                  | 25,098                 | 25,161           |
| Panama                   | 31,005                 | 17,012           |
| Guatemala                | 10,843                 | 11,145           |
| Paraguay                 | 6,737                  | 7,896            |
| Ecuador                  | 7,432                  | 7,500            |
| Costa Rica               | 5,719                  | 6,800            |
| Bahamas                  | 1,112                  | 2,024            |
| Netherlands Antilles     | 841                    | 1,398            |
| Other                    | 284,383                | 265,347          |
| Total Latin America      | <u>3,454,939</u>       | <u>3,534,127</u> |
| Israel                   | 151,423                | 143,678          |
| Europe                   | 55,972                 | 61,340           |
| Canada                   | 10,484                 | 16,719           |
| Australia                | 1,329                  | 9,071            |
| Africa                   | 2,775                  | 2,535            |
| Asia                     | 1,638                  | 2,513            |
| Total foreign customers  | <u>3,678,560</u>       | <u>3,769,983</u> |
| Domestic customers       | 1,988,180              | 1,433,224        |
| Broker deposits          | 578,282                | 592,519          |
| Affiliates               | 361,188                | 316,389          |
| Total deposits           | <u>\$ 6,606,210</u>    | <u>6,112,115</u> |

**(10) Securities Sold under Agreements to Repurchase**

The carrying values of securities sold under agreements to repurchase as of December 31, 2011 and 2010 were \$1.7 billion and \$2.0 billion, respectively. As of December 31, 2011 and 2010, the range in maturity of these repurchase agreements is from 33 days to 8.2 years, and from 3 days to 8.2 years, respectively. All of the outstanding repurchase agreements were secured by collateralized mortgage obligations or

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U.S. Government and U.S. Government sponsored enterprise securities, with fair value of \$2.1 billion and \$2.3 billion as of December 31, 2011 and 2010, respectively (see note 5).

The estimated maturity and average rate on repurchase agreements are as follows:

|                       |    | <b>December 31, 2011</b>    |                              |  |                                 |                    |
|-----------------------|----|-----------------------------|------------------------------|--|---------------------------------|--------------------|
|                       |    | <b>Less than<br/>1 year</b> | <b>1 year to<br/>3 years</b> | <b>Greater than<br/>3 years, less<br/>than 5 years</b> | <b>Greater than<br/>5 years</b> | <b>Grand total</b> |
|                       |    | (Dollars in thousands)      |                              |  |                                 |                    |
| Repurchase agreements | \$ | 291,084                     | 645,419                      | 81,500   | 729,596                         | 1,747,599          |
| Average rate          |    | 4.628%                      | 3.349%                       | 3.385%   | 3.809%                          | 3.756%             |

|                       |    | <b>December 31, 2010</b>    |                              |  |                                 |                    |
|-----------------------|----|-----------------------------|------------------------------|--|---------------------------------|--------------------|
|                       |    | <b>Less than<br/>1 year</b> | <b>1 year to<br/>3 years</b> | <b>Greater than<br/>3 years, less<br/>than 5 years</b> | <b>Greater than<br/>5 years</b> | <b>Grand total</b> |
|                       |    | (Dollars in thousands)      |                              |  |                                 |                    |
| Repurchase agreements | \$ | 281,085                     | 700,182                      | 278,620  | 770,055                         | 2,029,942          |
| Average rate          |    | 2.428%                      | 3.629%                       | 4.006%   | 3.400%                          | 3.427%             |

**(11) FHLB and Other Borrowed Funds**

FHLB and other borrowed funds are as follows:

|                               |    | <b>December 31</b>     |                |
|-------------------------------|----|------------------------|----------------|
|                               |    | <b>2011</b>            | <b>2010</b>    |
|                               |    | (Dollars in thousands) |                |
| Federal Home Loan Bank (FHLB) | \$ | 148,021                | 198,333        |
| Borrowings from customers     |    | 105                    | 3,678          |
| Demand notes – U.S. Treasury  |    | —                      | 1,432          |
| Other borrowed funds          |    | 299                    | 610            |
| Total                         | \$ | <u>148,425</u>         | <u>204,053</u> |

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Federal funds purchased are used by the bank for daily liquidity management purposes. The Bank had no federal funds purchased at December 31, 2011 or 2010. The average balance of federal funds purchased for 2011 and 2010 was \$110 million and \$96.5 million, respectively. The weighted average interest rate during 2011 and 2010 was 0.32% and 0.33%, respectively. Borrowings from the FHLB are at fixed rates, ranging from 3.69% to 5.79%, with maturities ranging from 2012 to 2018 and are summarized below:

|   | <b>December 31</b>     |                |
|---|------------------------|----------------|
|   | <b>2011</b>            | <b>2010</b>    |
|   | (Dollars in thousands) |                |
| FHLB borrowings at fixed rates:         |                        |                |
| Within six months                       | \$ 12,016              | 31,785         |
| Seven to twelve months                  | 36,059                 | 12,982         |
| Thirteen to thirty-six months           | 42,089                 | 91,527         |
| Thirty-seven to sixty months            | 33,448                 | 14,120         |
| Over five years                         | 24,409                 | 47,919         |
| Total                                   | <u>\$ 148,021</u>      | <u>198,333</u> |
| Average balance for the period          | \$ 169,961             | 232,878        |
| Maximum balance at any month end        | 197,229                | 253,794        |
| Weighted average rate during the period | 4.86%                  | 4.78%          |
| Weighted average rate at period end     | 4.87                   | 4.82           |

As a member of the FHLB of New York, the Bank may borrow in the form of term and overnight FHLB advances up to 30% of its total assets, or approximately \$2.8 billion at December 31, 2011 and \$2.8 billion at December 31, 2010, respectively. FHLB advances are secured by a blanket security agreement. In addition, the Bank must maintain as collateral certain qualifying assets (such as securities and qualifying loans) not otherwise pledged.

**(12) Accounts Payable, Accrued Expenses, and Other Liabilities**

|   | <b>December 31</b>     |                |
|---|------------------------|----------------|
|   | <b>2011</b>            | <b>2010</b>    |
|   | (Dollars in thousands) |                |
| Due to brokers                                      | \$ —                   | 25,252         |
| Payroll and employee benefits                       | 46,869                 | 42,580         |
| Accounts payable                                    | 3,615                  | 5,967          |
| Accrued interest payable – deposit accounts         | 11,443                 | 7,341          |
| Accrued interest payable – securities sold and repo | 5,960                  | 6,521          |
| Accrued expenses                                    | 6,729                  | 8,829          |
| Funded status – pension and benefit plans           | 17,531                 | 8,438          |
| Accrued interest payable – borrowings               | 829                    | 682            |
| Other liabilities – unused commitments              | 1,005                  | 508            |
| Other liabilities                                   | 5,885                  | 2,520          |
| Total   | <u>\$ 99,866</u>       | <u>108,638</u> |

## DISCOUNT BANCORP, INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

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#### **(13) Subordinated Capital Note Payable to Parent**

On December 31, 2008, Israel Discount Bank of New York issued a subordinated capital note in the amount of \$75,000,000 to Israel Discount Bank Limited. The note has an eight year final maturity of December 15, 2016 with principal repayments in three installments on March 15, 2015, March 15, 2016 and December 15, 2016, respectively. The Subordinated Capital Note carries no repayment call option at either the Borrower's or the Lender's discretion. Interest on the note was 3.93% until October 29, 2009 and 7.23% for the remainder of the term. For the years ended December 31, 2011 and 2010, the Bank recorded interest expense of \$5.5 million and \$5.5 million, respectively, which is included in interest expense on securities sold under repurchase agreements and borrowed funds in the Consolidated Statements of Income. This capital note contributes to the Banks' Tier 2 capital.

#### **(14) Stockholder's Equity**

##### **(a) Risk Based and Leverage Capital Ratios**

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

Quantitative measures established by regulation, to ensure capital adequacy, require Discount and the Bank to maintain minimum capital amounts and Total and Tier I capital ratios to risk-weighted assets and Tier I to average assets (as defined in the regulations). Management believes, as of December 31, 2011 and 2010, Discount and the Bank have met all capital adequacy requirements to which they are subject. Further, the most recent notification categorized the Bank as a well-capitalized institution under the prompt corrective action regulations. There have been no conditions or events since the notification that management believes have changed the Bank's capital classification.

To be classified as well-capitalized, an institution must maintain minimum Total risk-based, Tier I risk-based, and Tier I capital leverage ratios as disclosed in the following table.

**DISCOUNT BANCORP, INC. AND SUBSIDIARIES**

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The consolidated risk-based and leverage capital ratios for Discount and the Bank as of December 31, 2011 and 2010 are as follows:

| December 31, 2011                                     |            |        |                               |       |  |       |        |
|---|------------|--------|-------------------------------|-------|--|-------|--------|
|   | Actual     |        | For capital adequacy purposes |       | To be well-capitalized<br>under prompt corrective<br>action provisions |       |        |
|   | Amount     | Ratio  | Amount                        | Ratio | Amount   | Ratio |        |
| (Dollars in thousands)                                |            |        |                               |       |  |       |        |
| Total risk-based capital (to risk-weighted assets):   |            |        |                               |       |  |       |        |
| Discount  | \$ 948,132 | 16.48% | \$ 460,240                    | 8.00% | \$ N/A   |       | N/A    |
| Bank  | 838,854    | 14.59  | 459,915                       | 8.00  | 574,894  |       | 10.00% |
| Tier I capital (to risk-weighted assets):             |            |        |                               |       |  |       |        |
| Discount  | \$ 821,136 | 14.27% | \$ 230,120                    | 4.00% | \$ N/A   |       | N/A    |
| Bank  | 711,908    | 12.38  | 229,958                       | 4.00  | 344,937  |       | 6.00%  |
| Tier I capital/leverage (to adjusted average assets): |            |        |                               |       |  |       |        |
| Discount  | \$ 821,136 | 8.56%  | \$ 383,616                    | 4.00% | \$ N/A   |       | N/A    |
| Bank  | 711,908    | 7.43   | 383,472                       | 4.00  | 479,340  |       | 5.00%  |

  

| December 31, 2010                                     |            |        |                               |       |  |       |        |
|---|------------|--------|-------------------------------|-------|--|-------|--------|
|   | Actual     |        | For capital adequacy purposes |       | To be well-capitalized<br>under prompt corrective<br>action provisions |       |        |
|   | Amount     | Ratio  | Amount                        | Ratio | Amount   | Ratio |        |
| (Dollars in thousands)                                |            |        |                               |       |  |       |        |
| Total risk-based capital (to risk-weighted assets):   |            |        |                               |       |  |       |        |
| Discount  | \$ 910,956 | 14.69% | \$ 496,012                    | 8.00% | \$ N/A   |       | N/A    |
| Bank  | 901,529    | 14.55  | 495,699                       | 8.00  | 619,623  |       | 10.00% |
| Tier I capital (to risk-weighted assets):             |            |        |                               |       |  |       |        |
| Discount  | \$ 777,800 | 12.54% | \$ 248,006                    | 4.00% | \$ N/A   |       | N/A    |
| Bank  | 768,373    | 12.40  | 247,849                       | 4.00  | 371,774  |       | 6.00%  |
| Tier I capital/leverage (to adjusted average assets): |            |        |                               |       |  |       |        |
| Discount  | \$ 777,800 | 8.14%  | \$ 382,185                    | 4.00% | \$ N/A   |       | N/A    |
| Bank  | 768,373    | 8.18   | 375,650                       | 4.00  | 469,563  |       | 5.00%  |

Tangible and Tier 1 capital amounts represent total stockholder's equity, adjusted to reverse net unrealized gains (losses) on available-for-sale securities, less intangible assets and any disallowed deferred tax asset. Total risk-based capital represents Tier 1 capital plus the allowance for loan losses up to an amount equal to 1.25% of risk-weighted assets and qualifying subordinated debt.

**(b) Dividend Payments**

Under FDIC and New York Banking Department regulations, the Bank generally may declare annual cash dividends up to an amount equal to the sum of net income for the current year and net income

## DISCOUNT BANCORP, INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

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retained for the two preceding years. Dividend payments in excess of this amount require regulatory approval. In December 2011 the Bank declared and paid a cash dividend of \$100,000,000 to Discount Bancorp, Inc. The payment of this dividend did not require regulatory approval. The Bank did not pay a dividend for the year ended December 31, 2010.

Although unlike the Bank, Discount Bancorp, Inc. is not subject to regulatory limitations on the payment of dividends to its shareholder, its ability to pay dividends is dependent upon the receipt of dividends from the Bank. The board of directors of Discount Bancorp, Inc. may, on an annual, semi-annual, or quarterly basis, but not more frequently, declare dividends to be paid from net profits as the board of directors deems judicious and as is permitted by law.

In addition, rules and regulations of the Central Bank of Uruguay (Central Bank) require DBLA to maintain certain capital reserves for which there is no comparable requirement in the United States. These reserves are not subject to dividend distribution and can only be used for future increases of paid-in capital. In addition, their ability to pay dividends is limited to the amount they must maintain to meet the minimum capital requirement in compliance with the regulations of Central Bank. As of December 31, 2011 and 2010, the minimum capital requirement was \$49.9 million and \$46.6 million, respectively, as compared to the capital reported in their December 31, 2011 and 2010 Balance Sheets of \$69.8 million and \$65.3 million, respectively.

#### (15) Noninterest Income – Other

|                                    | <b>December 31</b>     |             |
|------------------------------------|------------------------|-------------|
|                                    | <b>2011</b>            | <b>2010</b> |
|                                    | (Dollars in thousands) |             |
| Bank-owned life insurance          | \$ 5,927               | 6,253       |
| Bank-owned life insurance proceeds | 3,153                  | 1,870       |
| Loss on sale of loans and leases   | (1,196)                | (683)       |
| Write-down of loans held for sale  | (750)                  | —           |
| Gain from partnerships             | 1,005                  | 191         |
| Other                              | 526                    | 392         |
| Total other noninterest income     | \$ 8,665               | 8,023       |

#### (16) Noninterest Expense – Other

Included in operating costs for representative offices are salaries of foreign representatives and staff of \$3.3 million and \$3.2 million for the years ended December 31, 2011 and 2010, respectively.

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Notes to Consolidated Financial Statements

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Other noninterest expense comprises of:

|   | <b>December 31</b>     |               |
|---|------------------------|---------------|
|   | <b>2011</b>            | <b>2010</b>   |
|   | (Dollars in thousands) |               |
| Bank assessments                        | \$ 9,194               | 11,097        |
| Outside service fees                    | 3,678                  | 2,687         |
| Loan expenses                           | 2,575                  | 255           |
| Data service fees                       | 2,116                  | 2,315         |
| Communications                          | 2,072                  | 2,012         |
| Taxes other than on income and premises | 2,921                  | 2,724         |
| Advertising and promotions              | 2,100                  | 2,198         |
| Insurance                               | 1,534                  | 1,813         |
| Travel and entertainment                | 1,695                  | 1,588         |
| Service fees                            | 2,047                  | 2,056         |
| Security                                | 1,960                  | 1,426         |
| Credit cards                            | 1,015                  | 1,228         |
| ATM network charges – NYCE system       | 1,241                  | 974           |
| Other operating expenses                | 4,807                  | 5,448         |
| Total other noninterest expense         | \$ <u>38,955</u>       | <u>37,821</u> |

The deposits of the Company are insured up to applicable limits by the FDIC Deposit Insurance Fund (DIF). Under the FDIC's risk-based assessment system, insured institutions are assigned to one of four risk categories based on supervisory evaluations, regulatory capital level, and certain other factors; therefore, an institution's assessment rate depends upon the category to which it is assigned. For calendar year 2008, assessments ranged from five to 43 basis points of each institution's deposit assessment base. Due to losses incurred by the DIF in 2008 from failed institutions, and anticipated future losses, the FDIC adopted an across the board seven-basis point increase in the assessment range for the first quarter of 2009. In April 2009, the FDIC made further refinements to its risk-based assessment system that effectively made the assessment range 7 to 77.5 basis points.

**DISCOUNT BANCORP, INC. AND SUBSIDIARIES**

## Notes to Consolidated Financial Statements

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**(17) Income Tax**

The following is a summary of the components of income tax expense (benefit) for the years ended December 31, 2011 and 2010, respectively:

|                 | <b>December 31</b>     |                |
|-----------------|------------------------|----------------|
|                 | <b>2011</b>            | <b>2010</b>    |
|                 | (Dollars in thousands) |                |
| Current:        |                        |                |
| Federal         | \$ 6,960               | 15,021         |
| State and local | 7,242                  | 8,424          |
| Foreign         | 233                    | (1,477)        |
| Subtotal        | <u>14,435</u>          | <u>21,968</u>  |
| Deferred:       |                        |                |
| Federal         | 1,005                  | (6,635)        |
| State and local | (1,277)                | (2,951)        |
| Foreign         | 6                      | 338            |
| Subtotal        | <u>(266)</u>           | <u>(9,248)</u> |
| Total           | <u>\$ 14,169</u>       | <u>12,720</u>  |

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Deferred tax assets, net consist of the following temporary differences:

|  | <b>December 31</b>     |               |
|--|------------------------|---------------|
|  | <b>2011</b>            | <b>2010</b>   |
|  | (Dollars in thousands) |               |
| <b>Assets:</b>   |                        |               |
| Allowance for loan losses                                | \$ 31,724              | 26,224        |
| Unrealized loss on securities available-for-sale, net    | 18,275                 | 7,917         |
| Deferred compensation                                    | 5,193                  | 5,060         |
| Post retirement benefits                                 | 3,944                  | 3,859         |
| Interest on nonaccrual and restructured loans            | 2,184                  | 2,541         |
| Cash Flow Hedge  | 1,824                  | —             |
| Hedge premiums   | 1,310                  | 1,401         |
| Funded status of pension and post retirement benefits    | 7,901                  | 3,486         |
| Pension  | 2,877                  | 2,467         |
| Unrealized loss (gain) on derivatives, net               | 1,287                  | (687)         |
| Supplemental executive retirement plan                   | 1,100                  | 1,205         |
| Severance  | 646                    | 64            |
| Foreign deferred taxes                                   | 210                    | 216           |
| Other-than-temporary impairment write-down of securities | 114                    | 5,834         |
| Investments in limited partnerships                      | 101                    | (1,352)       |
| Other  | —                      | 3,326         |
|  | <u>78,690</u>          | <u>61,561</u> |
| <b>Liabilities:</b>                                      |                        |               |
| Unrealized interest expense                              | 1,097                  | 902           |
| Unrealized gain on securities transferred to trading     | 186                    | 186           |
| Other  | 1,863                  | 1,418         |
|  | <u>3,146</u>           | <u>2,506</u>  |
| Total deferred tax liabilities                           | <u>3,146</u>           | <u>2,506</u>  |
| Deferred tax assets, net                                 | <u>\$ 75,544</u>       | <u>59,055</u> |

Based on management's consideration of historical and anticipated future pre-tax income, as well as the reversal period for the items giving rise to the deferred tax assets and liabilities, a valuation allowance for deferred assets was not considered necessary at December 31, 2011 and 2010. The Company believes that it is more likely than not that the results of future operations will generate sufficient taxable income to realize the deferred tax assets.

**DISCOUNT BANCORP, INC. AND SUBSIDIARIES**

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The provision for federal income taxes differs from that computed by applying federal statutory rate to income before federal income tax expense, as indicated in the following analysis.

|  | <b>December 31</b>     |             |
|--|------------------------|-------------|
|  | <b>2011</b>            | <b>2010</b> |
|  | (Dollars in thousands) |             |
| Federal statutory income tax at 35%    | \$ 20,984              | 22,410      |
| Effect of state and local income taxes | 3,877                  | 5,877       |
| Tax exempt interest                    | (6,765)                | (6,612)     |
| Effect of foreign subsidiary           | (2,822)                | (3,546)     |
| Bank owned life insurance              | (3,353)                | (2,826)     |
| Return to provision reconciliation     | 696                    | (84)        |
| Release of tax reserves                | —                      | (1,557)     |
| Other                                  | 1,552                  | (942)       |
|  | \$ 14,169              | 12,720      |

As of December 31, 2011 and 2010, the Company has not provided for U.S. income tax on approximately \$63.5 million and \$56.8 million, respectively, of the undistributed earnings of its subsidiary in Uruguay. Those earnings are considered to be permanently reinvested and, accordingly, no U.S. federal, state, or local income tax has been provided thereon. In the event these earnings are distributed, U.S. income taxes would be provided.

***Accounting for Uncertainty in Income Taxes***

FASB issued guidance prescribes a recognition threshold and measurement attribute for use in connection with the obligation of a Company to recognize, measure, present, and disclose in its financial statements uncertain tax positions that the Company has taken or expects to take on a tax return. Per this guidance, only tax positions that meet a “more likely than not” threshold may be recognized or may continue to be recognized. The balance of unrecognized tax benefits as of December 31, 2011 and 2010 is approximately \$0 million and \$0 million, respectively, which if recognized, would affect the effective tax rate.

The following table shows the reconciliation of unrecognized tax benefits at the beginning and end of the period:

|   | <b>December 31</b>     |             |
|---|------------------------|-------------|
|   | <b>2011</b>            | <b>2010</b> |
|   | (Dollars in thousands) |             |
| Change in unrecognized tax benefits:                      |                        |             |
| Balance at beginning of the year                          | \$ —                   | 825         |
| Interest  | —                      | 28          |
| Additions for tax positions of prior years                | —                      | 704         |
| Reductions resulting from lapse of statute of limitations | —                      | (1,557)     |
| Balance at end of the year                                | \$ —                   | —           |

## DISCOUNT BANCORP, INC. AND SUBSIDIARIES

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The Company is no longer subject to U.S. federal tax examinations by tax authorities for years before 2008. The NYS Department of Taxation and Finance and NYC Department of Finance are currently auditing the consolidated income tax returns for the years ended December 31, 2007, 2008 and 2009. Management believes that it has made adequate provisions for all income tax uncertainties, such that the outcome of any unresolved issues or claims will not result in a material change to the Company's financial position or results of operations.

The Company recognizes interest accrued and penalties related to unrecognized tax benefits as a component of income tax expense. The Company's liability for accrued interest amounted to approximately \$0 and \$0 at December 31, 2011 and 2010, respectively. In addition, the Company released \$0 and \$376,000 of accrued interest relating to the reductions resulting from lapse of statute of limitations, through a reduction of income tax expense in the Consolidated Statements of Income for the years ended December 31, 2011 and 2010, respectively.

#### **(18) Pension and Other Post Retirement Plans**

The Bank has a noncontributory defined benefit pension plan covering substantially all full time U.S. employees of the Bank who were hired prior to January 1, 2011. Employees who are twenty-one years of age or older and who have worked for the Bank for one year are eligible to participate in the plan. The Bank's funding policy is to contribute annually an amount sufficient to meet statutory minimum funding requirements, but not in excess of the maximum amount deductible for federal income tax purposes. Contributions are intended to provide not only for benefits attributed to service to date, but also for benefits expected to be earned in the future. Benefits are based on years of service and employees' compensation. The Bank's funding policy is to contribute annually an amount necessary to satisfy the Employee Retirement Income Security Act (ERISA) funding standards.

Other benefits include post-retirement medical, dental, and life insurance coverages as well as Supplemental Executive Retirement Plan and Benefits Restoration Plan.

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The funding status and reconciliation are as follows:

|  | <b>December 31, 2011</b> |                       |
|--|--------------------------|-----------------------|
|  | <b>Pension</b>           | <b>Other benefits</b> |
|  | (Dollars in thousands)   |                       |
| Change in benefit obligation:                  |                          |                       |
| Benefit obligation at beginning of year        | \$ 32,055                | 10,464                |
| Service cost                                   | 3,665                    | 652                   |
| Interest cost                                  | 1,601                    | 484                   |
| Actuarial loss                                 | 7,595                    | 1,337                 |
| Benefits paid                                  | (734)                    | (752)                 |
| Benefit obligation at end of year              | <u>44,182</u>            | <u>12,185</u>         |
| Change in plan assets:                         |                          |                       |
| Fair value of plan assets at beginning of year | 18,162                   | —                     |
| Actual return on plan assets                   | 335                      | —                     |
| Employer contribution                          | 3,600                    | 752                   |
| Benefits paid                                  | (734)                    | (752)                 |
| Fair value of plan assets at end of year       | <u>21,363</u>            | <u>—</u>              |
| Funded status                                  | (22,819)                 | (12,185)              |
| Unrecognized actuarial loss                    | 15,061                   | 1,449                 |
| Unrecognized transition assets                 | —                        | 129                   |
| Unrecognized prior service cost                | 1,590                    | (698)                 |
| Liability                                      | <u>\$ (6,168)</u>        | <u>(11,305)</u>       |

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|  | <b>December 31, 2010</b> |                       |
|--|--------------------------|-----------------------|
|  | <b>Pension</b>           | <b>Other benefits</b> |
|  | (Dollars in thousands)   |                       |
| Change in benefit obligation:                  |                          |                       |
| Benefit obligation at beginning of year        | \$ 26,917                | 9,160                 |
| Service cost                                   | 3,253                    | 602                   |
| Interest cost                                  | 1,533                    | 510                   |
| Actuarial gain                                 | 3,418                    | 804                   |
| Benefits paid                                  | (3,066)                  | (612)                 |
| Benefit obligation at end of year              | <u>32,055</u>            | <u>10,464</u>         |
| Change in plan assets:                         |                          |                       |
| Fair value of plan assets at beginning of year | 17,035                   | —                     |
| Actual return on plan assets                   | 2,193                    | —                     |
| Employer contribution                          | 2,000                    | 612                   |
| Benefits paid                                  | (3,066)                  | (612)                 |
| Fair value of plan assets at end of year       | <u>18,162</u>            | <u>—</u>              |
| Funded status                                  | (13,893)                 | (10,464)              |
| Unrecognized actuarial loss                    | 6,420                    | 144                   |
| Unrecognized transition assets                 | —                        | 258                   |
| Unrecognized prior service cost                | 1,872                    | (936)                 |
| Liability                                      | <u>\$ (5,601)</u>        | <u>(10,998)</u>       |

The discount rate with respect to the Plan's expense was 5.22% and 5.80% for plan years 2011 and 2010, respectively. The discount rate is based upon an analysis of projected benefit cash flows against the spot yield of corporate bonds that would be available to pay the benefits.

The above actuarial valuations are based on weighted average assumptions used to determine pension benefit obligations as follows:

|                                | <b>2011</b>    | <b>2010</b> |
|--------------------------------|----------------|-------------|
|                                | <b>Pension</b> |             |
| Discount rate                  | 4.15%          | 5.22%       |
| Expected return on plan assets | 8.25           | 8.25        |
| Rate of compensation increase  | 4.25           | 4.25        |

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***Estimated Future Benefit Payments***

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid over the next 10 years:

|             | <b>2011</b>            |                       |
|-------------|------------------------|-----------------------|
|             | <u>Pension</u>         | <u>Other benefits</u> |
|             | (Dollars in thousands) |                       |
| 2012        | \$ 1,432               | 784                   |
| 2013        | 1,878                  | 552                   |
| 2014        | 2,714                  | 613                   |
| 2015        | 1,632                  | 621                   |
| 2016        | 5,251                  | 794                   |
| 2017 – 2021 | 20,824                 | 5,276                 |

|   | <b>December 31</b>     |                       |                |                       |
|---|------------------------|-----------------------|----------------|-----------------------|
|   | <u>2011</u>            |                       | <u>2010</u>    |                       |
|   | <u>Pension</u>         | <u>Other benefits</u> | <u>Pension</u> | <u>Other benefits</u> |
|   | (Dollars in thousands) |                       |                |                       |
| Components of net periodic benefit cost:          |                        |                       |                |                       |
| Service cost                                      | \$ 3,665               | 652                   | 3,253          | 602                   |
| Interest cost                                     | 1,601                  | 484                   | 1,533          | 510                   |
| Expected return on plan assets                    | (1,583)                | —                     | (1,395)        | —                     |
| Amortization of prior services cost               | —                      | 129                   | 283            | (271)                 |
| Amortization of net (gain)/loss                   | 282                    | (239)                 | 111            | 1                     |
| Amortization of transition asset                  | 202                    | 32                    | —              | 129                   |
| Net periodic benefit cost                         | <u>4,167</u>           | <u>1,058</u>          | <u>3,785</u>   | <u>971</u>            |
| Nonperiodic benefit cost (Curtailment/Settlement) | <u>—</u>               | <u>—</u>              | <u>—</u>       | <u>—</u>              |
| Net benefit cost                                  | <u>\$ 4,167</u>        | <u>1,058</u>          | <u>3,785</u>   | <u>971</u>            |

**DISCOUNT BANCORP, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

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Amounts recognized in the consolidated balance sheets consist of:

|                          | <b>December 31</b>     |                           |                |                           |
|--------------------------|------------------------|---------------------------|----------------|---------------------------|
|                          | <b>2011</b>            |                           | <b>2010</b>    |                           |
|                          | <b>Pension</b>         | <b>Other<br/>benefits</b> | <b>Pension</b> | <b>Other<br/>benefits</b> |
|                          | (Dollars in thousands) |                           |                |                           |
| Prepaid benefit          | \$ —                   | —                         | —              | —                         |
| Accrued benefit cost     | (22,819)               | (12,185)                  | (13,893)       | (10,464)                  |
| Net amount<br>recognized | \$ (22,819)            | (12,185)                  | (13,893)       | (10,464)                  |

The accumulated benefit obligation for the defined benefit pension plan was \$32.9 million and \$23.3 million at December 31, 2011 and 2010, respectively.

The expected long-term return on plan assets is determined based on the asset composition of the pension portfolio. The actuary then prepares a financial model that calculates an appropriate range of rates which is reviewed and approved by Bank management.

Assumed health care cost trend rates have an effect on the amounts reported for the health care plans. A one percentage-point change in assumed health care cost trend rates would have the following effects:

|  | <b>One-<br/>percentage-<br/>point increase</b> | <b>One-<br/>percentage-<br/>point decrease</b> |
|--|--|--|
|  | (Dollars in thousands)                         |  |
| Effect on postretirement benefit obligation  | \$ 3   | (3)  |
| Effect on total of service and interest cost | —  | —  |

**DISCOUNT BANCORP, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

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**(a) Plan Assets**

Plan investments are intended to provide for the Plan a positive rate of return over a full market cycle (generally three to five years) and provide a consistent amount of cash flow. Also, plan assets should provide a long term rate of return that meets or exceeds the assumed actuarial rate. The Bank's overall investment strategy is to achieve a mix of approximately 65% of investments for long-term growth and 35% for near-term benefit payments with a well diversified large and medium cap equity portfolio and investment grade securities and government debt instruments. The target allocations for plan assets, as well as actual weighted average asset allocations as of December 31, 2011 and 2010 are as follows:

|                                 | <b>Target<br/>allocation<br/>2011</b> | <b>December 31</b>                         |  | <b>Weighted<br/>average<br/>expected<br/>long-term<br/>rate of return</b> |
|---------------------------------|---------------------------------------|--|--|---|
|                                 |                                       | <b>2011<br/>Plan assets<br/>percentage</b> | <b>2010<br/>Plan assets<br/>percentage</b> |   |
| Assets:                         |                                       |  |  |   |
| Equity securities               | 40-60%                                | 56%  | 46%  | 9.8%  |
| Mutual fund – bond<br>portfolio | 40-60                                 | 43   | 52   | 7.6%  |
| Cash liquidity funds            | 0-20                                  | 1  | 2  | —   |
|                                 |                                       | <u>100%</u>                                | <u>100%</u>                                |   |

**DISCOUNT BANCORP, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

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The following tables present, by FASB's valuation hierarchy as further described in note (21), the Bank's plan assets as of December 31, 2011 and 2010:

| <b>Fair value measurements at December 31, 2011 using</b> |   |  |  |                             |
|---|---|--|--|-----------------------------|
|   | <b>Quoted<br/>prices<br/>in active<br/>markets for<br/>identical<br/>assets<br/>(Level 1)</b> | <b>Significant<br/>other<br/>observable<br/>inputs<br/>(Level 2)</b> | <b>Significant<br/>unobservable<br/>inputs<br/>(Level 3)</b> | <b>Total fair<br/>value</b> |
|   | (Dollars in thousands)  |  |  |                             |
| Cash equivalents:   |   |  |  |                             |
| Short term investment fund                                | \$ 105  | —  | —  | 105                         |
| Debt securities:  |   |  |  |                             |
| U.S. government agency mortgage<br>backed securities      | —   | 3  | —  | 3                           |
| Other bonds, notes and debentures                         | —   | 33   | —  | 33                          |
| Fixed Income mutual funds:                                | 16,103  | —  | —  | 16,103                      |
| Equity securities:  |   |  |  |                             |
| Common stocks   | —   | —  | —  | —                           |
| Equity mutual funds                                       | 5,119   | —  | —  | 5,119                       |
| <b>Total plan assets</b>                                  | <b>\$ 21,327</b>  | <b>36</b>  | <b>—</b>   | <b>21,363</b>               |

| <b>Fair value measurements at December 31, 2010 using</b> |   |  |  |                             |
|---|---|--|--|-----------------------------|
|   | <b>Quoted<br/>prices<br/>in active<br/>markets for<br/>identical<br/>assets<br/>(Level 1)</b> | <b>Significant<br/>other<br/>observable<br/>inputs<br/>(Level 2)</b> | <b>Significant<br/>unobservable<br/>inputs<br/>(Level 3)</b> | <b>Total fair<br/>value</b> |
|   | (Dollars in thousands)  |  |  |                             |
| Cash equivalents:   |   |  |  |                             |
| Short term investment fund                                | \$ 306  | —  | —  | 306                         |
| Debt securities:  |   |  |  |                             |
| U.S. government agency mortgage<br>backed securities      | —   | 3  | —  | 3                           |
| Other bonds, notes and debentures                         | —   | 54   | —  | 54                          |
| Fixed Income mutual funds:                                | 9,527   | —  | —  | 9,527                       |
| Equity securities:  |   |  |  |                             |
| Common stocks   | 4,130   | —  | —  | 4,130                       |
| Equity mutual funds                                       | 4,142   | —  | —  | 4,142                       |
| <b>Total plan assets</b>                                  | <b>\$ 18,105</b>  | <b>57</b>  | <b>—</b>   | <b>18,162</b>               |

## DISCOUNT BANCORP, INC. AND SUBSIDIARIES

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Equity securities include investments in various mutual funds focused primarily on growth or dividend yield. Fixed income investments are in various bond mutual funds including a global fund, total return fund and an investment grade bond. The investment strategy seeks maximum current income and price appreciation consistent with the preservation of capital and prudent risk taking.

The Bank completed cash contributions to the pension plan of \$3.6 million and \$2.0 million for 2011 and 2010, respectively. The postretirement medical health care plan has no assets and therefore related costs, which are not material, have been recognized in the Consolidated Statements of Income.

The Bank's retirement benefits plans are all on a calendar year plan basis.

#### **(b) Defined Employer Contribution Plan**

The Bank has a noncontributory defined employer contribution pension plan covering substantially all full time U.S. employees of the Bank who were hired on or after January 1, 2011. Employees participating in the defined benefit pension plan are not eligible to participate in the defined employer contribution plan. The Bank contributes on behalf of each "eligible" participant a percentage of the "eligible" participant's compensation as follows:

- (1) three percent (3%), if such participant's years of credited service is less than ten;
- (2) Four percent (4%), if such participant's years of credited service is at least ten but less than twenty; and
- (3) Five percent (5%), if such participant's years of credited service is twenty or more.

The Bank contributes up to the lesser of the relevant percent of employee compensation per above or \$7,350 for 2011. The expense related to the defined employer contribution plan, included in Salaries and employee benefits in the Consolidated Statements of Income is approximately \$170,000 for the year ended December 31, 2011. There were no expenses related to the defined employer contribution plan for the year ended December 31, 2010.

#### **(c) Savings and Investment Plan (401(k))**

The Bank maintains a contributory Savings and Investment Plan (401k). Contributions are made by employees on a discretionary basis, subject to the applicable limitations of U.S. tax laws.

The Bank matches contributions up to the lesser of 3% of employee compensation or \$7,350 for 2011 and 2010. The expense related to the Bank match, included in Salaries and employee benefits in the Consolidated Statements of Income is approximately \$1.1 million and \$1.0 million for the years ended December 31, 2011 and 2010, respectively.

#### **(d) Other Benefit Plans**

The Bank maintains a Restoration Plan (RP) that provides its participants with the benefit of having their base annual salary, before the deduction of the annual deferred compensation election amount, considered as pensionable salary for computation purposes for their annual accrued pension calculation performed by the Bank's actuary. The actuarial determined benefit costs for the RP plan

## DISCOUNT BANCORP, INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

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was \$82,000 and \$77,000 for 2011 and 2010, respectively. The discount rates used to determine benefit obligations for 2011 and 2010 were 3.87% and 4.92%, respectively.

The Bank maintains a Defined Contribution Restorative Plan (DCRP) that restores lost non-elective employer contributions under the Bank's Qualified Defined Employer Contribution Plan for employees hired after January 1, 2011 as a result of applicable limitations under Internal Revenue Service (IRS) rules. The expense related to the Defined Contribution Restorative Plan, included in Salaries and employee benefits in the Consolidated Statements of Income is approximately \$10,000 for the year ended December 31, 2011. There were no expenses related to the Defined Contribution Restorative Plan for the year ended December 31, 2010.

The Bank maintains a Supplemental Executive Retirement Plan (SERP) for employees hired prior to January 1, 2011 that provides for payments to certain officers upon retirement, disability, death, and other circumstances under which their employment is ended. The annual benefit to be paid, as computed actuarially, is based upon their annual compensation. The actuarial determined benefit costs for the SERP plan was \$50,000 and \$4,000 for 2011 and 2010, respectively. The discount rates used to determine benefit obligations for 2011 and 2010 were 3.79% and 4.87%, respectively.

The Bank also maintains a Post Retirement Benefit Plan (PRB) which provides certain eligible employees with post retirement supplemental medical benefits. The actuarial determined benefit costs for the RP plan was \$926,000 and \$890,000 for 2011 and 2010, respectively. The discount rates used to determine benefit obligations for 2011 and 2010 were 4.14% and 5.20%, respectively.

**(e) *Deferred Compensation Plan***

The Bank has a deferred compensation plan, whose participation is open to First Vice Presidents and above and permits the participant to defer up to 10% of their base annual salary. The deferred compensation plan document describes methods by which the participants can receive a Bank match amount, as well as a return on their investment. The expense related to the deferred compensation plan, included in Salaries and employee benefits in the Consolidated Statements of Income is \$783,000 and \$900,000 for the years ended December 31, 2011 and 2010, respectively.

**(19) Commitments and Contingencies**

In the normal course of business, the Company makes various commitments and incurs certain contingent liabilities, which are not reflected in its consolidated financial statements. Management does not anticipate any material adverse effect on the consolidated financial statements as a result of these commitments and contingent liabilities.

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#### (a) *Leases*

The Company leases certain premises under noncancelable operating leases all of which expire by the year 2022. The following is a summary of future minimum rental payments under such leases (dollars in thousands):

| Year ending December 31: |                  |
|--------------------------|------------------|
| 2012                     | \$ 4,503         |
| 2013                     | 2,954            |
| 2014                     | 2,743            |
| 2015                     | 2,494            |
| 2016                     | 2,651            |
| Thereafter               | 10,156           |
|                          | <u>\$ 25,501</u> |

Rent expense, including real estate taxes, insurance and other related expenses, amounted to \$9.0 million and \$7.8 million, for the years ended December 31, 2011 and 2010, respectively.

Income in the amount of \$.5 million and \$.7 million, respectively, for amounts charged to third parties for sub-leases of premises has been recorded as a reduction of occupancy costs for each of the years ended December 31, 2011 and 2010.

#### (b) *Legal Proceedings*

Various legal actions and proceedings are pending against or involve the Company. While the outcome cannot be predicted at this time, management, after reviewing these actions and proceedings with counsel, believes it has meritorious defenses to all such actions and intends to defend each of these actions vigorously.

#### (20) **Related Party Transactions**

By a Sublease Agreement dated April 16, 2008, the Bank sublet the twelfth floor of its office located at 511 Fifth Avenue, New York, to 511 Fifth Avenue Tenant, L.L.C. one hundred percent (100%) of which is owned by the former Chairman of Discount. During the year ended December 31, 2010, the tenant paid \$243,000 for rent. The lease was terminated in October 2010 and the premises vacated.

Israel Discount Bank of New York has issued a Standby Letter of Credit to an IDBL investor, which balance as of December 31, 2011 and 2010, was \$750,000.

During 2006, the Company, serving as an intermediary for IDBL, entered into a pair of matched interest rate swaps (Swaps), each with a notional amount of 50,000,000 Israeli Shekels (Shekel), with certain U.S. investment banks in order to make a market in interest rate swaps in the Shekel. As of December 31, 2010, the equivalent in U.S. dollars of the total notional amount of the remaining Swaps were approximately \$14.2 million. The swaps matured in 2011.

**DISCOUNT BANCORP, INC. AND SUBSIDIARIES**

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As described in note 13, on December 31, 2008, Israel Discount Bank of New York issued a subordinated capital note in the amount of \$75.0 million to Israel Discount Bank Limited. Interest expense on this note for the years ended December 31, 2011 and 2010 was \$5.5 million and \$5.5 million, respectively.

Inter-company balances and financial transactions with the Company's affiliates, included in the consolidated financial statements are as follows:

|                                      | <b>December 31</b>     |             |
|--------------------------------------|------------------------|-------------|
|                                      | <b>2011</b>            | <b>2010</b> |
|                                      | (Dollars in thousands) |             |
| Assets:                              |                        |             |
| Interest-bearing deposits with banks | \$ 102,884             | 92,809      |
| Accrued interest receivable          | 563                    | 437         |
| Liabilities:                         |                        |             |
| Deposits:                            |                        |             |
| Domestic offices:                    |                        |             |
| Noninterest-bearing                  | \$ 2,336               | 2,444       |
| Interest-bearing                     | 390                    | 478         |
| Foreign offices:                     |                        |             |
| Noninterest-bearing                  | 50                     | 50          |
| Interest-bearing                     | 359,378                | 313,416     |
| Accrued interest payable             | 260                    | 531         |
| Subordinated capital note            | 75,000                 | 75,000      |

|                                       | <b>Years ended December 31</b> |             |
|---------------------------------------|--------------------------------|-------------|
|                                       | <b>2011</b>                    | <b>2010</b> |
|                                       | (Dollars in thousands)         |             |
| Income:                               |                                |             |
| Interest on deposits with banks       | \$ 1,347                       | 1,015       |
| Rent                                  | —                              | 243         |
| Expense:                              |                                |             |
| Interest on deposits                  | \$ 672                         | 795         |
| Interest on subordinated capital note | 5,498                          | 5,498       |
| Contingent liabilities:               |                                |             |
| Standby letters of credit             | \$ 804                         | 750         |

## DISCOUNT BANCORP, INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

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#### (21) Fair-Value Measurement

Fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, a fair value hierarchy was established, which prioritizes the inputs used in measuring fair value as follows:

- Level 1 – Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 – Inputs to the valuation methodology include quoted prices in markets that are not considered to be active or significant inputs to the methodology that are observable, either directly or indirectly.
- Level 3 – Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

A financial instrument's categorization within this valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

**DISCOUNT BANCORP, INC. AND SUBSIDIARIES**

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The following tables present, by valuation hierarchy, assets and liabilities that are measured at fair value on a recurring basis and that are included in the Company's Consolidated Balance Sheets as of December 31, 2011 and 2010:

|  | Fair value measurements at December 31, 2011 using                         |   |  |                     |
|--|--|---|--|---------------------|
|  | Quoted prices<br>in active<br>markets for<br>identical assets<br>(Level 1) | Significant<br>other<br>observable<br>inputs<br>(Level 2) | Significant<br>unobservable<br>inputs<br>(Level 3) | Total fair<br>value |
|  | (Dollars in thousands)   |   |  |                     |
| Assets:  |  |   |  |                     |
| Trading account assets, at fair value:   |  |   |  |                     |
| Foreign government securities  | \$ 89,663  | —   | —  | 89,663              |
| Corporate bonds, notes, and debentures   | —  | 105   | —  | 105                 |
| Mortgage backed securities:  |  |   |  |                     |
| U.S. government sponsored enterprise   | —  | 828   | —  | 828                 |
| U.S. government agency   | —  | 10  | —  | 10                  |
| Other U.S. government agency<br>and sponsored enterprise<br>mortgage backed securities | —  | 13,292  | —  | 13,292              |
| Total trading assets   | <u>\$ 89,663</u>   | <u>14,235</u>   | <u>—</u>   | <u>103,898</u>      |
| Available-for-sale securities, at fair value:  |  |   |  |                     |
| Debt securities:   |  |   |  |                     |
| U.S. Treasury securities   | \$ —   | 102,962   | —  | 102,962             |
| U.S. government sponsored<br>enterprise  | —  | 43,480  | —  | 43,480              |
| Foreign government securities  | —  | 86,314  | —  | 86,314              |
| Mortgage backed pass-through securities:   |  |   |  |                     |
| U.S. government agency   | —  | 60,688  | —  | 60,688              |
| U.S. government sponsored<br>enterprise  | —  | 871,846   | —  | 871,846             |
| Other mortgage backed securities:  |  |   |  |                     |
| U.S. government agency and<br>sponsored enterprise                                     | —  | 2,156,027   | —  | 2,156,027           |
| Corporate bonds, notes, and<br>debenture:  |  |   |  |                     |
| U.S. corporate securities  | —  | 278,814   | —  | 278,814             |
| Foreign corporate securities   | —  | 176,202   | —  | 176,202             |
| Mutual funds and equity securities   | 5,656  | —   | —  | 5,656               |
| Total available-for-sale<br>securities   | <u>\$ 5,656</u>  | <u>3,776,333</u>  | <u>—</u>   | <u>3,781,989</u>    |
| Unrealized gain on derivatives   | \$ —   | 16,514  | —  | 16,514              |
| Liabilities:   |  |   |  |                     |
| Unrealized loss on derivatives   | —  | 14,100  | —  | 14,100              |

**DISCOUNT BANCORP, INC. AND SUBSIDIARIES**

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| <b>Fair value measurements at December 31, 2010 using</b>                               |   |  |  |                             |
|---|---|--|--|-----------------------------|
|   | <b>Quoted prices<br/>in active<br/>markets for<br/>identical assets<br/>(Level 1)</b> | <b>Significant<br/>other<br/>observable<br/>inputs<br/>(Level 2)</b> | <b>Significant<br/>unobservable<br/>inputs<br/>(Level 3)</b> | <b>Total fair<br/>value</b> |
|   | (Dollars in thousands)  |  |  |                             |
| <b>Assets:</b>  |   |  |  |                             |
| Trading account assets, at fair value:  |   |  |  |                             |
| Corporate bonds, notes, and debentures  | \$ —  | 3,678  | —  | 3,678                       |
| Mortgage backed securities:   |   |  |  |                             |
| U.S. government sponsored enterprise  | —   | 1,106  | —  | 1,106                       |
| U.S. government agency  | —   | 11   | —  | 11                          |
| Other U.S. government agency<br>and sponsored enterprise<br>mortgage backed securities: | —   | 11,020   | —  | 11,020                      |
| <b>Total trading assets</b>   | <b>\$ —</b>   | <b>15,815</b>  | <b>—</b>   | <b>15,815</b>               |
| Available-for-sale securities, at fair value:   |   |  |  |                             |
| Debt securities:  |   |  |  |                             |
| U.S. Treasury securities  | \$ —  | 220,938  | —  | 220,938                     |
| U.S. government sponsored<br>enterprise   | —   | 56,866   | —  | 56,866                      |
| Foreign government securities   | —   | 76,983   | —  | 76,983                      |
| Mortgage backed pass-through securities:  |   |  |  |                             |
| U.S. government agency  | —   | 29,534   | —  | 29,534                      |
| U.S. government sponsored<br>enterprise   | —   | 761,165  | —  | 761,165                     |
| Other mortgage backed securities:   |   |  |  |                             |
| U.S. government agency and<br>sponsored enterprise                                      | —   | 1,727,789  | —  | 1,727,789                   |
| Residential mortgage backed<br>securities   | —   | 500  | —  | 500                         |
| Structured financial products   | —   | 3,485  | —  | 3,485                       |
| Corporate bonds, notes, and<br>debenture:   |   |  |  |                             |
| U.S. corporate securities   | —   | 335,354  | —  | 335,354                     |
| Foreign corporate securities  | —   | 118,890  | —  | 118,890                     |
| Mutual funds and equity securities  | 5,728   | —  | —  | 5,728                       |
| <b>Total available-for-sale<br/>securities</b>  | <b>\$ 5,728</b>   | <b>3,331,504</b>   | <b>—</b>   | <b>3,337,232</b>            |
| Unrealized gain on derivatives  | \$ 2,189  | 14,808   | —  | 16,997                      |
| <b>Liabilities:</b>   |   |  |  |                             |
| Unrealized loss on derivatives  | 2,094   | 12,818   | —  | 14,912                      |

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The following table presents information for recurring assets classified by the Company within Level 3 of the valuation hierarchy for the twelve months ended December 31, 2010 (dollars in thousands):

|  | <u>Fair value<br/>January 1,<br/>2010</u> | <u>Total realized/unrealized<br/>gains (losses) recorded in</u> |                                 |                        |                  | <u>Fair value<br/>December 31,<br/>2010</u> | <u>Change in<br/>Unrealized<br/>gains<br/>(losses)<br/>related to<br/>instruments<br/>held at<br/>December 31,<br/>2010</u> |
|--|---|---|---------------------------------|------------------------|------------------|---|---|
|  |   | <u>Income</u>   | <u>Comprehensive<br/>income</u> | <u>Paydowns</u>        | <u>Transfers</u> |   |   |
|  |   |   |                                 | (Dollars in thousands) |                  |   |   |
| Available-for-sale debt securities:        |   |   |                                 |                        |                  |   |   |
| Other mortgage<br>backed securities:       |   |   |                                 |                        |                  |   |   |
| Commercial mortgage<br>backed securities   | \$ 18,885                                 | —   | —                               | —                      | (18,885)         | —   | —   |
| Residential mortgage<br>backed securities  | 700                                       | (500)   | 300                             | —                      | (500)            | —   | 300   |
| Structured financial<br>products           | <u>4,643</u>                              | <u>(950)</u>  | <u>392</u>                      | <u>(600)</u>           | <u>(3,485)</u>   | <u>—</u>                                    | <u>392</u>  |
| Total securities<br>available-for-<br>sale | <u>\$ 24,228</u>                          | <u>(1,450)</u>  | <u>692</u>                      | <u>(600)</u>           | <u>(22,870)</u>  | <u>—</u>                                    | <u>692</u>  |

The Company did not have any Level 3 securities in 2011.

The commercial mortgage backed securities in the table above were included in the transfer of AFS securities to HTM in March 2010 as described in note 4 and are therefore no longer Level 3 fair value securities. The residential mortgage backed securities and structured financial products in the table above were impaired securities that were intended to be sold at December 31, 2010, as further described in note 4. Prices for these securities were obtained from independent brokers and as such they were transferred from Level 3 securities to Level 2 at December 31, 2010.

Fair value is based upon quoted market prices when available. If listed prices or quotes are not available fair value is based upon broker quotes or pricing models that primarily use market-based or independently sourced market parameters as inputs, including, but not limited to, yield curves, interest rates, equity or debt prices for similar securities, and credit curves. In addition to market information, models also incorporate transaction details, such as maturity and cash flow assumptions.

The Company reviews and updates the fair value hierarchy classifications on a quarterly basis. Changes from one quarter to the next that are related to the observability of inputs to a fair value measurement may result in a reclassification from one hierarchy level to another. Transfers between levels are recognized as of the end of the reporting period. There were no transfers between categories for the twelve months ended December 31, 2011. Transfers between categories for the twelve months ended December 31, 2010 are described above.

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A description of the methods and significant assumptions utilized in estimating the fair value of available-for-sale securities follows:

Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities include highly liquid government securities, exchange-traded equities and mutual funds.

If quoted market prices are not available for the specific security, then fair values are determined by using third party pricing services or quotes from brokers. The pricing services utilize various sources to determine fair value including pricing models, quoted prices of securities with similar characteristics or discounted cash flows. Securities valued by using such pricing services or broker quotes are classified within Level 2 of the valuation hierarchy, and include instruments such as mortgage-related securities, corporate debt, preferred stock, and municipal securities.

In certain cases where there is limited activity or less transparency around inputs to the valuation, securities are classified within Level 3 of the valuation hierarchy. As noted above, there are currently no Level 3 securities.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Company believes its valuation methods are appropriate and consistent with those of other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

Beginning in the second quarter of 2008, the Bank began writing short dated options transactions on certain available-for-sale securities including covered calls and puts. In exchange for a fee paid to the Bank, the put gives the respective counterparty the right, but not the obligation, to sell securities to the Bank. The covered calls give the respective counterparty the right, but not the obligation, to buy the security from the Bank. The underlying securities that the calls are written against are held in the available-for-sale portfolio. The exercise of the option by the counterparty is contingent upon the relationship between the option strike price and the then current market price of the underlying at expiry. The fee paid to the Bank for selling the option is initially recorded as an other liability. If a put option is exercised the fee is recorded as an adjustment to the basis of the security purchased. For put options expiring or expiring or exercised call options the fee is recorded as gains on derivatives and included in Gains on Securities, net in the Consolidated Statement of Income. As of December 31, 2011, the notional value of outstanding written option contracts was \$50 million. These options expired in January 2012.

In June 2011, the Bank entered into a \$100 million notional amount interest rate swap to hedge the variability in cash flows in certain floating rate money market deposit accounts. The swap is categorized as a cash flow hedge and since it was deemed fully effective, the unrealized loss on the swap as of December 31, 2011 was recorded in accumulated other comprehensive loss, net of tax.

#### ***Nonrecurring Fair Value Measurements***

Loan impairment is deemed to exist when full repayment of principal and interest according to the contractual terms of the loan is no longer probable. Impaired loans are reported based on one of three measures: the present value of expected future cash flows discounted at the loan's effective interest

**DISCOUNT BANCORP, INC. AND SUBSIDIARIES**

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rate; the loan's observable market price; or the fair value of the collateral if the loan is collateral dependent. Accordingly, certain impaired loans may be subject to measurement at fair value on a nonrecurring basis. The Company has estimated the fair values of these assets using Level 3 inputs, such as the fair value of collateral based on independent third-party appraisals for collateral-dependent loans.

The Company's loans held for sale and ORE are recorded at the lower of cost or fair value. Fair value for loans held for sale is determined either by quotes from brokers when available (Level 2 input) or if collateral dependent fair value is estimated based on the appraised value of the collateral (Level 3 input). Fair value for ORE is based on the appraised value of the collateral less estimated costs to sell.

The following table presents, by valuation hierarchy, assets that are measured at fair value on a nonrecurring basis and that are included in the Company's Consolidated Balance Sheets as of December 31, 2011 and 2010:

| <b>Non-recurring fair value measurements at<br/>December 31, 2011 using</b> |    |   |  |  |                             |
|---|----|---|--|--|-----------------------------|
|   |    | <b>Quoted<br/>prices<br/>in active<br/>markets for<br/>identical<br/>assets<br/>(Level 1)</b> | <b>Significant<br/>other<br/>observable<br/>inputs<br/>(Level 2)</b> | <b>Significant<br/>unobservable<br/>inputs<br/>(Level 3)</b> | <b>Total fair<br/>value</b> |
| <b>(Dollars in thousands)</b>   |    |   |  |  |                             |
| Loans held for sale   | \$ | —   | 700  | —  | 700                         |
| Loans:  |    |   |  |  |                             |
| Impaired loans  |    | —   | —  | 43,412   | 43,412                      |
| Other real estate owned   |    | —   | —  | 1,100  | 1,100                       |

| <b>Non-recurring fair value measurements at<br/>December 31, 2010 using</b> |    |   |  |  |                             |
|---|----|---|--|--|-----------------------------|
|   |    | <b>Quoted<br/>prices<br/>in active<br/>markets for<br/>identical<br/>assets<br/>(Level 1)</b> | <b>Significant<br/>other<br/>observable<br/>inputs<br/>(Level 2)</b> | <b>Significant<br/>unobservable<br/>inputs<br/>(Level 3)</b> | <b>Total fair<br/>value</b> |
| <b>(Dollars in thousands)</b>   |    |   |  |  |                             |
| Loans held for sale   | \$ | —   | 2,755  | —  | 2,755                       |
| Loans:  |    |   |  |  |                             |
| Impaired loans  |    | —   | —  | 46,865   | 46,865                      |
| Other real estate owned   |    | —   | —  | 2,628  | 2,628                       |

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#### (22) Fair Value of Financial Instruments

Fair values of financial instruments are generally determined by the quoted prices on trading exchanges. However, fair values are not readily available for financial instruments such as, certain investment securities, loans, and deposits, since there are no trading markets for these instruments. Furthermore, there is no prescribed procedure for valuing these instruments. Such a valuation is, therefore, subjective and may not be a true measure of the real worth of these instruments.

The following methods and assumptions were used by the Company in determining the fair value of financial instruments:

*Cash and due from banks* – The carrying amount reported in the consolidated balance sheets for cash and due from banks is comprised of cash and demand deposits with banks, all of which approximate fair value.

*Interest-bearing deposits with banks* – For these short-term instruments, the carrying amount is a reasonable estimate of fair value.

*Available-for-sale securities, Held-to-maturity securities and Trading account assets* – The fair values of investment securities are based on quoted market prices, or if unavailable, obtained from other sources, such as brokers, and valuation models (see note 21).

*Loans held for sale* – Fair value is based on broker quotes for the loan or if the loan is collateral dependent it is based on the appraised value less a discount and estimated selling costs.

*Loans* – The carrying value of variable-rate loans approximates their fair values, as these loans are re-priced on the basis of rate changes in prime, LIBOR, or other indexed interest rates. Loans deemed to have a higher than normal credit risk have been valued at management's estimate based on the sale value of the loan to a third party. Fixed rate loan values where there is no significant change in credit risk are obtained from a third party valuation consultant.

*Unrealized gain or loss on derivatives* – the total carrying amount approximates fair value. For foreign exchange options, which trade in an active market, fair value is determined by quotes obtained from a major pricing service. Other derivatives are priced by a third party service which utilizes market inputs to value these instruments.

*Deposits* – The fair value of demand deposits and money market deposit accounts is the amount payable on demand at the reporting date. All other time deposit liabilities are placed with Discount for short maturity periods, primarily three months or less; the rates currently offered approximate the existing rates on these deposits. Fair value has been calculated based on the difference between the weighted average yield on the existing portfolio and year end interest rates.

*Securities sold under agreements to repurchase* – The total carrying amount is determined using values obtained from a third party valuation consultant. This model incorporates the reporting date yield curves and spreads, as well as the specific debt structures to derive market value.

*Other borrowings* – Fair value has been calculated based on the difference between the weighted average yield on the existing portfolio and year end interest rates.

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*Off-balance sheet instruments* – The fair values of credit-related instruments were evaluated using fees currently charged to enter into similar agreements, taking into account the risk characteristics of the borrower. Discount has reviewed the unfunded portion of commitments to extend credit as well as standby and other letters of credit and has determined that the fair values of such financial instruments are not material.

The estimated fair values and related carrying values of Discount’s financial instruments are as follows:

|   | December 31            |               |                   |               |
|---|------------------------|---------------|-------------------|---------------|
|   | 2011                   |               | 2010              |               |
|   | Carrying<br>value      | Fair<br>value | Carrying<br>value | Fair<br>value |
|   | (Dollars in thousands) |               |                   |               |
| Financial assets:                                 |                        |               |                   |               |
| Cash and cash equivalents                         | \$ 168,414             | 168,414       | 127,584           | 127,584       |
| Interest-bearing deposits<br>with banks           | 440,083                | 440,381       | 342,246           | 342,382       |
| Trading account assets                            | 103,898                | 103,898       | 15,816            | 15,816        |
| Available-for-sale securities                     | 3,781,989              | 3,781,989     | 3,337,232         | 3,337,232     |
| Held-to-maturity securities                       | 830,520                | 866,679       | 1,220,859         | 1,218,385     |
| Loans, net  | 3,750,954              | 3,774,841     | 3,858,401         | 3,873,068     |
| Loans held for sale                               | 700                    | 700           | 2,755             | 2,755         |
| Unrealized gain on derivatives                    | 16,514                 | 16,514        | 16,997            | 16,997        |
| Financial liabilities:                            |                        |               |                   |               |
| Deposits  | 6,606,210              | 6,633,875     | 6,112,115         | 6,128,019     |
| Securities sold under<br>agreements to repurchase | 1,747,599              | 1,934,502     | 2,029,942         | 2,210,508     |
| FHLB and other borrowed<br>funds                  | 148,425                | 161,977       | 204,053           | 220,518       |
| Unrealized loss on derivatives                    | 14,100                 | 14,100        | 14,912            | 14,912        |
| Subordinated capital debt                         | 75,000                 | 83,066        | 75,000            | 75,107        |

### (23) Financial Instruments with Off-Balance Sheet Risk

In the normal course of business, the Company becomes a party to financial instruments with off-balance sheet risk. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the consolidated balance sheet. The contract or notional amounts of these instruments reflect the extent of involvement of the Company in particular classes of financial instruments.

The Company’s exposure to credit loss, in the event of nonperformance by the party to the financial instrument, for commitments to extend credit and standby letters of credit, is represented by the contractual notional amount of these instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. The Company does not require

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collateral or other security to support financial instruments with credit risk, unless otherwise noted for a specific transaction.

#### (a) *Credit Related Instruments*

Commitments to extend credit are agreements to lend funds to a customer, as long as there is no violation of any condition established in the contract. Generally, commitments have fixed expiration dates or other termination clauses and may require payment of a fee by the borrower. Since some of the Company's commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash funding requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary, by the Company upon extension of credit is based on management's credit evaluation of the borrower. Collateral held by the Company varies but may include time deposits, marketable securities, accounts receivable, inventory, property, plant, equipment, and income-producing commercial properties.

In order to meet the financing needs of its customers, the Company makes commitments to issue financial and performance standby letters of credit. Financial standby letters of credit are issued by the Company to guarantee payment of a specified financial obligation; performance standby letters of credit require the Company to make payments in the event a specified third party fails to perform under a nonfinancial contractual obligation.

In certain cases, the Company holds assignments of time deposits and marketable securities as collateral supporting many of the standby letters of credit for which collateral is deemed necessary.

A summary of the contractual amounts of credit related instruments is as follows:

|  | <b>December 31</b>            |             |
|--|-------------------------------|-------------|
|  | <b>2011</b>                   | <b>2010</b> |
|  | <b>(Dollars in thousands)</b> |             |
| Financial instruments whose contract amounts represent credit risk:                  |                               |             |
| Commitments to extend credit:  |                               |             |
| Commercial letters of credit   | \$ 128,748                    | 188,333     |
| Loan commitments   | 1,609,186                     | 1,754,075   |
| Standby letters of credit and foreign office guarantees:                             |                               |             |
| Financial standby letters of credit  | 121,761                       | 168,220     |
| Performance standby letters of credit  | 636                           | 2,469       |
| Foreign office guarantees  | 6,360                         | 5,236       |
| Participation agreements in acceptances, loans, and letters of credit of other banks | 130,993                       | 219,320     |

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Contractual commitments of credit by industry sectors are as follows:

|  | December 31            |         |
|--|------------------------|---------|
|  | 2011                   | 2010    |
|  | (Dollars in thousands) |         |
| Commercial industries (except real estate) | \$ 652,030             | 877,168 |
| Textile, clothing, and leather industries  | 619,029                | 600,059 |
| Construction (real estate)                 | 87,449                 | 136,809 |
| Financial services                         | 246,643                | 221,315 |
| All other industries                       | 392,533                | 502,302 |

**(b) Concentrations of Credit Risk**

In the normal course of its business, the Company's activities include significant amounts of credit risk to financial institutions. These concentrations may exist when the Company's assets are being held by financial institutions and these institutions may be impacted by economic or other conditions. These concentrations pertain to the Company's assets such as Cash and due from banks, Interest-bearing deposits with banks, loans to banks, available for sale securities (bank notes and debentures). Such concentrations aggregate approximately 12% and 11% of the Company's on-balance sheet financial instruments at December 31, 2011 and 2010.

**(24) Accumulated Other Comprehensive Loss, Net of Tax**

Comprehensive income represents the sum of net income and items of other comprehensive income or loss that are reported directly in Stockholder's equity, such as the change during the period in after-tax net unrealized gain and loss on available-for-sale securities. The Company has reported its comprehensive loss in the Consolidated Statement of Changes in Stockholder's Equity and Comprehensive Income.

Changes in each component of accumulated other comprehensive (loss) income for the years ended December 31, 2011 and 2010 are as follows:

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|   | <u>Net<br/>unrealized<br/>(loss) gain<br/>on securities</u> | <u>Cash<br/>Flow<br/>Hedge</u> | <u>Foreign<br/>currency<br/>translation<br/>adjustment</u> | <u>Funding of<br/>pension and<br/>other<br/>retirement<br/>benefits</u> | <u>Accumulated<br/>other<br/>comprehensive<br/>loss</u> |
|---|---|--------------------------------|--|---|---|
|   | (Dollars in thousands)                                      |                                |  |   |   |
| Balance, December 31, 2009  | (14,049)  | —                              | (6,877)  | (2,555)   | (23,481)  |
| Net unrealized gains arising during<br>the period, net of \$10,779 taxes                  | 17,832  | —                              | —  | —   | 17,832  |
| OTTI, net of \$651 taxes  | 799   | —                              | —  | —   | 799   |
| Realized gains, net of \$8,458 taxes  | (11,205)  | —                              | —  | —   | (11,205)  |
| Net unrealized gain on securities<br>transferred from AFS to HTM<br>net of taxes of \$899 | 1,102   | —                              | —  | —   | 1,102   |
| Net amortization of unrealized gain on transfer<br>of AFS to HTM, net of taxes of \$373   | (1,003)   | —                              | —  | —   | (1,003)   |
| Funded status of pension and post<br>retirement benefits,<br>net of \$1,431 taxes         | —   | —                              | —  | (1,718)   | (1,718)   |
| Balance, December 31, 2010  | \$ (6,524)  | —                              | (6,877)  | (4,273)   | (17,674)  |
| Net unrealized losses arising during<br>the period, net of \$5,129 taxes                  | (7,669)   | —                              | —  | —   | (7,669)   |
| Realized gains, net of \$5,221 taxes  | (8,867)   | —                              | —  | —   | (8,867)   |
| Net amortization of unrealized gain on transfer<br>of AFS to HTM, net of taxes of \$46    | (372)   | —                              | —  | —   | (372)   |
| Net unrealized loss on cash flow hedges<br>net of taxes of \$1,819                        | —   | (2,226)                        | —  | —   | (2,226)   |
| Funded status of pension and post<br>retirement benefits,<br>net of \$4,396 taxes         | —   | —                              | —  | (5,376)   | (5,376)   |
| Balance, December 31, 2011  | \$ (23,432)   | (2,226)                        | (6,877)  | (9,649)   | (42,184)  |

**(25) Derivative Instruments**

According to GAAP, Companies are required to recognize all derivative instruments as either assets or liabilities in the Consolidated Balance Sheets at fair value. The accounting for changes in the fair value (i.e., gains or losses) of the derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and further, on the type of hedging relationship. For those derivative instruments that are designated and qualify as hedging instruments, the Company designates the hedging instrument, based upon the exposure being hedged, as a fair value or cash flow hedge.

For derivative instruments that are designated and qualify as a fair value hedge (i.e., hedging the exposure to changes in the fair value of an asset or a liability or an identified portion thereof that is attributable to a particular risk), the gain or loss on the derivative instrument as well as the offsetting loss or gain on the hedged item attributable to the hedged risk are recognized in current earnings during the period of the

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change in fair values. For derivative instruments that are designated and qualify as a cash flow hedge (i.e., hedging the exposure to variability in expected future cash flows that is attributable to a particular risk), the effective portion of the gain or loss on the derivative instrument is reported as a component of AOCI and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. The remaining gain or loss on the derivative instrument in excess of the cumulative change in the present value of future cash flows of the hedged item, if any, is recognized in other income/expense in current earnings during the period of change. For derivatives that do not qualify as hedging instruments, the change in fair value is recognized in income and recorded in Gain from trading account assets, net in the Consolidated Statements of Income.

The fair value of the Company's derivative instruments portfolio is as shown below:

|                            | December 31, 2011      |        |           | December 31, 2010      |        |           |
|----------------------------|------------------------|--------|-----------|------------------------|--------|-----------|
|                            | Notional               | Asset  | Liability | Notional               | Asset  | Liability |
|                            | (Dollars in thousands) |        |           | (Dollars in thousands) |        |           |
| Indexed linked derivatives | \$ 118,645             | 423    | 579       | 190,427                | 1,324  | 1,652     |
| Interest rate swaps        | 215,791                | 3,413  | 6,323     | 109,738                | 5,893  | 4,360     |
| FX Derivatives             | 534,995                | 10,079 | 4,809     | 484,384                | 6,308  | 5,751     |
| Commodities-Linked         | 94,567                 | 2,599  | 2,389     | 84,167                 | 3,472  | 3,149     |
|                            | \$ 963,998             | 16,514 | 14,100    | 868,716                | 16,997 | 14,912    |

In June 2011, the Bank entered into a \$100 million notional amount interest rate swap to hedge the variability in cash flows in certain floating rate money market deposit accounts. The swap is categorized as a cash flow hedge and since it was deemed fully effective, the unrealized loss on the swap as of December 31, 2011 was recorded in AOCI. The Company does not have any derivatives designated as fair value hedges.

#### (26) Asset Restrictions

IDB Capital Corp. is required to maintain collateral with its clearing agent. Cash collateral maintained with the clearing agent was \$163,306 and \$162,709 at December 31, 2011 and 2010, respectively. Securities owned may be pledged to the Clearing Broker on terms which permit the Clearing Broker to sell or re-pledge the securities to others subject to certain limitations. At December 31, 2011 and 2010, mortgage-backed securities with a total market value of \$2,461 and \$2,877, respectively, were pledged as collateral to the Clearing Broker.

#### (27) New Accounting Pronouncements

In June 2011, the Financial Accounting Standards Board (FASB) issued an accounting standards update regarding the presentation of comprehensive income which requires that all nonowner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. The standard is effective retrospectively for fiscal years, and interim periods within those years, beginning after

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December 15, 2011. The Company is assessing the impact of this standard on our comprehensive income presentation.

In May 2011, the FASB issued an accounting standards update concerning fair value measurement that changes the wording used to describe many of the requirements in GAAP for measuring fair value and for disclosing information about fair value measurements. Consequently, the amendments in this update result in common fair value measurement and disclosure requirements in GAAP and IFRSs (International Financial Reporting Standards). The standard is effective prospectively during interim and annual periods beginning on or after December 15, 2011. Early application by public entities is not permitted. The Company is assessing the impact of this standard on its fair value disclosures.

In April 2011, the FASB issued an accounting standards update which addresses the accounting for repurchase agreements. The standard removes from the assessment of effective control the criterion relating to the transferor's ability to repurchase or redeem financial assets on substantially the agreed terms, even in the event of default by the transferee. The standard is effective for the first interim or annual period beginning on or after December 15, 2011. The guidance should be applied prospectively to transactions or modifications of existing transactions that occur on or after the effective date. Early adoption is not permitted. The Company believes that the adoption of the standard will not have a significant impact on the Company's consolidated financial statements.

In April 2011, the FASB issued an accounting standards update addressing whether a restructuring is a troubled debt restructuring, which clarifies when creditors should classify loan modifications as troubled debt restructurings. The guidance is effective for interim and annual periods beginning on or after June 15, 2011, and applies retrospectively to restructurings occurring on or after the beginning of the year. The guidance on measuring the impairment of a receivable restructured in a troubled debt restructuring, as clarified, is effective on a prospective basis. The Company has not early adopted the standard but believes that the adoption of the standard will not have a significant impact on the Company's consolidated financial statements.

In July 2010, the FASB issued an accounting standards update that will significantly increase disclosures that entities must make about the credit quality of financing receivables and the allowance for loan losses. The disclosures will provide financial statements users with additional information about the nature of credit risks inherent in entities' financing receivables, how credit risk is analyzed and assessed when determining the allowance for loan losses, and the reasons for the changes in it. Public entities are required to provide the additional disclosures in all interim and annual reporting periods ending on or after December 15, 2010. Nonpublic entities will need to provide the additional disclosures in annual reporting periods ending on or after December 15, 2011. The required disclosures are included in footnote 6.

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**(28) Subsequent Events**

The Bank has received regulatory approval to pre-pay the subordinated capital note (see Note 13) and the note was repaid on March 15, 2012. In connection with the pre-payment of the note, the Bank paid a termination fee of approximately \$7.1 million which will be reflected in the Bank's income statement in the first quarter of 2012.

The Company has evaluated subsequent events through March 26, 2012.