

EQUUS TOTAL RETURN, INC.
Form 10-K
March 13, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the year ended December 31, 2016

Or

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

For the transition period from to

Commission File Number 814-00098

EQUUS TOTAL RETURN, INC.

(Exact name of registrant as specified in its charter)

Delaware	76-0345915
(State or other jurisdiction of	(I.R.S. Employer Identification No.)
incorporation or organization)	

700 Louisiana St. 48th Floor, Houston, Texas	77002
(Address of principal executive offices)	(Zip Code)
(713) 529-0900	

Registrant's telephone number, including area code:

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

Title of each class	Name of each exchange
Common Stock	on which registered
	New York Stock Exchange
Securities registered pursuant to Section 12(g) of the Act: None	

Edgar Filing: EQUUS TOTAL RETURN, INC. - Form 10-K

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

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

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No

Approximate aggregate market value of common stock held by non-affiliates of the registrant: \$10,599,895 computed on the basis of \$1.78 per share, the closing price of the registrant's common stock on the New York Stock Exchange on June 30, 2016. For purposes of calculating this amount only, all directors and executive officers of the registrant have been treated as affiliates. There were 12,673,646 shares of the registrant's common stock, \$.001 par value, outstanding as of March 13, 2017. The net asset value of a share of the Registrant as of December 31, 2016 was \$3.37.

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

Portions of the Proxy Statement (to be filed) for the 2017 Annual Shareholder's meeting are incorporated by reference in Parts II and III.

Table of Contents

TABLE OF CONTENTS

	Page
<u>PART I</u>	
<u>Item 1</u> Business	3
<u>Item 1A</u> Risk Factors	10
<u>Item 1B</u> Unresolved Staff Comments	20
<u>Item 2</u> Properties	20
<u>Item 3</u> Legal Proceedings	20
<u>Item 4</u> Mine Safety Disclosures	21
<u>PART II</u>	
<u>Item 5</u> Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	21
<u>Item 6</u> Selected Financial Data	22
<u>Item 7</u> Management’s Discussion and Analysis of Financial Condition and Results of Operations	22
<u>Item 7A</u> Quantitative and Qualitative Information About Market Risk	35
<u>Item 8</u> Financial Statements and Supplementary Data	36
<u>Item 9</u> Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	63
<u>Item 9A</u> Controls and Procedures	63
<u>Item 9B</u> Other Information	63
<u>PART III</u>	
<u>Item 10</u> Directors and Executive Officers and Corporate Governance	64
<u>Item 11</u> Executive Compensation	64
<u>Item 12</u> Security Ownership of Certain Beneficial Owners, Management and Related Stockholder Matters	64
<u>Item 13</u> Certain Relationships and Related Transactions and Director Independence	64

<u>Item 14</u>	Principal Accountant Fees and Services	64
----------------	--	----

PART IV

<u>Item 15</u>	Exhibits and Financial Statement Schedules	64
----------------	--	----

<u>Item 16</u>	Form 10-K Summary	64
----------------	-------------------	----

Table of Contents

PART I

Item 1. *Business*

Equus Total Return, Inc. (“we,” “us,” “our,” “Equus” the “Company” or the “Fund”), a Delaware corporation, was formed by Equus Investments II, L.P. (the “Partnership”) on August 16, 1991. On July 1, 1992, the Partnership was reorganized and all of the assets and liabilities of the Partnership were transferred to the Fund in exchange for shares of common stock of the Fund. On August 11, 2006, our shareholders approved the change of the Fund’s investment strategy to a total return investment objective. This strategy seeks to provide the highest total return, consisting of capital appreciation and current income. In connection with this strategic investment change, the shareholders also approved the change of name from Equus II Incorporated to Equus Total Return, Inc.

We attempt to maximize the return to stockholders in the form of current investment income and long-term capital gains by investing in the debt and equity securities of companies with a total enterprise value between \$5.0 million and \$75.0 million, although we may engage in transactions with smaller or larger investee companies from time to time. We seek to invest primarily in companies pursuing growth either through acquisition or organically, leveraged buyouts, management buyouts and recapitalizations of existing businesses or special situations. Our income-producing investments consist principally of debt securities including bonds, subordinated debt, debt convertible into common or preferred stock, or debt combined with warrants and common and preferred stock. Debt and preferred equity financing may also be used to create long-term capital appreciation through the exercise and sale of warrants received in connection with the financing. We seek to achieve capital appreciation by making investments in equity and equity-oriented securities issued by privately-owned companies or smaller public companies in transactions negotiated directly with such companies. Given market conditions over the past several years and the performance of our portfolio, our management and board of directors believe it prudent to continue to review alternatives to refine and further clarify the current strategies.

Equus is a closed-end management investment company that has elected to be treated as a business development company (“BDC”) under the Investment Company Act of 1940 (“1940 Act”). In order to remain a BDC, we must meet certain specified requirements under the 1940 Act, including investing at least 70% of our assets in eligible portfolio companies and limiting the amount of leverage we incur (See “*Significant Developments – Authorization to Withdraw BDC Election*” below). Equus is also a regulated investment company (“RIC”) under Subchapter M of the U.S. Internal Revenue Code of 1986. As such, we are not required to pay corporate-level income tax on the Fund’s investment income. So long as we remain a BDC, we intend to maintain our RIC status, which requires that we qualify annually as a RIC by meeting certain specified requirements. For a discussion of these requirements necessary to maintain our status as a BDC and as a RIC, please see “*Business Development Company Requirements*” and “*Regulated Investment Company Tax Status*,” respectively.

Our principal office is located at 700 Louisiana St., 48th Floor, Houston, Texas, 77002, and the telephone number is 1-888-323-4533. Our corporate website is located at www.equuscap.com. We make available free of charge on our website our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all

amendments to those reports as soon as reasonably practicable after such material is electronically filed or furnished to the Securities and Exchange Commission ("SEC"). Our shares are traded on The New York Stock Exchange ("NYSE") under the ticker symbol "EQS".

Significant Developments

Plan of Reorganization and Share Exchange with MVC Capital. On May 14, 2014, we announced that the Fund intended to effect a reorganization pursuant to Section 2(a)(33) of the 1940 Act (hereinafter, the "Plan of Reorganization"). As a first step to consummating the Plan of Reorganization, we sold to MVC Capital, Inc. ("MVC") 2,112,000 newly-issued shares of the Fund's common stock in exchange for 395,839 shares of MVC (such transaction is hereinafter referred to as the "Share Exchange"). MVC is a business development company traded on the NYSE that provides long-term debt and equity investment capital to fund growth, acquisitions and recapitalizations of companies in a variety of industries. The Share Exchange was calculated based on the Fund's and MVC's respective net asset value per share. At the time of the Share Exchange, the number of MVC shares received by Equus represented approximately 1.73% of MVC's total outstanding shares of common stock.

Pursuant to the terms of a Share Exchange Agreement, dated May 12, 2014, entered into by Equus and MVC which memorialized the Share Exchange, we intend to finalize the Plan of Reorganization by pursuing a merger or consolidation with MVC, a subsidiary of MVC, or one or more of MVC's portfolio companies (the "Consolidation"). Absent Equus merging or consolidating with/into MVC or a subsidiary thereof, our current intention is for Equus to (i) consummate the Consolidation with a portfolio company of MVC, (ii) terminate its election to be classified as a BDC under the 1940 Act, and (iii) be restructured as a publicly-traded operating company focused on the energy and/or financial services sector. Our management is currently evaluating these alternatives and expects to commence and/or consummate a Consolidation during 2017.

Table of Contents

Authorization to Withdraw BDC Election. On January 6, 2017, holders of a majority of the outstanding common stock of the Fund approved our cessation as a BDC under the 1940 Act and authorized our Board of Directors (sometimes referred to hereinafter as the “Board”) to cause the Fund’s withdrawal of its election to be classified as a BDC, each effective as of a date designated by the Board and our Chief Executive Officer, but in no event later than July 31, 2017. The authorization given to our Board is a consequence of the Plan of Reorganization described above. Notwithstanding this authorization to withdraw our BDC election, we will not submit any such withdrawal unless and until Equus has entered into a definitive agreement to effect a Consolidation. Further, although our shareholders have authorized us to withdraw our election as a BDC, we will require a subsequent affirmative vote from holders of a majority of our outstanding voting shares to enter into any such definitive agreement or change the nature of our business.

Portfolio Investments. On January 29, 2016, we invested \$2.0 million in Biogenic Reagents, LLC, a developer and producer of high value carbon products from renewable biomass, in the form of a senior secured promissory note bearing cash and PIK interest at the combined rate of 16% per annum.

Outlook. Our Board and management of the Fund (“Management”) continue to believe that current market conditions and recent portfolio performance dictate the need to pursue a more active role in the management of our remaining investments and to seek liquidity events at the appropriate time to protect and enhance shareholder value. These activities include continuous monitoring and intensive reviews of portfolio company performance and expectations, providing follow-on capital when necessary, and the exploration of liquidity events for certain portfolio companies to position the Fund to maximize investment returns and, to the extent we intend to remain a BDC, actively pursuing suitable new investments for the Fund.

Investment Objective

To the extent we remain a BDC and do not complete the Consolidation as described above, our investment objective is to maximize the total return to our stockholders in the form of current investment income and long-term capital gains by investing in the debt and equity securities of small and middle market capitalization companies that are generally not publicly traded at the time of our investment. As a result of our endeavors in the energy sector, we also seek to purchase working interests and revenue leasehold interests in oil and gas properties, although we remain open to exploring investment opportunities in a variety of other sectors. Should we continue to grow and develop Equus as a closed-end fund instead of an operating company, we intend to include investments in progressively larger enterprises.

Investment Strategy

Our investment strategy attempts to strike a balance between the potential for gain and the risk of loss. With respect to capital appreciation, Equus is a “growth-at-reasonable-price” investor that seeks to identify and acquire securities that meet our criteria for selling at reasonable prices. We give priority to cash producing investments wherein we invest principally in debt or preferred equity financing with the objective of generating regular interest and dividend income back to the Fund. Debt and preferred equity financing may also be used to create long-term capital appreciation through the exercise and sale of warrants received in connection with the financing. Given market conditions over the past several years and the performance of our portfolio, our Management and Board believe it prudent to continue to review alternatives to refine and further clarify the current strategies.

Investment Criteria

Consistent with our investment objective and strategy, our Management evaluates prospective investments based upon the criteria set forth below. We may modify some or all of these criteria from time to time.

Management Competency and Ownership. We seek to invest in companies with experienced management teams who have demonstrated a track record of successful performance. Further, we desire to invest in companies with significant management ownership. We believe that significant management ownership in small capitalization and middle market companies provides appropriate incentives and an alignment of interests for management to maximize shareholder value. In addition, we will seek to design compensation and incentive arrangements that align the interests of the portfolio company’s management with those of the Fund to enhance potential returns.

Substantial Target Market. We desire to focus on companies whose products or services have favorable growth potential and strong competitive positions in their respective markets. These positions may be as leadership positions within a given industry or market niche positions in which the product or service has a demonstrated competitive advantage. The market in which a potential portfolio company operates should either be sizeable or have significant growth potential.

Table of Contents

History of Profitability and Favorable Growth Potential. We target companies that have demonstrated a history of profitability or a reasonable expectation of a return to profitability in the near future.

Ability to Provide Regular Cash Interest and Distributions. We look for companies with strong cash flow models sufficient to provide regular and consistent interest and/or preferred dividend payments.

Management Assistance and Substantial Equity. Given the requirements of a BDC under the 1940 Act, we seek to invest in companies that will permit substantial managerial assistance including representation on the board of directors of the company or its equivalent. With regard to equity investments, we desire to obtain a substantial investment position in portfolio companies. This position may be as a minority shareholder with certain contractual rights and powers, or as a majority shareholder, and should otherwise allow us to have substantive input on the direction and strategies of the portfolio company.

Plausible Exit and Potential for Appreciation. Prior to investing in a portfolio company, we will seek to analyze potential exit strategies and pursue those investments with such strategies as may be achievable.

Investment Operations

Our investment operations consist principally of the following basic activities:

Investment Selection. Historically, many of our investment opportunities have come from Management, members of our Board, other private equity investors, direct approaches from prospective portfolio companies and referrals from investment banks, business brokers, commercial, regional and local banks, attorneys, accountants and other members of the financial community. Subject to the approval of our Board, we may compensate certain referrals with finder's fees to the extent permissible under applicable law and consistent with industry practice.

Due Diligence. Once a potential investment is identified, we undertake a due diligence review using information provided by the prospective portfolio companies and publicly available information. Management may also seek input from consultants, investment bankers and other knowledgeable sources. The due diligence review will typically include, but is not limited to:

- Review of historical and prospective financial information including audits and budgets;
- On-site visits;
- Interviews with management, employees, customers and vendors of the potential portfolio company;
- Review of existing loan documents and credit arrangements, if any;
- Background checks on members of management; and
- Research relating to the company, its management, industry, markets, products and services and competitors.

Structuring Investments. We typically negotiate investments in private transactions directly with the owner or issuer of the securities acquired. Management structures the terms of a proposed investment, including the purchase price, the type of security to be purchased and our future involvement in the portfolio company's business. We seek to structure the terms of the investment to provide for the capital needs of the portfolio company while maximizing our opportunities for current income and capital appreciation. In addition, we may invest with other co-investors including private equity firms, business development companies, small business investment companies, venture capital groups, institutional investors and individual investors.

Providing Management Assistance and Monitoring of Investments. Successful private equity investments typically require active monitoring of, and significant participation in, major business decisions of portfolio companies. In several cases, officers and directors of the Fund serve as members of the governing boards of portfolio companies. Such management assistance is required of a BDC under the 1940 Act. We seek to provide guidance and management assistance with respect to such matters as capital structure, acquisitions, budgets, profit goals, corporate strategy, portfolio management and potential sale of the company or other exit strategies. In connection with their service as directors of portfolio companies, officers and directors of the Fund may receive and retain directors' fees or reimbursement for expenses incurred, and may participate in incentive stock option plans for non-employee directors, if any. When necessary and as requested by any portfolio company, Management, on behalf of the Fund, may also assign staff professionals with financial or management expertise to assist portfolio company management.

Table of Contents

Follow-On Investments

Following our initial investment, a portfolio company may request that we make follow-on investments by providing additional equity or loans needed to fully implement its business plans to develop a new line of business or to recover from unexpected business problems or other purposes. In addition, follow-on investments may be made to exercise warrants or other preferential rights granted to the Fund or otherwise to increase our position in a portfolio company. We may make follow-on investments in portfolio companies from cash on hand or borrow all or a portion of the funds required. If we are unable to make follow-on investments due to lack of available capital, the portfolio company in need of the investment may be negatively impacted, we may be required to subordinate our debt interest in the portfolio company to a new lender, and our equity interest in the portfolio company may be diluted if outside equity capital is required.

Disposition of Investments

The method and timing of the disposition of our investments in portfolio companies are critical to our ability to realize capital gains and minimize capital losses. We may dispose of our portfolio securities through a variety of transactions, including recapitalizations, refinancings, management buy-outs, repayments from cash flow, acquisitions of portfolio companies by a third party and outright sales of the Fund's securities in a portfolio company. In addition, under certain circumstances we may distribute our portfolio securities in-kind to our stockholders. In structuring our investments, we endeavor to reach an understanding with the management of the prospective portfolio company as to the appropriate method and timing of the disposition of the investment. In some cases, we seek registration rights for our portfolio securities at the time of investment which typically provide that the portfolio company will bear the cost of registration. To the extent not paid by the portfolio company, the Fund typically bears the costs of disposing of our portfolio investments.

Current Portfolio Companies

For a description of our current portfolio company investments, see “*Management’s Discussion and Analysis of Financial Condition and Results of Operations–Portfolio Securities.*”

Valuation

On a quarterly basis, Management values its portfolio investments. These valuations are subject to the approval and adoption of the Board. Valuations of our portfolio securities at “fair value” are performed in accordance with accounting

principles generally accepted in the United States of America (“GAAP”).

The fair value of investments for which no market exists (which includes most of our investments) is determined through procedures established in good faith by the Board. As a general principle, the current “fair value” of an investment is the amount the Fund might reasonably expect to receive upon its sale in an orderly manner. There are a range of values that are reasonable for such investments at any particular time.

We base our adjustments to fair value upon such factors as the portfolio company’s earnings, cash flow and net worth, the market prices for similar securities of comparable companies, an assessment of the company’s current and future financial prospects and various other factors and assumptions. In the case of unsuccessful or substantially declining operations, we may base a portfolio company’s fair value upon the company’s estimated liquidation value. Fair valuations are inherently subjective, and our estimate of fair value may differ materially from amounts actually received upon the disposition of its portfolio securities. Also, any failure by a portfolio company to achieve its business plan or obtain and maintain its financing arrangements could result in increased volatility and result in a significant and rapid change in its value.

Our general intent is to hold our loans to maturity when appraising our privately held debt investments. As such, we believe that the fair value will not exceed the cost of the investment; however, we perform a yield analysis to determine if a debt security has been impaired.

Our Management may engage independent, third-party valuation firms to conduct independent appraisals and review Management’s preliminary valuations of each privately-held investment in order to make their own independent assessment. Any third-party valuation data would be considered as one of many factors in a fair value determination. Management would then present its fair value recommendations to the Audit Committee of the Board of Directors for review. Following review and any adjustments required thereby, the Audit Committee would, in turn, recommend the fair values for all of the Fund’s portfolio investments to the Board of Directors for final approval.

Table of Contents

To the extent that market quotations are readily available for our investments and such investments are freely transferable, we value them at the closing market price on the date of valuation. For securities which are of the same class as a class of public securities but are restricted from free trading (such as Rule 144 stock), we establish our valuation by discounting the closing market price to reflect the estimated impact of illiquidity caused by such restrictions. We generally hold investments in debt securities to maturity. Accordingly, we determine the fair value of debt securities on the basis of the terms of the debt securities and the financial condition of the issuer. We value certificates of deposit at their face value, plus interest accrued to the date of valuation.

Our Board reviews the valuation policies on a quarterly basis to determine their appropriateness and reserves the right to hire and, from time to time, utilizes independent valuation firms to review Management's valuation methodology or to conduct an independent valuation.

On a daily basis, we adjust net asset value for changes in the value of publicly held securities, if any, and for material changes in the value of investments in securities issued by private companies. We report these amounts to Lipper Analytical Services, Inc. Our weekly and daily net asset values appear in various publications, including *Barron's* and *The Wall Street Journal*.

Competition

We compete with a large number of public and private equity and mezzanine funds and other financing sources, including traditional financial services companies such as finance companies and commercial banks. Many of our competitors are substantially larger and have considerably greater financial, technical and marketing resources than we do. Our competitors may have a lower cost of funds and many have access to funding sources that are not available to us. In addition, certain of our competitors may have higher risk tolerances or different risk assessments, which could allow them to consider a wider variety of investments and establish more relationships and build their market shares. In addition, many of our competitors are not subject to the regulatory restrictions that the 1940 Act imposes on us as a BDC.

We cannot assure you that the competitive pressures we face will not have a material adverse effect on our business, financial condition and results of operations. In addition, because of this competition, we may not be able to take advantage of attractive investment opportunities and may not be able to identify and make investments that satisfy our investment objectives or meet our investment goals.

Properties

Our principal executive offices are located at 700 Louisiana St., 48th Floor, Houston, Texas 77002. We believe that our office facilities are suitable and adequate for our operations as currently conducted and contemplated.

Business Development Company Requirements

Qualifying Assets. As a BDC, we may not acquire any asset other than qualifying assets, as defined by the 1940 Act, unless, at the time the acquisition is made, the value of our qualifying assets represent at least 70% of the value of our total assets. The principal categories of qualifying assets relevant to our business are the following:

- Securities purchased in transactions not involving any public offering from an issuer that is an eligible portfolio company. An eligible portfolio company is any issuer that (a) is organized and has its principal place of business in the United States, (b) is not an investment company other than a small business investment company wholly-owned by the BDC, and (c) either (i) (A) does not have any class of securities with respect to which a broker or dealer may extend margin credit, (B) is controlled by the BDC either singly or as part of a group and an affiliated person of the BDC is a member of the issuer's board of directors, or (C) has total assets of not more than \$4 million and capital and surplus of at least \$2 million, or (ii) does not have any class of securities listed on a national securities exchange, unless the total market capitalization of such issuer does not exceed \$250 million. Qualifying assets may also include follow-on investments in a company that was a particular type of eligible portfolio company at the time of the BDC's initial investment, but subsequently did not meet the definition;
- Securities received in exchange for or distributed with respect to securities described above, or pursuant to the exercise of options, warrants or rights relating to such securities; and
- Cash, cash items, government securities, or high quality debt securities maturing in one year or less from the time of investment.

Table of Contents

We may not change the nature of our business so as to cease to be, or withdraw our election as, a BDC unless authorized by vote of the holders of the majority of our outstanding voting securities, as defined in the 1940 Act. On January 6, 2017, we received this authorization from our shareholders to withdraw our BDC election. This authorization was provided as a consequence of our Plan of Reorganization announced on May 14, 2014, wherein we stated that we intended to: (i) consummate a Consolidation with MVC or one of its subsidiaries, (ii) terminate the Fund's election to be classified as a BDC under the 1940 Act, and (iii) be restructured as a publicly-traded operating company focused on the energy and/or financial services sector. While we have received authorization from our shareholders to withdraw our BDC election, we will require a separate affirmative vote of the holders of a majority of our outstanding voting securities to consummate a Consolidation and change the nature of our business (see "*Significant Developments—Plan of Reorganization*" and "*—Authorization to Withdraw BDC Election*" above).

To include certain securities above as qualifying assets for the purpose of the 70% test, a BDC must make available to the issuer of those securities significant managerial assistance, such as providing significant guidance and counsel concerning the management, operations, or business objectives and policies of a portfolio company. We offer to provide significant managerial assistance to each of our portfolio companies.

Temporary Investments. Pending investment in portfolio companies, we invest our available funds in interest-bearing bank accounts, money market mutual funds, U.S. Treasury securities and/or certificates of deposit with maturities of less than one year (collectively, "Temporary Investments"). Temporary Investments may also include commercial paper (rated or unrated) and other short-term securities. Temporary Investments constituting cash, cash items, securities issued or guaranteed by the U.S. Treasury or U.S. Government agencies and high quality debt securities (commercial paper rated in the two highest rating categories by Moody's Investor Services, Inc. or Standard & Poor's Corporation, or if not rated, issued by a company having an outstanding debt issue so rated, with maturities of less than one year at the time of investment) will qualify for determining whether we have 70% of our total assets invested in qualifying assets or in qualified Temporary Investments for purposes of the BDC provisions of the 1940 Act.

Leverage. We are permitted by the 1940 Act, under specified conditions, to issue multiple classes of senior debt and a single class of preferred stock senior to the common stock if our asset coverage, as defined in the 1940 Act, is at least 200% after the issuance of the debt or the senior stockholders' interests. In addition, provisions must be made to prohibit any distribution to common stockholders or the repurchase of any shares unless the asset coverage ratio is at least 200% at the time of the distribution or repurchase.

Fund Share Sales Below Net Asset Value. To the extent we remain a BDC, we generally may sell our common stock at a price that is below the prevailing net asset value per share only upon the approval of the policy by stockholders holding a majority of our issued shares, including a majority of shares held by nonaffiliated stockholders. We may, in accordance with certain conditions established by the SEC, sell shares below net asset value in connection with the distribution of rights to all of our stockholders. We may also issue shares at less than net asset value in payment of dividends to existing stockholders.

No Redemption Rights. Since we are a closed-end BDC, our stockholders have no right to present their shares to the Fund for redemption. Recognizing the possibility that our shares might trade at a discount, our Board has determined that it would be in the best interest of our stockholders for the Fund to be authorized to attempt to reduce or eliminate a market value discount from net asset value. Accordingly, from time to time we may, but are not required to, repurchase our shares (including by means of tender offers) to attempt to reduce or eliminate any discount or to increase the net asset value of our shares.

Affiliated Transactions. Many of the transactions involving the Fund and its affiliates (as well as affiliates of such affiliates) require the prior approval of a majority of the independent directors and a majority of the independent directors having no financial interest in the transactions. However, certain transactions involving closely affiliated persons of the Fund require the prior approval of the SEC.

Regulated Investment Company Tax Status

As a BDC, we operate to qualify as a RIC under Subchapter M of the Internal Revenue Code of 1986, as amended (the "Code"). If we qualify as a RIC and annually distribute to our stockholders in a timely manner at least 90% of our investment company taxable income, we will not be subject to federal income tax on the portion of our taxable income and capital gains we distribute to our stockholders. Taxable income generally differs from net income as defined by accounting principles generally accepted in the United States of America due to temporary and permanent timing differences in the recognition of income and expenses, returns of capital and net unrealized appreciation or depreciation.

Table of Contents

Generally, in order to maintain our status as a RIC, we must (i) continue to qualify as a BDC; (ii) distribute to our stockholders in a timely manner at least 90% of our investment company taxable income, as defined by the Code; (iii) derive in each taxable year at least 90% of our gross investment company income from dividends, interest, payments with respect to securities loans, gains from the sale of stock or other securities or other income derived with respect to our business of investing in such stock or securities as defined by the Code; and (iv) meet investment diversification requirements. The diversification requirements generally require us at the end of each quarter of the taxable year to have (a) at least 50% of the value of our assets consist of cash, cash items, government securities, securities of other RICs and other securities if such other securities of any one issuer do not represent more than 5% of our assets and 10% of the outstanding voting securities of the issuer and (b) no more than 25% of the value of our assets invested in the securities of one issuer (other than U.S. government securities and securities of other RICs), or of two or more issuers that are controlled by us and are engaged in the same or similar or related trades or businesses.

In addition, with respect to each calendar year, if we distribute or have treated as having distributed (including amounts retained but designated as deemed distributed) in a timely manner 98% of our net capital gain income for each one-year period ending on October 31, and distribute 98.2% of our investment company net ordinary income for such calendar year (as well as any ordinary income not distributed in prior years), we will not be subject to the 4% nondeductible Federal excise tax imposed with respect to certain undistributed income of RICs.

If we fail to satisfy the 90% distribution requirement or otherwise fail to qualify as a RIC in any taxable year, we will be subject to tax in such year on all of our taxable income, regardless of whether we make any distribution to our stockholders. In addition, in that case, all of our distributions to our stockholders will be characterized as ordinary income (to the extent of our current and accumulated earnings and profits). We have distributed and currently intend to distribute sufficient dividends to eliminate our investment company taxable income; however, none have been necessary in recent years.

Custodian

We act as the custodian of our securities to the extent permitted under the 1940 Act and are subject to the restrictions imposed on self-custodians by the 1940 Act and the rules and regulations thereunder. We have also entered into an agreement with Amegy Bank with respect to the safekeeping of our securities. The principal business office of Amegy Bank is 1717 West Loop South, Houston, Texas 77027.

Transfer and Disbursing Agent

We employ American Stock Transfer & Trust Company as our transfer agent to record transfers of our shares, maintain proxy records and to process distributions. The principal business office of our transfer agent is 6201 15th

Avenue, 2nd Floor, Brooklyn, NY 11219.

Certifications

In July 2016, pursuant to Section 303A.12(a) of the NYSE Listed Company Manual, we submitted to the NYSE an unqualified certification of our Chief Executive Officer. In addition, certifications by our Chief Executive Officer and Chief Financial Officer have been filed as exhibits to this annual report on Form 10-K as required by the Securities Exchange Act of 1934, as amended, and the Sarbanes-Oxley Act of 2002.

Forward-Looking Statements

All statements contained herein that are not historical facts including, but not limited to, statements regarding anticipated activity are “forward-looking statements” within the meaning of the federal securities laws, involve a number of risks and uncertainties, and are based on the beliefs and assumptions of Management, based on information currently available to Management. Actual results may differ materially. In some cases, readers can identify forward-looking statements by words such as “may,” “will,” “should,” “expect,” “objective,” “plan,” “intend,” “anticipate,” “believe,” “Management believes,” “estimate,” “predict,” “project,” “potential,” “forecast,” “continue,” “strategy,” or “position” or the negative of such terms or other variations of them or by comparable terminology. In particular, statements, express or implied, concerning future actions, conditions, or events, future operating results, or the ability to generate sales, income, or cash flow are forward-looking statements.

Table of Contents

Among the factors that could cause actual results to differ materially are the following: (i) changes in the economic conditions in which we operate negatively impacting our financial resources; (ii) certain of our competitors have substantially greater financial resources than the Fund reducing the number of suitable investment opportunities offered or reducing the yield necessary to consummate the investment; (iii) there is uncertainty regarding the value of our privately held securities that require a good faith estimate of fair value for which a change in estimate could affect the Fund's net asset value; (iv) our investments in securities of privately held companies may be illiquid which could affect our ability to realize a gain; (v) our portfolio companies could default on their loans or provide no returns on its investments which could affect the Fund's operating results; (vi) we are dependent on external financing to grow our business; (vii) our ability to retain key management personnel; (viii) an economic downturn or recession could impair our portfolio companies and therefore harm our operating results; (iv) our borrowing arrangements impose certain restrictions; (x) changes in interest rates may affect our cost of capital and net operating income; (xi) we cannot incur additional indebtedness unless the Fund maintains an asset coverage of at least 200%, which may affect returns to our stockholders; (xii) we may fail to continue to qualify for our pass-through treatment as a RIC which could have an effect on stockholder returns; (xiii) our common stock price may be volatile; (xiv) general business and economic conditions and other risk factors described in its reports filed from time to time with the SEC; and (xv) risks related to our Plan of Reorganization. We caution readers not to place undue reliance on any such forward-looking statements, which statements are made pursuant to the Private Securities Litigation Reform Act of 1995 and, as such, speak only as of the date made.

Item 1A. Risk Factors

An investment in our securities involves certain risks relating to our structure and investment objectives. The risks and uncertainties described below are not the only ones facing Equus. You should carefully consider these risks, together with all of the other information included in the annual report on Form 10-K, including our financial statements and the related notes thereto.

Additional risks and uncertainties not presently known to us, or not presently deemed material by us, may also impair our operations and performance.

If any of the following risks actually occur, our business, financial condition or results of operations could be materially adversely affected. If that happens, the trading price of our common stock could decline and you may lose all or part of your investment.

Risks Related to Our Investments

Investments in small capitalization companies present certain risks that may not exist to the same degree as investments in larger, more established companies and will cause such investments to be volatile and speculative.

We have invested and may continue to invest, in private, small and/or new companies that may be in their early stages of development. Investments in these types of companies involve a number of significant risks, including the following:

They typically have shorter operating histories, narrower product lines and smaller market shares than public companies, which tend to render them more vulnerable to competitors' actions and market conditions as well as

- general economic downturns;

They may have no earnings or experienced losses or may have limited financial resources and may be unable to meet their obligations under their securities, which may be accompanied by a deterioration in the value of their

- equity securities or any collateral or guarantees provided with respect to their debt;

They are more likely to depend on the management talents and efforts of a small group of persons and, as a result, the death, disability, resignation or termination of one or more of those persons could have a material adverse effect

- on their business and prospects and, in turn, on our investment;

They may have difficulty accessing the capital markets to meet future capital needs;

-

They generally have less predictable operating results, may from time to time be parties to litigation, may be engaged in rapidly changing businesses with products subject to a substantial risk of obsolescence and may require substantial additional capital to support their operations, finance expansion or maintain their competitive position;

- and

Generally little public information exists regarding these companies, and investors in these companies generally

- must rely on the ability of the equity sponsor to obtain adequate information for the purposes of evaluating potential returns and making a fully informed investment decision.

Table of Contents

There is uncertainty regarding the value of our privately held securities.

Our net asset value is based on the value we assign to our portfolio investments. For investments that are not listed on a securities exchange or quotation medium, we determine the value of our investments in securities for which market quotations are not available as of the end of each calendar quarter, unless there is a significant event requiring a change in valuation in the interim. Because of the inherent uncertainty of the valuation of portfolio securities that do not have readily ascertainable market values, our fair value determination may differ materially from the value that would have been used had a ready market existed for the securities. We determine the fair value of investments for which no market quotations are available based upon a methodology that we believe reaches a reasonable estimation of fair value. However, we do not necessarily apply multiple valuation metrics in reaching this determination and, in some cases, we do not obtain any third party valuations before reaching this determination. Our determinations of the fair value of our investments have a material impact on our net earnings through the recording of unrealized appreciation or depreciation of investments as well as our assessment of interest income recognition. Our net asset value could be affected materially if our determinations of the fair value of our investments differ significantly from values based on a ready market for these securities.

We depend upon Management for our future investment success.

We depend upon the diligence and skill of our Management to select, structure, close and monitor our investments. Management is responsible for identifying, structuring, evaluating, monitoring, and disposing of our investments, and the services they collectively provide significantly impact our results of operations. Our future success will depend to a significant extent on the continued service and coordination of Management. Our success will depend on our ability to retain our existing Management and to recruit additional other highly qualified individuals. If we are unable to integrate new investment and management personnel, we may be unable to achieve our desired investment results.

Management may not be able to implement our investment objective successfully.

Our Board is taking a more opportunistic approach to our portfolio investment strategy, shifting our investment emphasis from manufacturing and services to other sectors, such as energy. In order to implement our investment strategy, Management must analyze, conduct due diligence, invest in, monitor and sell investment interests in industries in which many of them have not previously been involved. Also, we expect that our investment strategy will continue to require Management to investigate and monitor investments that are much more broadly dispersed geographically. In addition, Management is required to provide valuations for investments in a broader range of securities, including debt securities, which may require expertise beyond that previously required. We cannot assure investors that the overall risk of their investment in the Fund will be reduced as a result of our investment strategy. If we cannot achieve our investment objective successfully, the value of your investment in our common stock could decline substantially.

We may not realize gains from our equity investments.

We frequently invest in the equity securities of our portfolio companies. Also, when we make a loan, we sometimes receive warrants to acquire stock issued by the borrower. Ultimately, our goal is to sell these equity interests and realize gains. These equity interests may not appreciate and, in fact, may depreciate in value. Some of our portfolio companies have experienced net losses in recent years or have negative net worth as of their most recent available balance sheet date. At December 31, 2016, several of our portfolio investments had estimated fair values, based upon our valuation methodologies, significantly below the initial cost of such investments. At December 31, 2016, the cost basis of our portfolio investments was \$19.4 million and our estimated fair value was \$29.7 million, although our equity investments in Equus Media Development Company, LLC, Equus Energy, LLC, and MVC had an aggregate fair value of \$10.5 million versus a cost basis of \$16.1 million. Also, the market value of our equity investments may fall below our estimate of the fair value of such investments before we sell them. Given these factors, there is a risk that we will not realize gains upon the sale of those or other equity interests that we hold.

Table of Contents

Our holdings in Equus Energy are subject to commodity price declines endemic to oil and gas companies.

The oil and gas business is fundamentally a commodity-based enterprise. This means that the operations and earnings of Equus Energy, LLC (“Equus Energy”) may be significantly affected by changes in prices of oil, gas and natural gas liquids. The prices of these products are also dependent upon local, regional and global events or conditions that affect supply and demand for the relevant commodity. In addition, the pricing of these commodities are highly dependent upon technological improvements in energy production and development, energy efficiency, and seasonal weather patterns. Moreover, as a worldwide commodity, the price of oil and natural gas is also influenced by changes in currency exchange rates, interest rates, and inflation. Equus Energy does not employ any hedging strategies in respect of its oil and gas holdings, and is therefore subject to price fluctuations resulting from these and other factors. The operational results and financial condition of Equus Energy, as well as the economic attractiveness of future capital expenditures for new drilling and recompletions, may be materially adversely affected as a result of lower oil and gas prices.

We may not be able to make additional investments in our portfolio companies from time to time, which may dilute our interests in such companies.

After our initial investment in a portfolio company, we may be called upon from time to time to provide additional funds to such company, or may have the opportunity to increase our investment in that company through the exercise of a warrant to purchase common stock or through follow-on investments in the debt or equity of that company. We cannot assure you that we will make, or have sufficient funds to make, any such follow-on investments. Any decision by us not to make a follow-on investment or any inability on our part to make such an investment may have a negative impact on a portfolio company in need of investment and may result in a missed opportunity for us to increase our participation in a successful operation. A decision not to make a follow-on investment may also require us to subordinate our debt interest to a new lender or dilute our equity interest in, or reduce the expected yield on, our investment.

We have invested in a limited number of portfolio companies.

The Fund is classified as a “non-diversified” investment company under the 1940 Act, which means we are not limited in the proportion of our assets that may be invested in the securities of a single issuer. As a matter of policy, we generally have not initially invested more than 25% of the value of our net assets in a single portfolio company. In view of the net asset value of the Fund as of December 31, 2016, however, we would expect that any new investments may exceed this percentage for the immediate future. Moreover, follow-on investments, disproportionate increases or decreases in the fair value of certain portfolio companies or sales of investments may result in more than 25% of our net assets being invested in a single portfolio company at a particular time.

A consequence of a limited number of investments is that changes in business or industry trends or in the financial condition, results of operations or the market's assessment of any single portfolio company will affect our net asset value and the market price of our common stock to a greater extent than would be the case if we were a "diversified" company holding a greater number of investments.

The lack of liquidity of our privately held securities may adversely affect our business

Our portfolio investments consist principally of securities that are subject to restrictions on sale because they are not listed or publicly traded securities. If any of these securities were to become publicly traded, our ability to sell them may still be restricted because we acquired them from the issuer in "private placement" transactions or because we may be deemed to be an affiliate of the issuer. We will not be able to sell these securities publicly without the expense and time required to register the securities under the Securities Act and applicable state securities laws, unless an exemption from such registration requirements is available. In addition, contractual or practical limitations may restrict our ability to liquidate our securities in portfolio companies because those securities are privately held and we may own a relatively large percentage of the issuer's outstanding securities. Sales also may be limited by market conditions, which may be unfavorable for sales of securities of particular issuers or generally. The illiquidity of our investments may preclude or delay any disposition of such securities, which may make it difficult for us to obtain cash equal to the value at which we record our investments if the need arises.

Table of Contents

In situations where we hold junior priority liens, our ability to control decisions with respect to our portfolio companies may be limited by lenders holding superior liens. In a default scenario, the value of collateral may be insufficient to repay us after the senior priority lenders are paid in full.

We make certain loans to portfolio companies that are secured by a junior priority security interest in the same collateral pledged to secure debt owed to lenders with liens senior to ours. Often, the senior lender has procured covenants from the portfolio company prohibiting the incurrence of additional secured debt without the senior lender's consent. As a condition of permitting the portfolio company to incur junior secured indebtedness, the senior lender will require that we, as junior lender, enter into an intercreditor agreement that, among other things, will establish the senior lender's right to control the disposition of any collateral in the event of an insolvency proceeding or other default situation. In addition, intercreditor agreements generally will expressly subordinate junior liens to senior liens as well as the repayment of junior debt to senior debt.

Because of the control we may cede to senior lenders under intercreditor agreements, we may be unable to control the manner or timing of collateral disposition. In addition, the value of collateral securing our debt investment will ultimately depend on market and economic conditions at the time of disposal, the availability of buyers and other factors. Therefore, we cannot assure you that the proceeds, if any, from the sale or sales of all of the collateral would be sufficient to satisfy the loan obligations secured by our liens. There is also a risk that such collateral securing our investments will be difficult to sell in a timely manner or to appraise. If the proceeds of the collateral are insufficient to repay our loans, then we will have an unsecured claim to the extent of the deficiency against any of the company's remaining assets, which claim will likely be shared with many other unsecured creditors.

As a debt or minority equity investor in a portfolio company, we may have little direct influence over the entity. The stockholders and management of the portfolio company may make decisions that could decrease the value of our portfolio holdings.

We make both debt and minority equity investments. Should a portfolio company make business decisions with which we disagree, or the stockholders and management of that company take risks or otherwise act in ways that do not serve our interests, the value of our portfolio holdings could decrease and have an adverse effect on our financial position and results of operations.

We may choose to waive or defer enforcement of covenants in the debt securities held in our portfolio, which may cause us to lose all or part of our investment in these companies.

We structure the debt investments in our portfolio companies to include business and financial covenants placing affirmative and negative obligations on the operation of the company's business and its financial condition. However,

from time to time we may elect to waive breaches of these covenants, including our right to payment, or waive or defer enforcement of remedies, such as acceleration of obligations or foreclosure on collateral, depending upon the financial condition and prospects of the particular portfolio company. These actions may reduce the likelihood of our receiving the full amount of future payments of interest or principal and be accompanied by a deterioration in the value of the underlying collateral as many of these companies may have limited financial resources, may be unable to meet future obligations and may go bankrupt. This could negatively impact our ability to pay dividends, could adversely affect our results of operation and financial condition and cause the loss of all or part of your investment.

We have limited public information regarding the companies in which we invest.

Except for our holdings in MVC, our portfolio consists entirely of securities issued by privately-held companies. There is generally little or no publicly available information about such companies, and we must rely on the diligence of Management to obtain the information necessary for our decision to invest in them and in order to monitor them effectively. We cannot assure you that such diligence efforts will uncover all material information about such privately held businesses necessary to make fully informed investment decisions.

Our portfolio companies may be highly leveraged.

Investments in leveraged buyouts and in highly leveraged companies involve a high degree of business and financial risk and can result in substantial losses. A leveraged company's income and net assets will tend to increase or decrease at a greater rate than if borrowed money were not used. The use of leverage by portfolio companies also magnifies the increase or decrease in the value of our investment as compared to the overall change in the enterprise value of a portfolio company.

Many of our portfolio companies have incurred substantial debt in relation to their equity capital. Such indebtedness generally has a term that will require that the balance of the loan be refinanced when it matures. If a portfolio company cannot generate adequate cash flow to meet the principal and interest payments on its debt or is not successful in refinancing the debt upon its maturity, our investment could be reduced or eliminated through foreclosure on the portfolio company's assets or by the portfolio company's reorganization or bankruptcy.

Table of Contents

A substantial portion of the debt incurred by portfolio companies may bear interest at rates that fluctuate in accordance with a stated interest rate index or the prime lending rate. The cash flow of a portfolio company may not be sufficient to meet increases in interest payments on its debt. Accordingly, the profitability of our portfolio companies, as well as the value of our investments in such companies, will depend significantly upon prevailing interest rates. In recent months, the level of interest rates has increased, which will have an adverse effect on the ability of our portfolio companies to service their floating rate debt and on their profits.

Leverage may impair the ability of our portfolio companies to finance their future operations and capital needs. As a result, the ability of our portfolio companies to respond to changing business and economic conditions and to business opportunities may be limited.

The use of leverage may adversely affect our performance.

We may utilize leverage for the Fund or its subsidiaries by borrowing or issuing preferred stock or short-term debt securities. Borrowings and other capital generated from leverage will result in lenders and other creditors with fixed dollar claims on our assets that are superior to the claims of our common shareholders. If the value of our assets increases, then leveraging would cause the net asset value attributable to our common stock to increase more sharply than it would have had we not leveraged. Conversely, if the value of our assets decreases, leveraging would cause net asset value to decline more sharply than it otherwise would have had we not leveraged. Similarly, any increase in our income in excess of interest payable on the borrowed funds would cause our net income to increase more than it would without the leverage, while any decrease in our income would cause net income to decline more sharply than it would have had we not borrowed. Leverage is generally considered a speculative investment technique.

Our business depends on external financing.

Our business requires a substantial amount of cash to operate. We may borrow funds to pay contingencies or expenses or to make investments, to maintain our pass-through tax status as a RIC under Subchapter M of the Code. We are permitted under the 1940 Act to borrow if, immediately after the borrowing, we have an asset coverage ratio of at least 200%. That is, we may borrow an amount equal to as much as 50% of the fair value of our total assets (including investments made with borrowed funds). The amount and nature of any such borrowings depend upon a number of factors over which we have no control, including general economic conditions, conditions in the financial markets and the impact of the financing on the tax treatment of our stockholders. The use of leverage, even on a short-term basis, could have the effect of magnifying increases or decreases in our net asset value.

While the “spread” between the current yields on our investments and the cost of any loan would augment the return to our stockholders, if the spread narrows (because of an increase in the cost of debt or insufficient income on our

investments), distributions to our stockholders could be adversely affected. This may render us unable to meet our obligations to our lenders, which might then require us to liquidate some or all of our investments. We cannot assure you that we would realize full value for our investments or recoup all of our capital if we needed to liquidate our portfolio investments.

Many financial institutions are unwilling to lend against a portfolio of illiquid, private securities. The make-up of our portfolio has made it more difficult for us to borrow at the level and on the terms that we desire. Our borrowings have historically consisted of a revolving line of credit which has since expired, and a margin account used quarterly to enable us to achieve adequate diversification to maintain our pass-through tax status as a RIC. Although we believe the Fund's liquidity is sufficient for our operating expenses for the next twelve months, we could be wrong. If we are wrong, we would have to obtain capital from other sources to pay Fund expenses, which could involve selling one or more of our portfolio holdings at an inopportune time and at a price that may be less than would be received if such holding were sold in a more competitive and orderly manner.

The costs of borrowing money may exceed the income from the portfolio securities we purchase with the borrowed money. We will suffer a decline in net asset value if the investment performance of the additional securities purchased with borrowed money fails to cover their cost to the Fund (including any interest paid on the money borrowed). A decline in net asset value could affect our ability to make distributions on our common stock. Our failure to distribute a sufficient portion of our net investment income and net realized capital gains could result in a loss of pass-through tax status or subject us to a 4% excise tax. If the asset coverage for debt securities issued by the Fund declines to less than 200% (as a result of market fluctuations or otherwise), we may be required to sell a portion of our investments when it is disadvantageous to do so. See "*Management's Discussion and Analysis of Financial Condition and Results of Operations.*"

Table of Contents

We have had a net investment losses in the past five years.

We have had net investment losses in the past five years, with a net investment loss of \$2.5 million for the year ended December 31, 2016. We cannot assure you that we will be able to increase our net assets or generate net investment income. If we fail to increase the Fund's net assets or generate net investment income, such failure will likely have a material adverse effect upon the Fund, its results of operation, and its financial condition. You could lose all or a substantial amount of your investment in the Fund as a result.

We do not currently intend to recommence our managed distribution policy and you might not receive dividends on your shares.

On March 24, 2009, we announced a suspension of our managed distribution policy and payment of quarterly dividends for an indefinite period, following the distribution of the first quarter 2009 dividend paid on March 30, 2009. As originally implemented, the policy provided for quarterly dividends at an annualized rate equal to 10% of the Fund's market value per share as at the end of the preceding calendar year. We subsequently undertook certain changes in our Board and Management. These changes have been pursued, in part, with the objective of increasing the number of attractive investment opportunities to us and revising our investment strategy to include more recurrent cash income producing investments, all of which could ultimately result in the resumption of our managed distribution policy at some time in the future. The implementation of these revisions to our investment strategy and the recurrent generation of cash income from our investments, however, cannot be guaranteed and will not occur if we complete the Consolidation. If we were unable to resume our managed distribution policy and were further unable to profitably sell or otherwise dispose of our portfolio company investments, you might not receive dividends on your shares.

We operate in a highly competitive market for investment opportunities

We compete with a large number of private equity funds and mezzanine funds, investment banks and other equity and non-equity based investment funds, investment entities, foreign investors and individuals and other sources of financing, including traditional financial services companies such as commercial banks. In recent years, the number of investment vehicles seeking small capitalization investments has increased dramatically. Many of our competitors are substantially larger and have considerably greater financial resources than we do, and some may be subject to different and frequently less stringent regulation. As our portfolio size increases, we expect that some of our investments will be larger. We believe that we will face increased competition to participate in these larger transactions. These competitors may have a lower cost of funds and many have access to funding sources that are not available to us. In addition, some of our competitors may have higher risk tolerances or different risk assessments, which could allow them to consider a wider variety of investments and establish more relationships and build their market shares. As a result of this competition, we may not be able to take advantage of attractive investment opportunities from time to time. We cannot assure you that the competitive pressures we face will not have a material adverse effect on our business, financial condition and results of operations.

An economic downturn could affect our operating results.

An economic downturn may have a particularly adverse effect upon small and medium-sized companies, which are our primary market for investments. During periods of volatile economic conditions such as presently exists generally in the United States, these companies often experience decreased revenues, financial losses, difficulty in obtaining access to financing and increased funding costs. During such periods, these companies also may have difficulty expanding their businesses and operations and may be unable to meet their debt service obligations or other expenses as they become due. Any of the foregoing developments could cause the value of our investments in these companies to decline. In addition, during periods of adverse economic conditions, we may have difficulty accessing financial markets, which could make it more difficult or impossible for us to obtain funding for additional investments. Any of these events could have a material adverse effect on our business, financial condition and results of operations.

We may experience fluctuations in our quarterly results.

We may experience fluctuations in our quarterly operating results due to a number of factors, including variations in, and the timing of, the recognition of realized and unrealized gains or losses, the degree to which we encounter competition in our markets, the ability to find and close suitable investments and general economic conditions. The volatility of our results is exacerbated by our relatively small number of investments. As a result of these factors, you should not rely on our results for any period as being indicative of performance in future periods.

Table of Contents

The due diligence process that we undertake in connection with our investments may not reveal all facts that may be relevant in connection with an investment.

Before making our investments, we conduct due diligence that we deem reasonable and appropriate based on the facts and circumstances applicable to each investment. The objective of the due diligence process is to identify attractive investment opportunities based on the facts and circumstances surrounding an investment and to prepare a framework that may be used from the date of an acquisition to drive operational achievement and value creation. When conducting due diligence, we evaluate a number of important business, financial, tax, accounting, environmental and legal issues in determining whether or not to proceed with an investment. Our due diligence review with respect to a potential portfolio company typically includes, but is not limited to, a review of historical and prospective financial information including audits and budgets, on-site visits and interviews with management, employees, customers and vendors, a review of business plans and an analysis of the consistency of operations with those plans, and other research relating to the company, management, industry, markets, products and services, and competitors. Outside consultants, legal advisers, accountants and investment banks are expected to be involved in the due diligence process in varying degrees depending on the type of investment. Nevertheless, when conducting due diligence and making an assessment regarding an investment, we are required to rely on resources available to us, including information provided by the portfolio company and, in some circumstances, third party investigations. The due diligence process may at times be subjective, including with respect to newly organized companies for which only limited information is available. Accordingly, we cannot assure you that the due diligence investigation that we will carry out with respect to any investment opportunity will reveal or highlight all relevant facts that may be necessary or helpful in evaluating such investment opportunity. We also cannot assure you that such an investigation will result in an investment being successful.

Risks Related to Our Business and Structure

Our ability to invest in private companies may be limited in certain circumstances.

If we maintain our status as a BDC and do not complete the Consolidation with MVC or one of its portfolio companies, we must not acquire any assets other than “qualifying assets” unless, at the time of and after giving effect to such acquisition, at least 70% of our total assets are qualifying assets. A principal category of qualifying assets relevant to our business is securities purchased in transactions not involving any public offer from issuers that are eligible portfolio companies under the 1940 Act. Investments in companies organized outside of the United States or having a principal place of business outside of the United States are not eligible portfolio companies.

Any failure on our part to maintain the Fund’s status as a BDC could reduce our operating flexibility.

If we do not maintain the Fund's status as a BDC and we do not complete the Consolidation, we might be regulated as a closed-end investment company under the 1940 Act, which would subject us to substantially more regulatory restrictions under the 1940 Act. This could impose tighter limitations on Equus in terms of the use of leverage and transactions with affiliated entities. Such developments could correspondingly decrease our operating flexibility.

We may not continue to qualify as a RIC under the Code.

To remain entitled to the tax benefits accorded to RICs under the Code while we maintain our status as a BDC, we must meet certain income source, asset diversification and annual distribution requirements. To qualify as a RIC, we must derive each taxable year at least 90% of our gross income from dividends, interest, payments with respect to certain securities loans, gains from the sale of stock or other securities or foreign currencies, or other income derived with respect to our business of investing in such stock or securities or currencies and net income from interests in certain "qualified" publicly traded partnerships. The annual distribution requirement for a RIC is satisfied if we distribute at least 90% of our ordinary net taxable income and realized net short-term capital gains in excess of realized net long-term capital losses, if any, to our stockholders on an annual basis. As discussed above in "*Our business is dependent on external financing*," we historically have borrowed funds necessary to make qualifying investments to satisfy the Subchapter M diversification requirements. If we fail to satisfy such diversification requirements and cease to qualify for conduit tax treatment, we will be subject to income tax on our income and gains and will not be permitted to deduct distributions paid to stockholders. In addition, our distributions will be taxable as dividends to the extent paid from earnings and profits. We may also cease to qualify as a RIC, or be subject to income tax and/or a 4% excise tax, if we fail to distribute a sufficient portion of our net investment income and net realized capital gains. The loss of our RIC qualification would have a material adverse effect on the total return, if any, obtainable from an investment in our common stock.

Table of Contents

Because we intend to distribute substantially all of our income and net realized capital gains to our stockholders, if we continue to operate as a BDC and as a RIC, we will need additional capital to finance our growth.

In order to qualify as a RIC, to avoid payment of excise taxes and to minimize or avoid payment of income taxes, for so long as we maintain our status as a BDC, we intend to distribute to our stockholders substantially all of our net ordinary income and realized net capital gains except for certain net long-term capital gains (which we may retain, pay applicable income taxes with respect thereto, and elect to treat as deemed distributions to our stockholders). As a BDC, we are generally required to meet a coverage ratio of total assets to total senior securities, which includes all of our borrowings and any preferred stock we may issue in the future, of at least 200%. This requirement limits the amount that we may borrow. Because we will continue to need capital to grow our investment portfolio, this limitation may prevent us from incurring debt and require us to issue additional equity at a time when it may be disadvantageous to do so. We cannot assure you that debt and equity financing will be available to us on favorable terms, or at all, and debt financings may be restricted by the terms of any of our outstanding borrowings. In addition, as a BDC, except for limited situations such as this offering, we are generally not permitted to issue equity securities priced below net asset value without stockholder approval. If additional funds are not available to us, we could be forced to curtail or cease new lending and investment activities, and our net asset value could decline.

Our Board of Directors may change our investment objective, operating policies and strategies without prior notice or stockholder approval.

Our Board of Directors has the authority to modify or waive certain of our operating policies and strategies without prior notice (except as required by the 1940 Act) and without stockholder approval. However, absent stockholder approval, we may not change the nature of our business so as to cease to be, or withdraw our election as, a BDC. As described above under “*Significant Developments – Authorization to Withdraw BDC Election*”, our shareholders have provided this authorization, although we will not withdraw our election as a BDC unless and until we have entered into a definitive agreement to effect a Consolidation. We cannot predict the effect any changes to our current operating policies and strategies would have on our business, operating results and value of our stock. Nevertheless, any such effects may adversely affect our business and impact our ability to make distributions.

Risks Related to Our Operation as a BDC

Our ability to enter into transactions with our affiliates is restricted.

As an investment company, we are prohibited under the 1940 Act from participating in certain transactions with certain of our affiliates without the prior approval of our independent directors and, in some cases, the SEC. Any person that owns, directly or indirectly, 5% or more of our outstanding voting securities is our affiliate for purposes of

the 1940 Act, and we generally are prohibited from buying or selling any security from or to such affiliate, absent the prior approval of our independent directors. The 1940 Act also prohibits certain “joint” transactions with certain of our affiliates, which could include investments in the same portfolio company (whether at the same or different times), without prior approval of our independent directors and, in some cases, the SEC. If a person acquires more than 25% of our voting securities, we are prohibited from buying or selling any security from or to such person or certain of that person’s affiliates, or entering into prohibited joint transactions with such persons, absent the prior approval of the SEC. Similar restrictions limit our ability to transact business with our officers or directors or their affiliates.

Regulations governing our operation as a BDC affect our ability to, and the way in which we, raise additional capital.

Our business requires a substantial amount of additional capital. We may acquire additional capital from the issuance of senior securities or other indebtedness, the issuance of additional shares of our common stock or from securitization transactions. However, we may not be able to raise additional capital in the future on favorable terms or at all. We may issue debt securities or preferred securities, which we refer to collectively as “senior securities,” and we may borrow money from banks or other financial institutions, up to the maximum amount permitted by the 1940 Act. The 1940 Act permits us to issue senior securities or incur indebtedness only in amounts such that our asset coverage, as defined in the 1940 Act, equals at least 200% after such issuance or incurrence. Our ability to pay dividends or issue additional senior securities would be restricted if our asset coverage ratio were not at least 200%. If the value of our assets declines, we may be unable to satisfy this test. If that happens, we may be required to liquidate a portion of our investments and repay a portion of our indebtedness at a time when such sales may be disadvantageous.

Senior Securities. As a result of issuing senior securities, we would also be exposed to typical risks associated with leverage, including an increased risk of loss. If we issue preferred securities, they would rank “senior” to common stock in our capital structure. Preferred stockholders would have separate voting rights and may have rights, preferences or privileges more favorable than that of our common stockholders. Furthermore, the issuance of preferred securities could have the effect of delaying, deferring or preventing a transaction or a change of control that might involve a premium price for our common stockholders or otherwise be in your best interest.

Table of Contents

Additional Common Stock. Our Board of Directors may decide to issue common stock to finance our operations rather than issuing debt or other senior securities. As a BDC, we are generally not able to issue our common stock at a price below net asset value without first obtaining required approvals from our stockholders and our independent directors. In any such case, the price at which our securities are to be issued and sold may not be less than a price, that in the determination of our Board of Directors, closely approximates the market value of such securities (less any commission or discount). We may also make rights offerings to our stockholders at prices per share less than the net asset value per share, subject to the 1940 Act. If we raise additional funds by issuing more common stock or senior securities convertible into, or exchangeable for, our common stock, the percentage ownership of our stockholders at that time would decrease, and you may experience dilution.

Changes in the laws or regulations governing our business, or changes in the interpretations thereof, and any failure by us to comply with these laws or regulations, could negatively affect the profitability of our operations.

To the extent we remain a BDC, changes in the laws or regulations or the interpretations of the laws and regulations that govern BDCs, RICs or non-depository commercial lenders, could significantly affect our operations and our cost of doing business. We are subject to federal, state and local laws and regulations and are subject to judicial and administrative decisions that affect our operations, including our loan originations, maximum interest rates, fees and other charges, disclosures to portfolio companies, the terms of secured transactions, collection and foreclosure procedures and other trade practices. If these laws, regulations or decisions change, or if we expand our business into jurisdictions that have adopted more stringent requirements than those in which we currently conduct business, we may have to incur significant expenses in order to comply or we might have to restrict our operations. In addition, if we do not comply with applicable laws, regulations and decisions, we may lose licenses needed for the conduct of our business and be subject to civil fines and criminal penalties, any of which could have a material adverse effect upon our business, results of operations or financial condition.

Risks Related to Our Announced Plan of Reorganization

Pursuant to our Plan of Reorganization, we are exploring and evaluating strategic alternatives for the Fund and we cannot assure you that we will be successful in identifying a strategic alternative, that such strategic alternative will yield additional value for our stockholders or that the process will not have an adverse impact on our business.

On May 14, 2014, we announced that we had adopted a Plan of Reorganization within the meaning of Section 2(a)(33) of the 1940 Act. The Plan of Reorganization contemplates the possible merger of the Fund with and into another BDC, or the restructuring of the Fund as an operating company no longer subject to the 1940 Act, which is referred to in the Plan of Reorganization as a “Consolidation”. A Consolidation could constitute, among other things, a sale of Equus, a restructuring, a recapitalization, merger, or other business combination. We cannot provide any assurance that the exploration of strategic alternatives will result in the identification or consummation of a Consolidation. Similarly, any strategic decision will involve risks and uncertainties, and we cannot provide any

assurance that any strategic alternative, if identified, evaluated and consummated, will provide the anticipated benefits or otherwise enhance stockholder value. The process is ongoing and, although we believe we will consummate a Consolidation during 2017, we may be wrong. Our Board of Directors has not set a timetable for completion of the evaluation of a potential Consolidation.

We expect to incur substantial costs associated with identifying and evaluating potential strategic alternatives incident to a Consolidation. Any potential transaction would be dependent upon a number of factors that may be beyond our control, including, among other factors, market conditions, industry trends, the interest of third parties in our business, stockholder approval and the availability of financing to potential buyers or to Equus on reasonable terms. The process of exploring strategic alternatives may be time consuming and disruptive to our business operations. We are also subject to other risks in connection with the uncertainty created by the strategic review process, including stock price volatility and the ability to retain qualified employees. We do not currently intend to disclose further developments with respect to this process, unless and until our Board of Directors approves a specific transaction or otherwise concludes the review of strategic alternatives.

If we are unable to effectively manage the strategic review process, our business, financial condition, liquidity and results of operations could be adversely affected (see “*Significant Developments—Plan of Reorganization*” above).

If we reorganize as an operating company, we will likely not continue to qualify as a RIC under the Code.

Pursuant to our Plan of Reorganization, if we were to reorganize as an operating company, we may lose our status as a RIC. If we fail to qualify as a RIC, we will be subject to corporate income tax, which would substantially reduce the amount of income we might otherwise distribute to our shareholders (see “*Significant Developments—Plan of Reorganization*” above).

Table of Contents

If we reorganize as an operating company, we will not continue to operate as a BDC.

We have elected to be classified as a BDC under the 1940 Act. In connection with our announcement on May 14, 2014 to effect a Plan of Reorganization, if we effect a reorganization of the Fund into an operating company, we will seek to terminate our BDC classification. On January 6, 2017, holders of a majority of our outstanding common stock approved our cessation as a BDC and authorized our Board to withdraw our BDC election on or prior to July 31, 2017. If we were to terminate our election to be classified as a BDC and were still determined by the SEC to constitute an “investment company,” we would be subject to significantly greater regulatory requirements and constraints than under those which we presently operate, the result of which could have a material adverse effect on our results and financial condition.

If we reorganize as an operating company, we may not be able to utilize our capital losses.

As of December 31, 2016, we have incurred cumulative capital losses of \$31.3 million, of which \$14.4 million will begin expiring after 2017, with the remainder carried over indefinitely. Pursuant to the Plan of Reorganization announced on May 14, 2014, we may reorganize as an operating company. If we reorganize as an operating company, we may lose our ability to offset future income against our cumulative capital losses, including capital losses that would otherwise continue past 2017. If we reorganized as an operating company and were unable to offset future income against these capital losses, the result could have a material adverse effect on our future operating results and our financial condition.

If we reorganize as an operating company, our stockholders will no longer have certain protections under the 1940 Act.

If we withdraw the Fund’s election to be treated as a BDC, Equus will no longer be subject to regulation under the 1940 Act, which is designed to protect the interests of investors in investment companies. Specifically, our stockholders would no longer have the following protections of the 1940 Act:

Leverage Limits. We would no longer be subject to the requirement in Section 61 of the 1940 Act that we maintain a ratio of assets to senior securities (such as senior debt or preferred stock) of at least 200% and we would not be limited by statute or regulation to the amount of leverage we could incur.

Range of Investments. We would no longer be prohibited from investing in certain types of companies, such as brokerage firms, insurance, companies, and investment companies.

•

Changes in Financial Reporting. While the conversion of Equus into an operating company will enable us to consolidate the financial results of entities we control, a change in our method of accounting could also reduce the reported value of our investments in controlled privately-held companies by eliminating our ability to report an increase in the fair value of these holdings.

Protection of Directors and Officers. We would no longer be prohibited from protecting any director or officer against any liability to the Fund or our stockholders arising from willful malfeasance, bad faith, gross negligence, or reckless disregard of the duties involved in the conduct of that person's office, although there are similar limitations under Delaware law, our Certificate of Incorporation, and our Bylaws that would still apply.

Fidelity Bond. We would no longer be required to provide and maintain an investment company blanket bond issued by a reputable fidelity insurance company to protect us against larceny and embezzlement.

Director Independence. We would no longer be required to ensure that a majority of our directors are persons who are not "interested persons," as that term is defined in the 1940 Act, and certain persons, such as investment bankers, that would be prevented from serving on our Board if we were a BDC. However, assuming we can comply with the NYSE's listing standards for operating companies, we will remain subject to NYSE listing standards that require the majority of directors of a listed company and all members of its compensation, audit and nominating committees to be "independent" as defined under NYSE rules.

Affiliate Transactions. We would no longer be subject to provisions of the 1940 Act regulating transactions between BDCs and certain affiliates, although we would still be subject to conflict of interest rules and governance procedures that exist under Delaware law and NYSE rules.

Share Issuances. We would no longer be subject to provisions of the 1940 Act restricting our ability to issue shares below NAV or in exchange for services, nor would we be restricted in issuing more than one class of equity securities or instruments that could be converted into other classes of equity securities.

Table of Contents

Share Repurchases. We would no longer be restricted under the 1940 Act in our ability to repurchase shares from our stockholders, and would instead be subject only to NYSE rules and Delaware corporate law requirements for such repurchases.

Change of Business. We would be able to change the nature of our business and fundamental investment policies without having to obtain the approval of our stockholders.

Director and Officer Incentives. We would no longer require exemptive relief from the SEC before implementing incentive compensation plans for our key executives and non-executive directors.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

We do not own any real estate or other physical properties. Our principal executive offices are located at 700 Louisiana St. 48th Floor, Houston, Texas 77002. We believe that these leased office facilities are suitable and adequate for the business as it is contemplated to be conducted.

Item 3. Legal Proceedings

Shareholder Complaint—On November 16, 2016, Samuel Zalmanoff filed a lawsuit against the Fund and members of the Board of Directors in the Court of Chancery in the State of Delaware. The lawsuit was filed in connection with the Fund's 2016 Equity Incentive Plan ("Incentive Plan") which was adopted by the Board of Directors on April 15, 2016, approved by the Equus shareholders on June 13, 2016, and approved, with certain standard exceptions, by the Securities and Exchange Commission on January 10, 2017. Mr. Zalmanoff's complaint, which purports to be on behalf of all non-affiliate Equus shareholders entitled to vote for the Incentive Plan, alleges a breach by the Board of Directors of its fiduciary duties of disclosure in connection with the Incentive Plan, and seeks an order from the court: (i) enjoining implementation of the Incentive Plan, (ii) requiring the Fund to revise its disclosures relating to the Incentive Plan, and (iii) for an award of costs, attorneys' fees, and expenses. We believe this lawsuit is without merit and intend to vigorously dispute the claims made therein. Accordingly, on January 9, 2017, we filed a Motion to Dismiss the complaint, which was followed on January 27, 2017 with a supporting brief and other corroborative items. Mr. Zalmanoff is required to file a response to this motion no later than March 13, 2017.

Champion Window Arbitration Settlement—In January 2006, we sold our 31.5% ownership interest in Champion Window, Inc. (“Champion”), a portfolio company of the Fund, to Atrium Companies Inc. (“Atrium”) pursuant to a Stock Purchase Agreement (“SPA”) dated December 22, 2005. The SPA contained certain limited rights of indemnification for Atrium in connection with its purchase of such ownership interest.

More than five years after the closing of the sale of our Champion interest, Atrium filed suit in Texas state court, which was subsequently consolidated into an Arbitration Action, against two former officers of Champion, Equus, and another former Champion shareholder. The suit alleged breaches of fiduciary duty against Champion’s former officers for hiring undocumented workers that were discovered as a result of an investigation by the U.S. Immigration and Customs Enforcement agency (“ICE”) into Atrium’s hiring practices. The suit also sought indemnification under the SPA from these officers, Equus, and another former Champion shareholder, for a payment of \$2.0 million made to ICE in settlement of the investigation and associated legal costs, as well as for claimed lost profits as a result of the investigation.

On February 4, 2015, without admitting to any liability on the part of Equus, we entered into a settlement agreement with Atrium and its associated companies. Pursuant to the settlement agreement and in view of the estimated costs of protracted litigation and the associated disruption to the operations of the Fund, we agreed to pay \$500,000, in complete settlement of the lawsuit, as being in the best interests of the Fund and its shareholders. This amount was accrued as of December 31, 2014. The settlement payment was made on February 6, 2015. Atrium filed a motion to dismiss the lawsuit with prejudice on February 4, 2015.

From time to time, the Fund is also a party to certain proceedings incidental to the normal course of our business including the enforcement of our rights under contracts with our portfolio companies. While the outcome of these legal proceedings cannot at this time be predicted with certainty, we do not expect that these proceedings will have a material effect upon the Fund’s financial condition or results of operations.

Table of Contents**Item 4. Mine Safety Disclosures**

Not applicable.

PART II**Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

Our common stock is listed on the NYSE under the symbol "EQS". We had approximately 2,267 stockholders as of December 31, 2016, 705 of whom were registered holders. Registered holders do not include those stockholders whose stock has been issued in street name. As of December 31, 2016, our net asset value per share was \$3.37.

The following table reflects the high and low closing sales prices per share of our common stock on the NYSE, and net asset value ("NAV") per share for the two years ended December 31, 2016, by quarter:

	2016				2015			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
High	\$1.77	\$1.85	\$1.86	\$2.04	\$2.10	\$1.97	\$1.68	\$1.79
Low	1.45	1.59	1.60	1.77	1.90	1.84	1.93	1.47
NAV	2.96	3.13	3.27	3.37	2.79	3.00	2.97	2.94

As a RIC, we are required to distribute to our stockholders, in a timely manner, at least 90% of our taxable net investment income each year. If we do not distribute, in a timely manner, 98.2% of our taxable net capital gains and 90% of our taxable net investment income each year (as well as any portion of the respective 2% balances not distributed in the previous year), we will be subject to a 4% non-deductible federal excise tax on certain undistributed income of regulated investment companies. Under the 1940 Act, we are not permitted to pay dividends to stockholders unless we meet certain asset coverage requirements. If taxable net investment income is retained, we will be subject to federal income and excise taxes. We reserve the right to retain net long-term capital gains in excess of net short-term capital losses for reinvestment or to pay contingencies and expenses. Such retained amounts, if any, will be taxable to the Fund as long-term capital gains and our stockholders will be able to claim their proportionate share of the federal income taxes paid by the Fund on such gains as a credit against their own federal income tax liabilities. Stockholders will also be entitled to increase the adjusted tax basis of their fund shares by the difference between their undistributed capital gains and their tax credit.

We invest in companies that are believed to have a high potential for capital appreciation, and we intend to realize the majority of our profits upon the sale of our investments in portfolio companies. Consequently, most of the companies in which we invest do not have established policies of paying annual dividends. However, a portion of the investments in portfolio securities held by the Fund consists of interest-bearing subordinated debt securities or dividend-paying preferred stock.

Table of Contents**Item 6. Selected Financial Data**

The following is a summary of selected financial data and per share data of the Fund for the five years ended December 31, 2016 (in thousands, except per share data):

	2016	2015	2014	2013	2012
Total investment income	\$748	\$446	\$965	\$7	\$516
Net investment loss	(2,451)	(2,351)	(2,418)	(3,129)	(2,653)
Net realized (loss) gain of portfolio securities	(13)	(2,483)	660	(9,795)	(2,797)
Net change in unrealized appreciation (depreciation) of portfolio securities	7,347	6,755	2,116	13,266	177
Net change in unrealized depreciation of portfolio securities - related party	549	(814)	(1,725)	—	—
Net increase (decrease) in net assets resulting from operations	5,432	1,107	(1,367)	342	(5,273)
Total assets	73,146	52,530	52,038	48,349	33,283
Net assets	42,740	37,308	36,201	33,217	32,875
Net cash (used in) provided by operating activities	(20,069)	1,338	(3,367)	(19,662)	12,874
Shares outstanding at end of year	12,674	12,674	12,674	10,562	10,562
Weighted average shares outstanding, basic	12,674	12,674	11,904	10,562	10,562

Per Share Data:

	2016	2015	2014	2013	2012
Net investment loss	\$(0.19)	\$(0.19)	\$(0.20)	\$(0.30)	\$(0.25)
Net realized (loss) gain of portfolio securities	—	(0.20)	0.06	(0.93)	(0.27)
Net change in unrealized appreciation (depreciation) of portfolio securities	0.62	0.47	0.03	1.26	0.02
Net increase (decrease) in net amounts resulting from operations per share, basic and diluted	0.43	0.08	(0.11)	0.03	(0.50)
Net asset value (including unrealized appreciation)	3.37	2.94	2.86	3.14	3.11

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**Overview**

Equus is a BDC that provides financing solutions for privately held middle market and small capitalization companies. We began operations in 1983 and have been a publicly traded closed-end fund since 1991. Our investment objective is

to seek the highest total return, consisting of capital appreciation and current income. On May 15, 2014, we announced that the Fund had adopted a Plan of Reorganization that would, if effected, transform Equus into an operating company. On January 6, 2017, our shareholders authorized our Board to withdraw our BDC election, although we will not withdraw this election unless and until we have entered into a definitive agreement to effect a Consolidation. Further, we will require a subsequent affirmative vote from holders of a majority of our outstanding voting shares to enter into any such definitive agreement or change the nature of our business. See “*Significant Developments – Plan of Reorganization and Share Exchange with MVC Capital*” and “*– Authorization to Withdraw BDC Election*” above.

As a BDC, we are required to comply with certain regulatory requirements. For instance, we generally have to invest at least 70% of the Fund’s total assets in “qualifying assets,” including securities of private U.S. companies, certain public U.S. companies with a total market capitalization not in excess of \$250 million, cash, cash equivalents, U.S. government securities and short-term high-quality debt investments. Equus is a RIC under Subchapter M of the Code. To qualify as a RIC, we must meet certain source of income and asset diversification requirements. If we comply with the provisions of Subchapter M, the Fund generally does not have to pay corporate-level income taxes on any income that distributed to our stockholders.

Table of Contents

Investment Income. We generate investment income from interest payable on the debt securities that the Fund holds, dividends received on equity interests in our portfolio companies and capital gains, if any, realized upon sales of equity and, to a lesser extent, debt securities in the investment portfolio. Our equity investments may include shares of common and preferred stock, membership interests in limited liability companies and warrants to purchase additional equity interests. These equity securities may or may not pay dividends, and the exercise prices of warrants that we acquire in connection with debt investments, if any, vary by investment. Our debt investments in portfolio companies may be in the form of senior or subordinated loans and may be unsecured or have a first or second lien on some or all of the assets of the borrower. Our loans typically have a term of three to seven years and bear interest at fixed or floating rates. Interest on these debt securities is generally payable either quarterly or semiannually. Some promissory notes held by the Fund provide that a portfolio company may elect to pay interest in cash or provide that discount interest may accrete in the form of original issue discount or payment-in-kind (PIK) over the life of the notes by adding unpaid interest amounts to the principal balance. Amortization of principal on our debt investments is generally deferred for several years from the date of initial investment. The principal amount of these debt securities and any accrued but unpaid interest generally will become due at maturity. We also earn interest income at market rates on investments in short-term marketable securities. From time to time, we generate income from time to time in the form of commitment, origination, structuring, and extension fees in connection with our investments. We recognize all such fees when earned.

Expenses. Currently, our primary operating expenses include director fees and expenses, professional fees, compensation expense, general and administrative fees, and professional fees incurred in connection with our Plan of Reorganization. During 2016 and 2015, we did not incur any non-recurring expenses. During 2014, we incurred non-recurring expenses, including settlement expenses of \$0.5 million, and legal expenses of \$0.1 million related to certain legal proceedings described in Item 3 above.

Non-Operating Subsidiary. We have established Equus Total Return (Canada) Inc. as a wholly-owned subsidiary to facilitate payments to Canadian personnel and contractors who provide services to the Fund. We consider Equus Total Return (Canada) Inc. a disregarded entity for accounting purposes, inasmuch as it does not have active operations.

Operating Activities. We use cash to make new investments and follow-on investments in our existing portfolio companies. We record these investments at cost on the applicable trade date. Realized gains or losses are computed using the specific identification method. On an ongoing basis, we carry our investments in our financial statements at fair value, as determined by our board of directors. See “*Critical Accounting Policies – Valuation of Investments*” below. As of December 31, 2016, we had invested 86.4% of our assets in securities of portfolio companies that constituted qualifying investments under the 1940 Act. At that time, we had invested 47.3% by value in shares of common stock, 15.1% in membership interests in limited liability companies, and 7.0% in various debt instruments.

Commitments. Under certain circumstances, we make follow-on investments in some of our portfolio companies. As of December 31, 2016, we had no outstanding commitments to our portfolio company investments.

Financing Activities. From time to time, we use leverage to finance a portion of our investments. We then repay such debt from the sale of portfolio securities. Under the 1940 Act, we have the ability to borrow funds and issue debt securities or preferred stock that are referred to as senior securities, subject to certain restrictions including an overall limitation on the amount of outstanding debt, or leverage, relative to equity of 1:1. Because of the nature and size of our portfolio investments, we periodically borrow funds to make qualifying investments in order to maintain our qualification as a RIC. During 2016 and 2015, we borrowed such funds by accessing a margin account with a securities brokerage firm. We invest the proceeds of these margin loans in high-quality securities such as U.S. Treasury securities until they are repaid. We refer to these high-quality investments as “restricted assets” because they are not generally available for investment in portfolio companies under the terms of borrowing. If, in the future, we cannot borrow funds to make such qualifying investments at the end of any future quarter, we may not qualify as a RIC and would become subject to corporate-level income tax on our net investment income and realized capital gains, if any. In addition, our distributions to stockholders would be taxable as ordinary dividends to the extent paid from earnings and profits. See “Federal Income Tax Considerations.”

Distributions. So long as we remain a BDC, we will continue to pay out net investment income and/or realized capital gains, if any, on an annual basis as required under the 1940 Act.

Table of Contents

Possible Share Repurchase. As a closed-end BDC, our shares of common stock are not redeemable at the option of stockholders, and our shares currently trade at a discount to their net asset value. Our Board has determined that it would be in the best interests of our stockholders to reduce or eliminate this market value discount. Accordingly, we have been authorized to, and may from time to time, repurchase shares of our outstanding common stock (including by means of tender offers or privately negotiated transactions) in an effort to reduce or eliminate this market discount or to increase the net asset value of our shares. We are not required to undertake, and we have not previously undertaken, any such share repurchases, nor do we further anticipate taking any such action in 2017.

2016 Equity Incentive Plan

On June 13, 2016, our shareholders approved the adoption of our Incentive Plan. On January 10, 2017, the SEC issued an order approving the Incentive Plan and certain awards intended to be made thereunder. The Incentive Plan is intended to promote the interests of the Fund by encouraging officers, employees, and directors of the Fund and its affiliates to acquire or increase their equity interest in the Fund and to provide a means whereby they may develop a proprietary interest in the development and financial success of the Fund, to encourage them to remain with and devote their best efforts to the business of the Fund, thereby advancing the interests of the Fund and its stockholders. The Incentive Plan is also intended to enhance the ability of the Fund and its affiliates to attract and retain the services of individuals who are essential for the growth and profitability of the Fund. The Incentive Plan permits the award of restricted stock as well as common stock purchase options. The maximum number of shares of common stock that are subject to awards granted under the Incentive Plan is 2,434,728 shares. The term of the Incentive Plan will expire on June 13, 2026. No awards have yet been granted under the Incentive Plan and, consequently, no compensation expense has been recorded for the year ended December 31, 2016.

Critical Accounting Policies and Estimates

We follow the accounting and reporting guidance in FASB Accounting Standards Codification Topic 946 “*Financial Services – Investment Companies*.” Our financial statements are based on the selection and application of significant accounting policies, which require management to make significant estimates and assumptions. We believe that the following are some of the more critical judgment areas in the application of our accounting policies that currently affect our financial condition and results of operations.

Valuation of Investments

For most of our investments, market quotations are not available. With respect to investments for which market quotations are not readily available or when such market quotations are deemed not to represent fair value, our Board has approved a multi-step valuation process each quarter, as described below:

1. Each portfolio company or investment is reviewed by our investment professionals;

With respect to investments with a fair value exceeding \$2.5 million that have been held for more than one year, we

2. engage independent valuation firms to assist our investment professionals. These independent valuation firms conduct independent valuations and make their own independent assessments;

3. Our Management produces a report that summarized each of our portfolio investments and recommends a fair value of each such investment as of the date of the report;

The Audit Committee of our Board reviews and discusses the preliminary valuation of our portfolio investments as recommended by Management in their report and any reports or recommendations of the independent valuation

4. firms, and then approves and recommends the fair values of our investments so determined to our Board for final approval; and

5. The Board discusses valuations and determines the fair value of each portfolio investment in good faith based on the input of our Management, the respective independent valuation firm, as applicable, and the Audit Committee.

During the first twelve months after an investment is made, we rely on the original investment amount to determine the fair value unless significant developments have occurred during this twelve month period which would indicate a material effect on the portfolio company (such as results of operations or changes in general market conditions).

Table of Contents

Investments are valued utilizing a yield analysis, enterprise value (“EV”) analysis, net asset value analysis, liquidation analysis, discounted cash flow analysis, or a combination of methods, as appropriate. The yield analysis uses loan spreads and other relevant information implied by market data involving identical or comparable assets or liabilities. Under the EV analysis, the EV of a portfolio company is first determined and allocated over the portfolio company’s securities in order of their preference relative to one another (i.e., “waterfall” allocation). To determine the EV, we typically use a market multiples approach that considers relevant and applicable market trading data of guideline public companies, transaction metrics from precedent M&A transactions and/or a discounted cash flow analysis. The net asset value analysis is used to derive a value of an underlying investment (such as real estate property) by dividing a relevant earnings stream by an appropriate capitalization rate.

For this purpose, we consider capitalization rates for similar properties as may be obtained from guideline public companies and/or relevant transactions. The liquidation analysis is intended to approximate the net recovery value of an investment based on, among other things, assumptions regarding liquidation proceeds based on a hypothetical liquidation of a portfolio company’s assets. The discounted cash flow analysis uses valuation techniques to convert future cash flows or earnings to a range of fair values from which a single estimate may be derived utilizing an appropriate discount rate. The measurement is based on the net present value indicated by current market expectations about those future amounts.

In applying these methodologies, additional factors that we consider in fair value pricing our investments may include, as we deem relevant: security covenants, call protection provisions, and information rights; the nature and realizable value of any collateral; the portfolio company’s ability to make payments; the principal markets in which the portfolio company does business; publicly available financial ratios of peer companies; the principal market; and enterprise values, among other factors. Also, any failure by a portfolio company to achieve its business plan or obtain and maintain its financing arrangements could result in increased volatility and result in a significant and rapid change in its value.

Our general intent is to hold our loans to maturity when appraising our privately held debt investments. As such, we believe that the fair value will not exceed the cost of the investment. However, in addition to the previously described analysis involving allocation of value to the debt instrument, we perform a yield analysis assuming a hypothetical current sale of the security to determine if a debt security has been impaired. The yield analysis considers changes in interest rates and changes in leverage levels of the portfolio company as compared to the market interest rates and leverage levels. Assuming the credit quality of the portfolio company remains stable, the Fund will use the value determined by the yield analysis as the fair value for that security if less than the cost of the investment.

We will record unrealized depreciation on investments when we determine that the fair value of a security is less than its cost basis, and will record unrealized appreciation when we determine that the fair value is greater than its cost basis.

Because of the inherent uncertainty of the valuation of portfolio securities which do not have readily ascertainable market values, amounting to \$25.6 million and \$16.2 million as of December 31, 2016 and 2015, respectively, our fair value determinations may materially differ from the values that would have been used had a ready market existed for the securities. As of December 31, 2016 and December 31, 2015, one of our portfolio investments, MVC, was publicly listed on the NYSE with 468,608 common shares and 428,662 common shares, respectively.

We adjust our net asset value for the changes in the value of our publicly held securities, if applicable, and material changes in the value of private securities, generally determined on a quarterly basis or as announced in a press release, and report those amounts to Lipper Analytical Services, Inc. Our net asset value appears in various publications, including *Barron's* and *The Wall Street Journal*.

Federal Income Taxes

So long as we maintain our status as a BDC, we intend to comply with the requirements of the Code necessary for us to qualify as a RIC. So long as we comply with these requirements, we generally will not be subject to corporate-level federal income taxes on otherwise taxable income (including net realized capital gains) distributed to stockholders. Therefore, we did not record a provision for federal income taxes in our financial statements. As of December 31, 2016, we had a capital loss carry forward of \$31.3 million which may be used to offset future capital gains. We may borrow money from time to time to maintain our status as a RIC under the Code. See “*Overview – Financing Activities*” above.

Table of Contents

Interest Income Recognition

We record interest income, adjusted for amortization of premium and accretion of discount, on an accrual basis to the extent that we expect to collect such amounts. We stop accruing interest on investments when we determine that interest is no longer collectible. We may also impair the accrued interest when we determine that all or a portion of the current accrual is uncollectible. If we receive any cash after determining that interest is no longer collectible, we treat such cash as payment on the principal balance until the entire principal balance has been repaid, before we recognize any additional interest income. We accrete or amortize discounts and premiums on securities purchased over the life of the respective security using the effective yield method. The amortized cost of investments represents the original cost adjusted for the accretion of discount and/or amortization of premium on debt securities.

Payment in Kind Interest

We have loans in our portfolio that may pay PIK interest. We add PIK interest, if any, computed at the contractual rate specified in each loan agreement, to the principal balance of the loan and recorded as interest income. To maintain our status as a RIC, we must pay out to our stockholders this non-cash source of income in the form of dividends even if we have not yet collected any cash in respect of such investments.

Recent Accounting Pronouncements

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606). ASU 2014-09 supersedes the revenue recognition requirements under ASC 606, Revenue Recognition, and most industry-specific guidance throughout the Industry Topics of the ASC. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which an entity expects to be entitled in exchange for those goods or services. Under the new guidance, an entity is required to perform the following five steps: (1) identify the contract(s) with a customer; (2) identify the performance obligations in the contract; (3) determine the transaction price; (4) allocate the transaction price to the performance obligations in the contract, and (5) recognize revenue when (or as) the entity satisfies a performance obligation. The new guidance will significantly enhance comparability of revenue recognition practices across entities, industries, jurisdictions and capital markets. Additionally, the guidance requires improved disclosures as to the nature, amount, timing and uncertainty of revenue that is recognized. In March 2016, the FASB issued ASU 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net), which clarified the implementation guidance on principal versus agent considerations. In April 2016, the FASB issued ASU 2016-10, Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing, which clarified the implementation guidance regarding performance obligations and licensing arrangements. In May 2016, the FASB issued ASU No. 2016-12, Revenue from Contracts with Customers (Topic 606) — Narrow-Scope Improvements and Practical Expedients, which clarified guidance on assessing collectability, presenting sales tax, measuring noncash consideration, and certain transition matters. The new

guidance will be effective for the annual reporting period beginning after December 15, 2017, including interim periods within that reporting period. Early adoption would be permitted for annual reporting periods beginning after December 15, 2016. The Company expects to complete its assessment of the impact of adoption of ASU 2014-09 during the first half of 2017.

In August 2014, the FASB issued ASU 2014-15, Presentation of Financial Statements—Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern ("ASU 2014-15"), which requires management to assess an entity's ability to continue as a going concern, and to provide related footnote disclosures in certain circumstances. The amendments in this update are effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. Early application is permitted. The Fund adopted ASU 2014-15 as of and for the annual period ended December 31, 2016, which did not have any impact on its financial statements.

In May 2015, the FASB issued ASU 2015-07, Fair Value Measurements — Disclosures for Certain Entities that Calculate Net Asset Value per Share. This amendment updates guidance intended to eliminate the diversity in practice surrounding how investments measured at net asset value under the practical expedient with future redemption dates have been categorized in the fair value hierarchy. Under the updated guidance, investments for which fair value is measured at net asset value per share using the practical expedient should no longer be categorized in the fair value hierarchy, while investments for which fair value is measured at net asset value per share but the practical expedient is not applied should continue to be categorized in the fair value hierarchy. The updated guidance requires retrospective adoption for all periods presented and is effective for interim and annual reporting periods beginning after December 15, 2015, with early adoption permitted. The Company adopted this standard during the three months ended March 31, 2016. There was no impact of the adoption of this new accounting standard on the Company's financial statements as none of its investments are measured through the use of the practical expedient.

Table of Contents

In January 2016, the FASB issued ASU No. 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities. Among other things, this ASU requires that public business entities use the exit price notion when measuring the fair value of financial instruments for disclosure purposes. ASU No. 2016-01 is effective for public entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. Our adoption of ASU No. 2016-01 is not anticipated to have a material effect on our financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases, which requires lessees to recognize on the balance sheet a right of use asset, representing its right to use the underlying asset for the lease term, and a lease liability for all leases with terms greater than 12 months. The guidance also requires qualitative and quantitative disclosures designed to assess the amount, timing, and uncertainty of cash flows arising from leases. The standard requires the use of a modified retrospective transition approach, which includes a number of optional practical expedients that entities may elect to apply. The new guidance is effective for annual periods beginning after December 15, 2018, and interim periods therein. Early application is permitted. The adoption of ASU 2016-02 will not have an impact on our financial statements as we currently have no operating leases and our principal offices are under a month-to-month lease arrangement.

In March 2016, the FASB issued ASU No. 2016-09, Compensation-Stock Compensation (Topic 718) —Improvements to Employee Share-Based Payment Accounting (“ASU 2016-09”), which is intended to improve the accounting for share-based payments and affects all organizations that issue share-based payment awards to their employees. ASU 2016-09 primarily simplifies the accounting for and classification of, income taxes related to share-based payment awards, including the impact of income taxes withheld on the classification of awards as equity or liabilities and the classification of income taxes on the statement of cash flows. ASU 2016-09 also permits an entity to elect a forfeiture rate assumption based on the estimated number of awards expected to vest or to account for forfeitures when they occur. ASU 2016-09 is effective for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. We elected to early adopt ASU 2016-09 effective January 1, 2016. The provisions of ASU 2019-06 should be adopted on a modified retrospective, retrospective or prospective basis, depending on the provision. We recently adopted an incentive plan for management; however, no issuances or awards have occurred to date. We are currently evaluating the impact ASU 2016-13 will have on future issuances and awards.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments-Credit Losses (Topic 326) —Measurement of Credit Losses on Financial Instruments (“ASU 2016-13”), which amends the financial instruments impairment guidance so that an entity is required to measure expected credit losses for financial assets based on historical experience, current conditions and reasonable and supportable forecasts. As such, an entity will use forward-looking information to estimate credit losses. ASU 2016-13 also amends the guidance in FASB ASC Subtopic No. 325-40, Investments-Other, Beneficial Interests in Securitized Financial Assets, related to the subsequent measurement of accretable yield recognized as interest income over the life of a beneficial interest in securitized financial assets under the effective yield method. ASU 2016-13 is effective for public business entities that meet the U.S. GAAP definition of an SEC filer, for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted as of the fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. We are currently evaluating the impact of ASU 2016-13 on our financial statements.

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments (a consensus of the Emerging Issues Task Force) (“ASU 2016-15”), which addresses the diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows under ASC 230, Statement of Cash Flows, and other topics. ASU 2016-15 provides guidance on eight specific cash flow issues including the statement of cash flows treatment of beneficial interests in securitized financial transactions as well as the treatment of debt prepayment and extinguishment costs. ASU 2016-15 also provides guidance on the predominance principle to clarify when cash receipts and cash payments should be separated into more than one class of cash flows. ASU 2016-15 is effective for public business entities for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. We are currently evaluating the impact of ASU 2016-15 on our statements of cash flows.

From time to time, new accounting pronouncements are issued by the FASB or other standards setting bodies that are adopted by the Company as of the specified effective date. Management believes that the impact of recently issued standards and any that are not yet effective will not have a material impact on its financial statements upon adoption.

Current Market Conditions

Overall economic conditions in the United States have improved, albeit slowly, since the market downturn of 2008-09. The U.S. economy is experiencing relatively low unemployment, but grew at only 1.6% in 2016, down from 2.6% in 2015, and the International Monetary Fund is forecasting somewhat higher growth in 2017 and 2018 at 2.3% and 2.5%, respectively. However, global growth for 2017 and 2018 is predicted at 3.4% and 3.6%, respectively, largely driven by growth in emerging markets. (Sources: *Bureau of Economic Analysis* and *International Monetary Fund*).

Table of Contents

Market conditions for business transactions including mergers and acquisitions and private equity investments in 2016 improved to their highest level (\$4.3 trillion) since prior to the 2008 financial crisis, as corporations have been deleveraging and are holding significant amounts of cash and many have focused on acquisitions as part of future growth plans. Private equity funds increased their assets under management to a projected \$681 billion, up 9% from 2015, as private equity firms as a group enjoyed more success during the year in attracting investment capital. (Source: *Forbes*)

During 2016, our net asset value increased from \$2.94 per share to \$3.37 per share, an increase of 14.6%. As of December 31, 2016, our common stock was trading at a 40.4% discount to our net asset value as compared to 39.1% as of December 31, 2015.

Over the past several years, we have executed certain initiatives to enhance liquidity, achieve a lower operational cost structure, provide more assistance to portfolio companies and realize certain of our portfolio investments. Specifically, we changed the composition of our Board of Directors and Management, terminated certain of our follow-on investments, internalized the management of the Fund, suspended our managed distribution policy, modified our investment strategy to pursue shorter term liquidation opportunities, pursued non-cash investment opportunities, and sold certain of our legacy and underperforming investment holdings. We believe these actions continue to be necessary to protect capital and liquidity during the turbulent oil and gas market downturn in order to preserve and enhance shareholder value. Because our Management is internalized, certain of our expenses should not increase commensurate with an increase in the size of the Fund and, therefore, if we remain a BDC, we expect to achieve efficiencies in our cost structure if we are able to grow the Fund.

Liquidity and Capital Resources

We generate cash primarily from maturities, sales of securities and borrowings, as well as capital gains realized upon the sale of portfolio investments. We use cash primarily to make additional investments, either in new companies or as follow-on investments in the existing portfolio companies and to pay the dividends to our stockholders.

Because of the nature and size of the portfolio investments, we may periodically borrow funds to make qualifying investments to maintain our tax status as a RIC. We often borrow such funds by utilizing a margin account with a securities brokerage firm. There is no assurance that such arrangement will be available in the future. If the Fund is unable to borrow funds to make qualifying investments, it may no longer qualify as a RIC. The Fund would then be subject to corporate income tax on its net investment income and realized capital gains, and distributions to stockholders would be subject to income tax as ordinary dividends.

The Fund has the ability to borrow funds and issue forms of senior securities representing indebtedness or stock, such as preferred stock, subject to certain restrictions. Net taxable investment income and net taxable realized gains from the sales of portfolio investments are intended to be distributed at least annually, to the extent such amounts are not reserved for payment of expenses and contingencies or to make follow-on or new investments.

The Fund reserves the right to retain net long-term capital gains in excess of net short-term capital losses for reinvestment or to pay contingencies and expenses. Such retained amounts, if any, will be taxable to the Fund as long-term capital gains and stockholders will be able to claim their proportionate share of the federal income taxes paid on such gains as a credit against their own federal income tax liabilities. Stockholders will also be entitled to increase the adjusted tax basis of their Fund shares by the difference between their undistributed capital gains and their tax credit.

We are evaluating the impact of current market conditions on our portfolio company valuations and their ability to provide current income. We have followed valuation techniques in a consistent manner; however, we are cognizant of current market conditions that might affect future valuations of portfolio securities. We believe that our operating cash flow and cash on hand will be sufficient to meet operating requirements and to finance routine capital expenditures through the next twelve months. If we effect a Consolidation of the Fund as described under “*Significant Developments – Plan of Reorganization and Share Exchange with MVC Capital*” and “– *Authorization to Withdraw BDC Election*” above, we may utilize some or a substantial portion of our current liquidity in connection with a contemplated transaction as payment of the purchase price and to pay associated legal, due diligence, accounting, and other fees. Further, we may borrow funds from financial institutions or other providers of debt capital to provide and pay for a part of the consideration and expenses necessary to effect a Consolidation.

Year Ended December 31, 2016

As of December 31, 2016, we had total assets of \$73.1 million, of which \$29.7 million were invested in portfolio investments and \$12.0 million were invested in cash and cash equivalents. Among our portfolio investments, \$3.0 million (at fair value) or 7.0% of net asset value were in the form of notes receivable from portfolio companies as of December 31, 2016.

Table of Contents

As of December 31, 2016, we also had \$30.3 million of temporary cash investments and restricted cash, including primarily the proceeds of a quarter-end margin loan that we incurred to maintain the diversification requirements applicable to a RIC. Of this amount, \$30.0 million was invested in U.S. Treasury bills and \$0.3 million represented a required 1% brokerage margin deposit. These securities were held by a securities brokerage firm and pledged along with other assets to secure repayment of the margin loan. The U.S. Treasury bills were sold on January 3, 2017 and we subsequently repaid this margin loan. The margin interest was paid on February 3, 2017.

Operating Activities. We used \$20.1 million in cash for operating activities in 2016. In 2016, we made new investments of \$2.0 million in portfolio companies. We paid fees to our professional advisers, directors, banks and others of \$3.2 million, while realizing a loss of \$13 thousand from the disposition of temporary cash investments.

Financing Activities. We provided \$15.0 million in cash from financing activities for 2016. We did not declare any dividends in 2016.

Year Ended December 31, 2015

As of December 31, 2015, we had total assets of \$52.5 million, of which \$19.4 million were invested in portfolio investments and \$17.0 million were invested in cash and cash equivalents. Among our portfolio investments, \$0.9 million (at fair value) or 2.5% of net asset value were in the form of notes receivable from portfolio companies as of December 31, 2015.

As of December 31, 2015, we also had \$15.1 million of temporary cash investments and restricted cash, including primarily the proceeds of a quarter-end margin loan that we incurred to maintain the diversification requirements applicable to a RIC. Of this amount, \$15.0 million was invested in U.S. Treasury bills and \$0.1 million represented a required 1% brokerage margin deposit. These securities were held by a securities brokerage firm and pledged along with other assets to secure repayment of the margin loan. The U.S. Treasury bills were sold on January 4, 2016 and we subsequently repaid this margin loan. The margin interest was paid on February 3, 2016.

Operating Activities. We provided \$1.3 million in cash for operating activities in 2015. In 2015, we made no new investments in portfolio companies. We paid fees to our professional advisers, directors, banks and others of \$2.8 million, while realizing a loss of \$2.5 million from the disposition of portfolio securities.

Financing Activities. We provided \$1.0 thousand in cash from financing activities for 2015. We did not declare any dividends in 2015.

Year Ended December 31, 2014

As of December 31, 2014, we had total assets of \$52.0 million, of which \$19.6 million were invested in portfolio investments and \$15.7 million were invested in cash and cash equivalents. Among our portfolio investments, \$4.7 million (at fair value) or 12.9% of net asset value were in the form of notes receivable from portfolio companies as of December 31, 2014. We continued to classify the promissory note issued by Spectrum Management, LLC ("Spectrum"), \$3.2 at million (fair value), as non-income producing.

As of December 31, 2014, we also had \$15.1 million of restricted cash and cash equivalents, including primarily the proceeds of a quarter-end margin loan that we incurred to maintain the diversification requirements applicable to a RIC. Of this amount, \$15.0 million was invested in U.S. Treasury bills and \$0.1 million represented a required 1% brokerage margin deposit. These securities were held by a securities brokerage firm and pledged along with other assets to secure repayment of the margin loan. The U.S. Treasury bills were sold on January 2, 2015 and we subsequently repaid this margin loan. The margin interest was paid on February 4, 2015.

Operating Activities. We used \$3.4 million in cash for operating activities in 2014. In 2014, we made investments in portfolio companies of \$0.8 million and paid fees to our professional advisers, directors, banks and others of \$2.5 million, while realizing a gain of \$0.7 million from the disposition of portfolio securities. During 2014, we incurred non-recurring expenses including settlement expenses of \$0.5 million and legal expenses of \$0.1 million related to the various legal proceedings described in Item 3.

Financing Activities. We used \$1.0 thousand in cash from financing activities for 2014. We did not declare any dividends in 2014.

Table of Contents

Results of Operations

Investment Income and Expense

Year Ended December 31, 2016 as compared to Year Ended December 31, 2015

Total income from portfolio securities increased \$0.3 million in 2016 due to the increase in interest-bearing investments.

Professional fees increased to \$1.2 million during 2016 from \$0.6 million during 2015. These increases were principally due to increases in consulting and legal fees associated with our Plan of Reorganization and due diligence and other activities incidental to a potential Consolidation as described in the Plan.

Compensation expense decreased to \$1.1 million from \$1.3 million in 2016 primarily due to officer bonuses earned during 2015.

General and administrative expenses were comparable from 2015 to 2016, and were \$0.3 million and \$0.4 million respectively.

As a result of the factors described above, net investment loss after expenses was \$2.5 million for 2016 as compared to a net investment loss of \$2.4 million in 2015.

Year Ended December 31, 2015 as compared to Year Ended December 31, 2014

Total income from portfolio securities decreased \$0.5 million in 2015 due to the decrease in interest-bearing investments resulting from the sale of our interests in Spectrum Management, LLC ("Spectrum") and Orco Property Group, S. A. ("OPG") in January 2015 and February 2015, respectively.

Professional fees decreased to \$0.6 million during 2015 from \$1.1 million during 2014. These decreases were due to the absence of legal proceedings in 2015 as compared to 2014 which required the services of various law firms and consultants during the year.

Compensation expense was increased to \$1.3 million from \$0.9 million in 2014 during 2015 primarily due to officer and employee bonuses earned during 2015. Based on our management's review of the Fund's operations during 2014 and, in view of formal and informal criteria used to determine staff bonuses, no officer or employee bonuses were earned or paid during 2014.

General and administrative expenses were comparable from 2014 to 2015, and were \$0.3 million in each of these years.

There were no settlement expenses in 2015 as compared to the \$0.5 million in settlement expenses for 2014 related to certain legal proceedings.

As a result of the factors described above, net investment loss after expenses was relatively unchanged at \$2.4 million for both 2015 and 2014.

Summary of Portfolio Investment Activity

Year Ended December 31, 2016

During the year ended December 31, 2016, we had investment activity of \$2.4 million in three portfolio companies. We invested \$2.0 million in Biogenic Reagents, LLC ("Biogenic") in the form of a senior secured promissory note, bearing cash and PIK interest at the combined rate of 16% per annum. During 2016, we received \$0.04 million in semi-annual interest and \$13 thousand in PIK'd interest in respect of this note. During 2016, we received 22,863 shares of MVC in the form of stock dividend payments. We received \$50 thousand in PIK'd interest in respect to our loan to 5TH Element Tracking, LLC ("5TH Element").

Table of Contents

The following table includes significant investment activity during the year ended December 31, 2016 (in thousands):

	Investment Activity		Existing Investments	PIK	Total
	New Investments				
Portfolio Company	Cash	Non-Cash	Follow-On		
Biogenic Reagents, LLC	\$2,000	\$—	\$—	\$13	\$2,013
MVC Capital, Inc.	—	—	—	313	313
5 TH Element Tracking, LLC	—	—	—	50	50
	\$2,000	\$—	\$—	\$376	\$2,376

Year Ended December 31, 2015

During the year ended December 31, 2015, we received a one-year subordinated note from 5TH Element in the original principal amount of \$0.9 million, bearing interest at the rate of 14% per annum in connection with the sale of our interest in Spectrum. We also received 23,694 shares of MVC in the form of dividend payments.

The following table includes significant investment activity during the year ended December 31, 2015 (in thousands):

	Investment Activity		Existing Investments	PIK	Total
	New Investments				
Portfolio Company	Cash	Non-Cash	Follow-On		
MVC Capital, Inc.	\$—	\$ —	\$ —	\$ 222	\$222
5 TH Element Tracking, LLC	—	915	—	—	915
	\$—	\$ 915	\$ —	\$ 222	\$1,137

Year Ended December 31, 2014

During the year ended December 31, 2014, we capitalized legal and consulting expenses of \$0.3 million relating to Spectrum. We also received a semi-annual interest payment of \$0.04 million in cash and \$0.2 million in the form of PIK'd interest in respect of our €1.2 million [\$1.5 million] in OPG notes. On May 14, 2014, we sold to MVC 2,112,000 newly-issued shares of our common stock in exchange for 395,839 shares of MVC (see “*Significant Events—Plan of Reorganization*” above). During the year ended December 31, 2014, we also received 9,129 shares of MVC in the form of dividend payments.

The following table includes significant investment activity during the year ended December 31, 2014 (in thousands):

Portfolio Company	Investment Activity				Total
	New Investments		Existing Investments		
	Cash	Non-Cash	Follow-On	OK	
MVC Capital, Inc.	\$524	\$ 5,075	\$—	\$ 107	\$5,706
Orco Property Group, S. A.	—	—	—	171	171
Spectrum Management, LLC	—	—	269	—	269
	\$524	\$ 5,075	\$269	\$278	\$6,146

Realized Gains and Losses on Sales of Portfolio Securities

Year Ended December 31, 2016

During 2016, we realized capital losses of \$13 thousand as a result of disposition of temporary cash investments.

Year Ended December 31, 2015

During 2015, we realized capital losses of \$2.5 million, including the following significant transactions:

Portfolio Company	Industry	Type	Transaction Type	Realized Gain (Loss)
Spectrum Management, LLC	Business products and services	Control	Disposition	\$(2,850)
Orco Property Group S. A.	Real estate	Non-affiliate	Disposition	372
Various others			Disposition	(5)
				\$(2,483)

Table of Contents***Year Ended December 31, 2014***

During 2014, we realized capital gains of \$0.7 million, including the following significant transactions:

Portfolio Company	Industry	Type	Transaction Type	Realized Gain (Loss)
Orco Property Group S. A.	Real estate	Non-affiliate	Disposition	\$ (63)
MVC Capital, Inc.	Financial services	Non-affiliate	Share exchange	724
Various others			Disposition	(1)
				\$ 660

Changes in Unrealized Appreciation/Depreciation of Portfolio Securities***Year Ended December 31, 2016***

During 2016, we recorded an increase of \$7.9 million in net unrealized appreciation, from \$2.4 million at December 31, 2015 to \$10.3 million at December 31, 2016, in our portfolio securities. Such increase resulted primarily from the following changes:

- (i) Increase in the fair value of our shareholding in MVC of \$0.5 million due to an increase in the MVC share price during 2016 and the receipt of dividend payments in the form of additional shares of MVC;
- (ii) Increase in fair value of our shareholding in PalletOne, Inc. ("PalletOne") of \$6.6 million due to continued strong revenue and earnings growth, as well as an overall improvement in comparable industry sectors; and
- (iii) Increase in the fair value of our holdings in Equus Energy of \$0.8 million, principally due to an increase in comparable transactions for mineral leases, a combination of increased production, and a continued increase in short- and long-term prices for crude oil and natural gas.

Year Ended December 31, 2015

Edgar Filing: EQUUS TOTAL RETURN, INC. - Form 10-K

During 2015, we recorded a net decrease in unrealized depreciation of \$5.9 million, to arrive at a net unrealized appreciation of our portfolio securities of \$2.4 million, resulting principally from the following:

- (i) Decrease in the fair value of our holdings in Equus Energy of \$4.3 million, principally due to a combination of production without a corresponding increases in proved reserves and declining short- and long-term prices for crude oil and natural gas;
- (ii) Decrease in the fair value of our shareholding in MVC of \$0.8 million due to a decrease in the MVC share price during the period, which was partially offset by \$0.2 million in dividends received in the form of additional MVC shares and \$0.2 million in purchase price adjustment;
- (iii) Increase in fair value of our shareholding in PalletOne of \$8.6 million due to an overall improvement in the industry sector for packaging companies, as well as continued revenue and earnings growth for the company;
- (iv) Transfer of unrealized depreciation to realized gain on our holding of OPG Notes of \$0.4 million in connection with the sale of our interest in the OPG Notes; and
- (v) Transfer of unrealized depreciation to realized loss on our holdings in Spectrum of \$2.9 million in connection with the sale of our interest in Spectrum.

Table of Contents

Year Ended December 31, 2014

During 2014, we recorded a net decrease in unrealized depreciation of \$0.4 million, to arrive at a net unrealized depreciation of \$3.6 million as of December 31, 2014. Such change in depreciation resulted primarily from the following changes:

- (i) Increase in fair value of our holding in Equus Energy of \$1.8 million due to an increase in comparable transactions for mineral leases, increased oil and gas production, as well as additional proved developed producing and proved developed producing behind-pipe reserves from new drilling and recompletion activities;
- (ii) Decrease in fair value of Equus Media Development Company, LLC of \$0.1 million due to a net operating loss for the period equal to the amount of the decrease;
- (iii) Decrease in fair value of MVC of \$1.7 million due to the decline in the stock price of MVC, which was partially offset by \$0.1 million in dividends received in the form of additional MVC shares;
- (iv) Decrease in fair value of our holding of OPG Notes of \$0.1 million due to adverse changes in the USD-EUR exchange rate; and
- (v) Increase in fair value of our shareholding in PalletOne of \$0.7 million due to an improvement in the industry sector for packaging companies and continued revenue and earnings growth.

Portfolio Securities

As of December 31, 2016, we had active investments in the following entities or portfolio companies:

5TH Element Tracking, LLC

5TH Element is a technology holding company based outside of Boston, Massachusetts. On January 6, 2015, in connection with the sale of the Fund's interest in Spectrum to 5TH Element, we received a subordinated note in the original principal amount of \$0.9 million maturing March 31, 2017 and bearing interest at the rate of 14% per annum. As of December 31, 2016, we valued the promissory note at its original investment amount of \$0.9 million plus certain PIK interest, as accrued.

Biogenic Reagents, LLC

Biogenic was organized as a developer and producer of high value carbon products from renewable biomass, headquartered in Minneapolis. The company developed and partially commercialized a low-cost platform technology to make carbon products such as activated carbon for use in purification of air, water, food and pharmaceuticals and agricultural carbon to improve crop production. On January 29, 2016, we invested \$2.0 million in Biogenic in the form of a senior secured promissory note bearing cash and PIK interest at the combined rate of 16% per annum. Although this note is presently in default, we hold a senior security interest in the assets of Biogenic which have been appraised at an amount that is considerably in excess of the face amount of the note. As of December 31, 2016, we valued the promissory note at its original investment amount of \$2.0 million, plus PIK interest accrued in the amount of \$13 thousand.

Equus Energy, LLC

We formed Equus Energy, as a wholly-owned subsidiary of the Fund, to make investments in companies in the energy sector, with particular emphasis on income-producing oil & gas properties. In December 2011, we contributed \$250,000 to the capital of Equus Energy. On December 27, 2012, we invested an additional \$6.8 million in Equus Energy for the purpose of additional working capital and to fund the purchase of \$6.6 million in working interests presently represented by 111 producing and non-producing oil and gas wells, including associated development rights of approximately 20,900 acres situated on 12 separate properties in Texas and Oklahoma. The working interests range from a *de minimus* amount to 50% of the leasehold production of these wells. The wells are operated by a number of experienced operators such as Apache, Chesapeake, and Chevron, which has operating responsibility for leasehold interests in the Conger Field, representing approximately one-third of the producing well interests. The assets were purchased from Warren American Oil Company, LLC, a Tulsa-based oil and gas firm. During the fourth quarter of 2016, Equus Energy sold a small working interest it held in the Permian Basin in west Texas for an aggregate selling price of \$250,000, or approximately \$12,500 per acre. Due to forward commodity price increases and increased acreage values, particularly in respect of Equus Energy's other holdings in the Permian Basin, the fair value of this holding increased to approximately \$6.3 million at December 31, 2016 from \$5.5 million at December 31, 2015.

Table of Contents

Equus Media Development Company, LLC

Equus Media Development Company, LLC (“EMDC”) is a company engaged in the acquisition and development of creative properties with the purpose of developing the properties for release in various entertainment mediums. We formed EMDC in 2007 as a wholly-owned subsidiary of the Fund in connection with a management and development agreement with Kopelson Entertainment (“KE”).

The concept of the business of EMDC is to partner with creators, developers and producers of creative work, such as scripts, short stories or books, by providing capital necessary to enhance the creative development and package the assets to companies, such as major and independent studios, to produce and release. In December 2011, our agreement with KE expired and EMDC distributed \$1 million to the Fund. As of December 31, 2016, we valued EMDC at \$0.2 million, which was unchanged from December 31, 2015.

MVC Capital, Inc.

MVC is a BDC traded on the NYSE that provides long-term debt and equity investment capital to fund growth, acquisitions and recapitalizations of companies in a variety of industries. On May 14, 2014, as part of our Plan of Reorganization, we sold to MVC 2,112,000 newly-issued shares of the Fund’s common stock in exchange for 395,839 shares of MVC (see “*Significant Events—Plan of Reorganization*” above). During 2016, we received 22,863 additional shares in the form of dividend payments. As of December 31, 2016, we valued our 468,608 MVC shares at \$4.0 million, an increase from \$3.2 million at December 31, 2015. The value of our MVC shares was based on MVC’s closing trading price on the NYSE as of such dates.

PalletOne, Inc.

PalletOne is considered one of the largest wooden pallet manufacturer in the United States, operating 19 facilities in 11 states, with approximately 1,400 employees. The company manufactures and recycles a variety of pallet types and pressure-treated lumber. The company also sells its byproducts of mulch and scrap metal. PalletOne also owns and operates three wood treating plants. PalletOne has a diverse customer base and competes with numerous other manufacturers on a regional basis. Its largest pallet customers are agricultural and construction related companies including growers, grocery stores, and housing construction companies, and home-improvement chains. We believe PalletOne’s numerous locations allows for a slight advantage in pursuing large corporate accounts, as sales of pallets and pressure-treated wood are typically regionalized to specific locations. The pallet manufacturing industry is mature and is experiencing continuing slow growth as the number of participants shrinks due to consolidation and underutilized plants, which have been eliminated. However, demand continues to increase for pressure-treated lumber for residential fencing and decking which has been the principal contributor to the increases in PalletOne’s revenue.

We initially invested in PalletOne in October 2001. Our investment in PalletOne presently consists of 350,000 shares of common stock, which represents a fully-diluted equity interest of 18.7%. Due to substantially improved operating performance, we valued our interest in PalletOne as of December 31, 2016 as of \$16.2 million, an increase from \$9.6 million from December 31, 2015.

Off Balance Sheet Arrangements

We had an operating lease for office space that expired in September 2014. Our current office space lease as of December 31, 2016 is month-to-month. Rent expense under the operating lease agreement, inclusive of common area maintenance costs, was \$61,000 for the year ended December 31, 2014.

Contractual Obligations

As of December 31, 2016, we had no outstanding commitments to our portfolio company investments.

Dividends

We will continue to pay out net investment income and/or realized capital gains, if any, on an annual basis as required under the 1940 Act.

Subsequent Events

Our Management performed an evaluation of the Fund's activity through the date the financial statements were issued, noting the following subsequent events:

On January 3, 2017, we sold U. S. Treasury Bills for \$30.0 million and repaid our year-end margin loan.

Table of Contents

On January 6, 2017, holders of a majority of the outstanding common stock of the Fund approved our cessation as a BDC under the 1940 Act and authorized our Board to cause the Fund's withdrawal of its election to be classified as a BDC, each effective as of a date designated by the Board and our Chief Executive Officer, but in no event later than July 31, 2017. The authorization given to our Board is a consequence of the Plan of Reorganization described above. Notwithstanding this authorization to withdraw our BDC election, we will not submit any such withdrawal unless and until Equus has entered into a definitive agreement to effect a Consolidation. Further, although our shareholders have authorized us to withdraw our election as a BDC, we will require a subsequent affirmative vote from holders of a majority of our outstanding voting shares to enter into any such definitive agreement or change the nature of our business. See "*Significant Developments – Plan of Reorganization and Share Exchange with MVC Capital*" above.

Item 7A. *Quantitative and Qualitative Disclosures About Market Risk*

We are subject to financial market risks, including changes in interest rates with respect to investments in debt securities and outstanding debt payable, as well as changes in marketable equity security prices. In the future, we may invest in companies outside the United States, including in Europe and Asia, which would give rise to exposure to foreign currency value fluctuations. We do not use derivative financial instruments to mitigate any of these risks. The return on investments is generally not affected by foreign currency fluctuations.

Our investments in portfolio securities consist of some fixed-rate debt securities. Since the debt securities are generally priced at a fixed rate, changes in interest rates do not directly affect interest income. In addition, changes in market interest rates are not typically a significant factor in the determination of fair value of these debt securities, since the securities are generally held to maturity. We determine their fair values based on the terms of the relevant debt security and the financial condition of the issuer.

A major portion of our investment portfolio consists of debt and equity investments in private companies. Modest changes in public market equity prices generally do not significantly impact the estimated fair value of these investments. However, significant changes in market equity prices can have a longer-term effect on valuations of private companies, which could affect the carrying value and the amount and timing of gains or losses realized on these investments. A small portion of the investment portfolio also consists of common stocks in publicly traded companies. These investments are directly exposed to equity price risk, in that a hypothetical ten percent change in these equity prices would result in a similar percentage change in the fair value of these securities.

We are classified as a "non-diversified" investment company under the 1940 Act, which means we are not limited in the proportion of our assets that may be invested in the securities of a single user. The value of one segment called "Shipping products and services" includes one portfolio company and was 37.9% of our net asset value, 22.1% of our total assets and 54.6% of our investments in portfolio company securities (at fair value) as of December 31, 2016. The value of one segment called "Energy" includes one portfolio company and was 14.6% of our net asset value, 8.5% of our total assets and 21.1% of our investments in portfolio company securities (at fair value) as of December 31, 2016.

Changes in business or industry trends or in the financial condition, results of operations, or the market's assessment of any single portfolio company will affect the net asset value and the market price of our common stock to a greater extent than would be the case if we were a "diversified" company holding numerous investments.

Table of Contents

Item 8. Financial Statements and Supplementary Data

Report of Independent Registered Public Accounting Firm

To the Board of Directors and

Stockholders of Equus Total Return, Inc.:

We have audited the accompanying balance sheets of Equus Total Return, Inc. (a Delaware corporation) (the “Fund”), including the schedule of investments, as of December 31, 2016 and 2015 and the related statements of operations, changes in net assets and cash flows for the years ended December 31, 2016, 2015 and 2014 and the selected per share data and ratios for the years ended December 31, 2016, 2015 and 2014. These financial statements and selected per share data and ratios are the responsibility of the management of the Fund. Our responsibility is to express an opinion on these financial statements and selected per share data and ratios based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements and selected per share data and ratios are free of material misstatement. The Fund is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Fund’s internal control over financial reporting. Accordingly, we express no opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements and selected per share data and ratios. Our procedures included verification by examination or confirmation of securities held by the custodian as of December 31, 2016 and 2015, or by other appropriate auditing procedures where replies were not received. An audit also includes 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 financial statements and selected per share data and ratios referred to above present fairly, in all material respects, the financial position of Equus Total Return, Inc. as of December 31, 2016 and 2015 and the results of its operations and its cash flows for the years ended December 31, 2016, 2015 and 2014 and the selected per share data and ratios for the years ended December 31, 2016, 2015 and 2014 in conformity with accounting principles generally accepted in the United States of America.

/s/ BDO USA, LLP

Houston, TX

March, 13, 2017

Table of Contents

Report of Independent Registered Public Accounting Firm

To the Board of Directors and

Stockholders of Equus Total Return, Inc.:

We have audited the accompanying selected per share data and ratios of Equus Total Return, Inc. (a Delaware corporation) (the "Fund") for each of the two years in the period ended December 31, 2013. These selected per share data and ratios are the responsibility of the management of the Fund. Our responsibility is to express an opinion on these selected per share data and ratios based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the selected per share data and ratios are free of material misstatement. The Fund is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the selected per share data and ratios. An audit also iadding-right:2px;">

2015

First quarter (through February 20, 2015)

\$
22.43

\$
17.96

2014

Fourth quarter

\$

20.16

\$

17.10

Third quarter

20.66

17.71

Second quarter

21.25

18.25

First quarter

20.03

17.27

2013

Fourth quarter

\$

21.04

\$

14.39

Third quarter

16.35

14.12

Second quarter

16.36

13.77

First quarter

16.82

12.27

As of February 20, 2015, there were: (1) approximately 504 shareholders of record of our Voting Common Stock and one shareholder of record of our Class B Non-Voting Common Stock; and (2) 25,685,524 outstanding shares of our Voting Common Stock and 1,121,730 outstanding shares of our Class B Non-Voting Common Stock.

Dividends on Voting Common Stock

Neither Customers Bancorp nor Customers Bank (prior to the reorganization into a Bank Holding Company structure), historically has paid any cash dividends on its shares of common stock. Customers Bancorp does not expect to do so in the foreseeable future and Customers Bank may begin payment of dividends to the parent in 2015. Any future determination relating to dividend policy will be made at the discretion of Customers Bancorp's board of directors and will depend on a number of factors, including earnings and financial condition, liquidity and capital requirements, the general economic and regulatory climate, ability to service any equity or debt obligations senior to the Voting Common Stock, and other factors deemed relevant by the board of directors.

In addition, as a bank holding company, Customers Bancorp is subject to general regulatory restrictions on the payment of cash dividends. Federal bank regulatory agencies have the authority to prohibit bank holding companies from engaging in unsafe or unsound practices in conducting their business, which depending on the financial condition and liquidity of the holding company at the time, could include the payment of dividends. Further, various federal and state statutory provisions limit the amount of dividends that bank subsidiaries can pay to their parent holding company without regulatory approval. Generally, subsidiaries are prohibited from paying dividends when doing so would cause them to fall below the regulatory minimum capital levels, and limits exist on paying dividends in excess of net income for specified periods.

Beginning January 1, 2015, the ability to pay dividends and the amounts that can be paid, will be limited to the extent the bank capital ratios do not exceed the minimum required levels plus 250 basis points, as these requirements are phased in through January 1, 2019. See "Item 1, Business- Federal Banking Laws" for more information relating to restrictions on the Bank's ability to pay dividends to the Company and the Company's payment of dividends.

40

Table of Contents

Issuer Purchases of Equity Securities

On November 26, 2013, the Bancorp's Board of Directors authorized a stock repurchase plan in which the Bancorp could acquire up to 5% of its current outstanding shares at prices not to exceed a 20% premium over the then current book value. The repurchase program has no expiration date but may be suspended, modified or discontinued at any time, and the Bancorp has no obligation to repurchase any amount of its common stock under the program. There were no common stock repurchases during 2014.

EQUITY COMPENSATION PLANS

The following table provides certain summary information as of December 31, 2014 concerning our compensation plans (including individual compensation arrangements) under which shares of our common stock may be issued.

Plan Category	Number of Securities to be Issued upon Exercise of Outstanding Options, Warrants, and Rights (#)	Weighted-Average Exercise Price of Outstanding Options (\$ (2)	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in the First Column) (#)
Equity Compensation Plans Approved by Security Holders (1)	3,957,038	12.61	3,605,394 (3)

Equity Compensation Plans Not

Approved by Security Holders N/A N/A N/A

(1) Includes shares of common stock that may be issued upon the exercise of awards granted or rights accrued under the Amended and Restated Customers Bancorp, Inc. 2004 Incentive Equity and Deferred Compensation Plan, the Customers Bancorp, Inc. 2010 Stock Option Plan, the Bonus Recognition and Retention Program ("BRRP"), and the Customers Bancorp, Inc. Amended and Restated 2014 Employee Stock Purchase Plan.

(2) Does not include restricted stock units and stock awards for which, by definition, there exists no exercise price.

(3) Does not include securities available for future issuance under the BRRP as there is no specific number of shares reserved under this plan. By its terms, the plan limits the award of restricted stock units to the amount of the cash bonuses paid to the participants in the BRRP.

Common Stock Performance Graph

The following graph compares the performance of our common stock over the period from December 31, 2012 to December 31, 2014, to that of the total return index for the SNL Mid-Atlantic Bank Index, SNL U.S. Bank NASDAQ Index and SNL U.S. Bank NYSE Index, assuming an investment of \$100 on December 31, 2012. The SNL U.S. Bank NYSE Index was added to the performance graph because the Bancorp changed the listing of its Voting Common Stock to the NYSE from NASDAQ in December 2014. In calculating total annual shareholder return, reinvestment of dividends, if any, is assumed. Customers Bancorp obtained the information contained in the performance graph from SNL Financial.

Table of Contents

The graph below is furnished under this Part II, Item 5 of this Form 10-K and shall not be deemed to be “soliciting material” or to be “filed” with the Commission or subject to Regulation 14A or 14C, or to the liabilities of Section 18 of the Exchange Act of 1934, as amended.

Total Return Performance

Table of Contents

Item 6. Selected Financial Data

Customers Bancorp, Inc. and Subsidiaries

The following table presents Customers Bancorp's summary consolidated financial data. Customers Bancorp derived the balance sheet and income statement data for the years ended December 31, 2014, 2013, 2012, 2011, and 2010 from its audited financial statements. The summary consolidated financial data should be read in conjunction with, and is qualified in their entirety by, Customers Bancorp's financial statements and the accompanying notes and the other information included elsewhere in this Annual Report on Form 10-K. Certain amounts reported in this table have been reclassified to conform to the 2014 presentation. These reclassifications did not significantly impact the Bancorp's financial position or results of operations.

	2014	2013	2012	2011 (1)	2010 (2)
	(dollars in thousands, except per share information)				
For the Year ended December 31,					
Interest income	\$190,427	\$128,156	\$93,814	\$61,245	\$30,907
Interest expense	38,504	24,301	21,761	22,464	11,546
Net interest income	151,923	103,855	72,053	38,781	19,361
Provision for loan losses	14,747	2,236	14,270	7,495	10,397
Bargain purchase gains on acquisitions	—	—	—	—	40,254
Total non-interest income, excluding bargain purchase gains	25,126	22,703	28,958	11,469	5,416
Total non-interest expense	98,914	74,024	50,651	36,886	26,168
Income before taxes	63,388	50,298	36,090	5,869	28,466
Income tax expense	20,174	17,604	12,272	1,835	4,731
Net income	43,214	32,694	23,818	4,034	23,735
Net income attributable to common shareholders	43,214	32,694	23,818	3,990	23,735
Basic earnings per common share (3) (9)	1.62	1.34	1.61	0.36	3.44
Diluted earnings per common share (3) (9)	1.55	1.30	1.57	0.35	3.35
At Period End					
Total assets	\$6,825,370	\$4,153,173	\$3,201,234	\$2,077,532	\$1,374,407
Cash and cash equivalents	371,023	233,068	186,016	73,570	238,724
Investment securities (4)	416,685	497,573	129,093	398,684	205,828
Loans held for sale (6)	1,435,459	747,593	1,439,889	174,999	199,970
Loans receivable not covered by Loss Sharing Agreements with the FDIC (5)	4,269,480	2,399,265	1,216,941	1,215,117	514,087
Allowance for loan losses	30,932	23,998	25,837	15,032	15,129
Loans receivable covered by Loss Sharing Agreements with the FDIC (5)	42,181	66,725	107,526	126,276	164,885
FDIC loss sharing receivable (5)	2,320	10,046	12,343	13,077	16,702
Deposits	4,532,538	2,959,922	2,440,818	1,583,189	1,245,690
Borrowings	1,816,250	771,750	471,000	331,000	11,000
Shareholders' equity	443,145	386,623	269,475	147,748	105,140
Tangible common equity (8)	439,481	382,947	265,786	144,043	105,140
Selected Ratios and Share Data					

Edgar Filing: EQUUS TOTAL RETURN, INC. - Form 10-K

Return on average assets	0.78	% 0.95	% 1.02	% 0.24	% 3.40	%
Return on average equity	10.39	% 9.49	% 12.69	% 3.06	% 41.29	%
Book value per share (3) (9)	\$16.57	\$14.51	\$13.27	\$11.84	\$11.38	
Tangible book value per common share (3) (8) (9)	\$16.43	\$14.37	\$13.09	\$11.54	\$11.38	
Common shares outstanding (3) (9)	26,745,529	26,646,566	20,305,452	12,482,451	9,237,815	

43

Table of Contents

Net interest margin	2.86	% 3.13	% 3.21	% 2.47	% 2.76	%
Equity to assets	6.49	% 9.31	% 8.42	% 7.11	% 7.65	%
Tangible common equity to tangible assets (8) (9)	6.44	% 9.23	% 8.31	% 6.95	% 7.65	%
Tier 1 leverage ratio – Customers Bank	7.39	% 10.81	% 7.74	% 7.11	% 8.67	%
Tier 1 leverage ratio – Customers Bancorp	6.69	% 10.11	% 9.30	% 7.37	% n/a	
Tier 1 risk-based capital ratio – Customers Bank	9.27	% 13.33	% 8.50	% 9.66	% 19.65	%
Tier 1 risk-based capital ratio – Customers Bancorp	8.39	% 12.44	% 10.23	% 10.01	% n/a	
Total risk-based capital ratio – Customers Bank	11.98	% 14.11	% 9.53	% 10.78	% 21.14	%
Total risk-based capital ratio – Customers Bancorp	11.09	% 13.21	% 11.26	% 11.13	% n/a	
Asset Quality – Non-covered Assets (5)						
Non-performing loans	\$7,487	\$13,513	\$22,347	\$29,633	\$22,242	
Non-performing loans to total non-covered loans	0.18	% 0.56	% 1.84	% 2.44	% 4.33	%
Other real estate owned	\$5,926	\$5,312	\$4,005	\$7,316	\$1,906	
Non-performing assets	13,413	18,825	26,352	36,949	24,148	
Non-performing non-covered assets to total non-covered assets	0.31	% 0.78	% 2.16	% 3.02	% 4.68	%
Allowance for loan losses to total non-covered loans (7)	0.67	% 0.62	% 1.20	% 1.24	% 2.94	%
Allowance for loan losses to non-performing non-covered loans (7)	382.80	% 109.16	% 65.26	% 50.73	% 68.02	%
Net charge-offs	\$3,124	\$6,894	\$5,466	\$9,547	\$5,250	
Net charge-offs to average non-covered loans	0.09	% 0.38	% 0.45	% 1.10	% 1.41	%
Asset Quality – Covered Assets (5)						
Non-performing loans	\$4,246	\$5,650	\$10,504	\$6,993	\$8,084	
Non-performing loans to total covered loans	10.07	% 8.47	% 22.69	% 16.72	% 9.18	%
Other real estate owned	\$9,445	\$6,953	\$4,109	\$6,166	\$5,342	
Non-performing assets	13,691	12,603	14,613	13,159	13,426	
Non-performing assets to total covered assets	26.52	% 17.11	% 13.09	% 9.94	% 7.89	%

On September 17, 2011, Customers Bancorp completed its acquisition of Berkshire Bancorp, Inc. using the (1) purchase accounting method in accounting for the acquisition. The purchase method provides that all transactions after the acquisition date are reflected in the acquirers' financial accounting records.

(2) During the third quarter of 2010, Customers Bancorp acquired two banks in FDIC assisted transactions using the purchase accounting method.

Effective September 17, 2011, Customers Bank reorganized into the holding company structure pursuant to which all of the issued and outstanding common stock of the Bank was exchanged on a one-for-three basis for common (3) stock of Customers Bancorp. All share and per share information for periods prior to the reorganization has been restated retrospectively to reflect the reorganization.

(4) Includes available-for-sale and held-to-maturity investment securities.

(5) Certain loans and other real estate owned (described as “covered”) acquired in the two FDIC assisted transactions in 2010 are subject to loss sharing agreements between Customers Bank and the FDIC. If certain provisions within the loss sharing agreements are maintained, the FDIC will reimburse Customers Bank for 80% of the unpaid principal balances and certain expenses. A loss sharing receivable was recorded based upon the credit evaluation of the acquired loan portfolio and the estimated periods for repayments. Loans receivable and assets that are not subject to the loss sharing agreement are described as “non-covered”.

Table of Contents

(6) In 2014 and 2013, loans held for sale included \$1,332,019 and \$740,694 of mortgage warehouse loans at fair value, respectively.

(7) Allowance for loan losses used for this calculation excludes the portion related to purchased-credit-impaired ("PCI") loans of \$7.0 million in 2014 and \$9.2 million in 2013.

Customers Bancorp's selected financial data contains non-GAAP financial measures calculated using non-GAAP amounts. These measures include tangible common equity and tangible book value per common share and tangible common equity to tangible assets. Management uses these non-GAAP measures to present historical periods comparable to the current period presentation. In addition, management believes the use of these non-GAAP measures provides additional clarity when assessing the Bancorp's financial results and use of equity. These disclosures should not be viewed as substitutes for results determined to be in accordance with U.S. GAAP, nor are they necessarily comparable to non-GAAP performance measures that may be presented by other entities.

(8) Customers Bancorp calculates tangible common equity by excluding intangible assets from total shareholders' equity. Tangible book value per common share equals tangible common equity divided by common shares outstanding.

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

A reconciliation of shareholders' equity to tangible common equity and other related amounts is set forth below.

	2014	2013	2012	2011	2010
	(in thousands, except per share data)				
Shareholders' equity	\$443,145	\$386,623	\$269,475	\$147,748	\$105,140
Less: intangible assets	(3,664)	(3,676)	(3,689)	(3,705)	—
Tangible common equity	\$439,481	\$382,947	\$265,786	\$144,043	\$105,140
Shares outstanding	26,746	26,647	20,305	12,482	9,238
Book value per share	\$16.57	\$14.51	\$13.27	\$11.84	\$11.38
Less: effect of excluding intangible assets	(0.14)	(0.14)	(0.18)	(0.30)	—
Tangible book value per share	\$16.43	\$14.37	\$13.09	\$11.54	\$11.38
Total assets	\$6,825,370	\$4,153,173	\$3,201,234	\$2,077,532	\$1,374,407
Less: intangible assets	(3,664)	(3,676)	(3,689)	(3,705)	—
Total tangible assets	\$6,821,706	\$4,149,497	\$3,197,545	\$2,073,827	\$1,374,407
Equity to assets	6.49 %	9.31 %	8.42 %	7.11 %	7.65 %
Less: effect of excluding intangible assets	(0.05)	(0.08)	(0.11)	(0.16)	—
Tangible common equity to tangible assets	6.44 %	9.23 %	8.31 %	6.95 %	7.65 %

Table of Contents

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

You should read this Management's Discussion and Analysis in conjunction with "Business – Executive Summary" and the Bancorp's consolidated financial statements and related notes for the year ended December 31, 2014. Certain amounts reported in the 2013 and 2012 financial statements have been reclassified to conform to the 2014 presentation. These reclassifications did not significantly impact the Bancorp's financial position or results of operations.

Critical Accounting Policies

Customers Bancorp has adopted various accounting policies that govern the application of accounting principles generally accepted in the United States of America (US GAAP) and that are consistent with general practices within the banking industry in the preparation of its financial statements. The Bancorp's significant accounting policies are described in "NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES AND BASIS OF PRESENTATION" to its audited financial statements.

Certain accounting policies involve significant judgments and assumptions by Customers Bancorp that have a material impact on the carrying value of certain assets and liabilities. Customers Bancorp considers these accounting policies to be critical accounting policies. The judgment and assumptions used are based on historical experience and other factors, which are believed to be reasonable under the circumstances. Because of the nature of the judgments and assumptions management makes, actual results could differ from these judgments and estimates, which could have a material impact on the carrying values of the Bancorp's assets and liabilities and results of operations.

The following is a summary of the policies Customers Bancorp recognizes as involving critical accounting estimates: Allowance for Loan Losses, Stock-Based Compensation, Unrealized Gains and Losses on Available for Sale Securities, Fair Value Accounting, Accounting for Purchased-Credit-Impaired (PCI) Loans, FDIC Receivable for Loss Share Agreements, and Deferred Income Taxes.

Allowance for Loan Losses. Customers Bancorp maintains an allowance for loan losses at a level management believes is sufficient to absorb estimated credit losses incurred as of the report date. Management's determination of the adequacy of the allowance is based on periodic evaluations of the loan portfolio and other relevant factors. However, this evaluation is inherently subjective as it requires significant estimates by management. Consideration is given to a variety of factors in establishing these estimates including historical losses, current and anticipated economic conditions, the size and composition of the loan portfolio, delinquency statistics, criticized and classified assets and impaired loans, results of internal loan reviews, borrowers' perceived financial and management strengths, the adequacy of underlying collateral, the dependence on collateral, or the strength of the present value of future cash flows and other relevant factors. These factors may be susceptible to significant change. To the extent actual outcomes differ from management estimates, additional provisions for loan losses may be required which may adversely affect the Bancorp's results of operations in the future.

Estimates of cash flows expected to be collected for purchased-credit-impaired loans are updated each reporting period. If the Bank has probable decreases in expected cash flows to be collected after acquisition, the Bank charges the provision for loan losses and establishes an allowance for loan losses.

Stock-Based Compensation. Customers Bancorp recognizes compensation expense for share-based awards in accordance with ASC 718 Compensation – Stock Compensation. Expense related to stock option awards is based on the fair value of the option at the grant date, with compensation expense recognized over the service period, which is usually the vesting period. Customers Bancorp utilizes the Black-Scholes option-pricing model to estimate the fair value of each option on the date of grant. The Black-Scholes model takes into consideration the exercise price of the option, the expected life of the option, the current price of the underlying stock and its expected volatility, expected dividends on our stock, and the current risk-free interest rate for the expected life of the option. The Bancorp's estimate of the fair value of a stock option is based on expectations derived from its limited historical experience and may not necessarily equate to market value when fully vested.

Unrealized Gains and Losses on Securities Available for Sale. Customers Bancorp receives estimated fair values of debt securities from independent valuation services and brokers. In developing these fair values, the valuation services and brokers use estimates of cash flows based on historical performance of similar instruments in similar rate environments. Debt securities available for sale are mostly comprised of mortgage backed securities and U.S.

government agency securities. Customers Bancorp uses various indicators in determining whether a security is other-than-temporarily impaired including, for debt securities, when it is probable that the contractual interest and principal will not be collected, or for equity securities, whether the market value is below its cost for an extended period of time with low expectation of recovery. The debt securities are monitored for changes in credit ratings because adverse changes in credit ratings could indicate a change in the estimated cash flows of the underlying collateral or issuer. The unrealized losses associated with securities that management does not intend to

Table of Contents

sell, and more likely than not will not be required to sell prior to maturity or market price recovery, were not considered to be other-than-temporarily impaired as of December 31, 2014 and December 31, 2013, because the unrealized losses were related to changes in interest rates and did not affect the expected cash flows of the underlying collateral or issuer. The unrealized losses associated with the equity investments that management does not intend to sell, and more likely than not will not be required to sell, were not considered other-than-temporarily impaired as of December 31, 2014 or 2013 because the decrease in market price or foreign currency exchange rates was estimated to be temporary.

Fair Value. The fair value of a financial instrument is defined as the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Management estimates the fair value of a financial instrument using a variety of valuation methods. Where financial instruments are actively traded and have quoted market prices, the quoted market prices are used for fair value. When the financial instruments are not actively traded, other observable market inputs, such as quoted prices of securities with similar characteristics, may be used, if available, to determine fair value. When observable market prices do not exist, Customers Bancorp estimates fair value using unobservable data. The valuation methods and inputs consider factors such as types of underlying assets or liabilities, rates of estimated credit losses, interest rate or discount rate and collateral. The best estimate of fair value involves assumptions including, but not limited to, various performance indicators, such as historical and projected default and recovery rates, credit ratings, current delinquency rates, loan-to-value ratios and the possibility of obligor refinancing. US GAAP requires the use of fair values in determining the carrying values of certain assets and liabilities, as well as for specific disclosures. The most significant uses of fair values include residential mortgage loans acquired subject to an agreement to resell, residential mortgage loans originated with an intent to sell, impaired loans and foreclosed property and the net assets acquired in business combinations. For additional information, refer to “NOTE 19 – DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS.”

Purchased Credit-Impaired Loans

For certain acquired loans that have experienced a deterioration of credit quality, Customers Bancorp follows the guidance contained in ASC 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality. Purchased credit-impaired (“PCI”) loans are loans that were acquired in business combinations or asset purchases with evidence of credit deterioration since origination to the date acquired and for which it is probable that all contractually required payments will not be collected are considered to be credit impaired. Evidence of credit quality deterioration as of purchase dates may include information such as past-due and non-accrual status, borrower credit scores and recent loan to value percentages.

The fair value of loans with evidence of credit deterioration is recorded net of a nonaccretable difference and, if appropriate, an accretable yield. The difference between contractually required payments at acquisition and the cash flows expected to be collected at acquisition is the nonaccretable difference, which is not included in the carrying amount of acquired loans. Subsequent decreases in the estimated cash flows of the loan will generally result in a provision for loan losses. Subsequent to acquisition, estimates of cash flows expected to be collected are updated each reporting period based on updated assumptions regarding default rates, loss severities, and other factors that are reflective of current market conditions. Subsequent increases in cash flows result in a reversal of the provision for loan losses to the extent of prior charges, or a reclassification of the difference from nonaccretable to accretable with a positive impact on accretion of interest income in future periods. Further, any excess of cash flows expected at the time of acquisition over the estimated fair value is referred to as the accretable yield and is recognized in interest income over the remaining life of the loan when there is a reasonable expectation about the amount and timing of those cash flows.

Purchased-credit-impaired loans acquired in the same fiscal quarter may be aggregated into one or more pools, provided that the loans have common risk characteristics. A pool is then accounted for as a single asset with a single composite interest rate and an aggregate expectation of cash flows. On a quarterly basis, the Bank re-estimates the total cash flows (both principal and interest) expected to be collected over the remaining life of each pool. These estimates incorporate assumptions regarding default rates, loss severities, the amounts and timing of prepayments and other factors that reflect then-current market conditions. If the timing and/or amounts of expected cash flows on

purchased-credit-impaired loans were determined not to be reasonably estimable, no interest would be accreted and the loans would be reported as non-accrual loans; however, when the timing and amounts of expected cash flows for purchased-credit-impaired loans are reasonably estimable, interest is being accreted and the loans are being reported as performing loans. Charge-offs are not recorded on purchased-credit-impaired loans until actual losses exceed the estimated losses that were recorded as purchase accounting adjustments at acquisition date.

FDIC Receivable for Loss Share Agreements. The majority of the loans and other real estate assets acquired in an FDIC-assisted acquisition is covered under loss share agreements with the FDIC in which the FDIC has agreed to reimburse the Bank for 80% of all losses incurred in connection with those assets. Management estimated the amount that the Bank will receive from the FDIC under the loss share agreements that will result from losses incurred as the Bank disposes of covered loans and other real estate assets and records the estimate as a receivable from the FDIC.

Table of Contents

The FDIC loss sharing receivable is measured separately from the related covered assets because it is not contractually embedded in the assets and is not transferable if the assets are sold. Management estimated the fair value of the FDIC loss sharing receivable using the present value of cash flows related to the loss share agreements based on the expected reimbursements for losses and the applicable loss share percentages. Management reviews and updates the fair value of the FDIC receivable prospectively as loss estimates related to covered loans and other real estate owned change. The ultimate realization of the FDIC loss sharing receivable depends on the performance of the underlying covered assets, the passage of time, and claims paid by the FDIC. Changes in estimated cash flows of the covered assets likewise result in changes in the estimated cash flows to be received pursuant to the reimbursement agreement between the Bank and the FDIC. An increase in a cash flow estimate for a covered loan will result in a decrease in the indemnification asset, and a decrease in a cash flow estimate for a covered loan will result in an increase in the indemnification asset. Increases to the indemnification asset are recorded as a reduction to the provision for loan losses and decreases to the indemnification asset are recorded either as an increase to the provision for loan losses (to the extent an increase in the FDIC receivable balance was previously recorded as a reduction to the provision for loan losses) or recognized over the life of the loss share agreements.

Deferred Income Taxes. The Bancorp provides for deferred income taxes on the liability method whereby tax assets are recognized for deductible temporary differences and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities in the financial statements and their tax basis. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

Accounting Changes

The Fair Value Option

The Bank elected the fair value option for mortgage warehouse lending transactions documented under a master repurchase agreement originated after July 1, 2012 in order to more accurately represent the short-term nature of the transaction and its inherent credit risk. The Bank also elected the fair value option for mortgage loans originated with the intent to sell effective October 1, 2013. These adoptions are in accordance with the parameters established by ASC 825-10-25, Financial Instruments-Overall-Recognition: The Fair Value Option. The interest income from the warehouse lending transactions and mortgage loans originated with the intent to sell are classified in “Interest Income – Loans held for sale” on the income statement. The unrealized fair value changes related to these loans are classified in “Mortgage loan and banking income” on the consolidated statements of income. An allowance for loan losses is not recorded for loans measured at fair value under ASC 825 as the exit price (the repurchase price or sales price) used as the fair value measurement considers estimated credit losses.

Change in Accounting Estimates

Estimates of cash flows from purchased-credit-impaired loans were revised during the third quarter of 2012 due to a conversion to a more sophisticated and precise loan valuation system. In accordance with the guidance in ASC 310-30, interest income is based on an acquired loan’s expected cash flows. Complex models are needed to calculate loan-level and/or pool level expected cash flows in accordance with ASC 310-30. The loan data analysis provided by the loan valuation system was determined to be a more precise quantification of future cash flows than the analysis that was previously calculated manually. Upon conversion to the new software, acquisition date loan values were loaded into the system, and the software calculated their fair values using a complex valuation model. Conversion to the new system was completed in September 2012. To adjust the acquisition date loan balances recorded on Customers Bank’s books to the amounts calculated by the new software, approximately \$4.5 million was recognized as a reduction to the provision for loan losses in the third quarter of 2012. The revised valuation for the purchased-credit-impaired acquisition date loan balances due to the conversion to the new software was accounted for prospectively as a change in accounting estimate.

When converting to the new software system, the Bank was required to calculate the estimated cash flows from the various acquisition dates of the purchased-credit-impaired loans through the date the software was implemented as it was impracticable to perform these calculations on a monthly or quarterly basis. In the third quarter of 2012, approximately \$4.5 million was recognized in interest income related to this change. The impact of the revised

valuation of cash flows for the purchased-credit-impaired loan activity due to the conversion to the new software was accounted for prospectively as a change in accounting estimate.

Also during the third quarter of 2012, the Bank re-estimated the cash flows for the purchased-credit-impaired loans using current data. The re-estimated expected cash flows decreased from prior estimated cash flows. Consistent with ASC 310-10's fundamental premise that a decrease in expected cash flows results in accrual of a loss contingency and should not result in a

Table of Contents

change in yield, the Bank evaluated the adequacy of the allowance for loan losses for purchased-credit-impaired loans and determined that an additional provision for loan losses of \$7.5 million was appropriate. As a result of the changes in estimates, net income for the year ended December 31, 2012 increased by \$900,000, net of tax, and basic and diluted earnings increased by \$0.06 per share, as adjusted for 2014 stock dividend.

Overview

Like most financial institutions, the Bancorp derives the majority of its income from interest it receives on its interest-earning assets, such as loans and investments. The Bancorp's primary source of funds for making these loans and investments is its deposits, on which it pays interest. Consequently, one of the key measures of the Bancorp's success is its amount of net interest income, or the difference between the income on its interest-earning assets and the expense on its interest-bearing liabilities, such as deposits and borrowings. Another key measure is the spread between the yield earned on these interest-earning assets and the rate paid on these interest-bearing liabilities, which is referred to as net interest spread.

There is credit risk inherent in all loans, so Customers Bancorp maintains an allowance for loan losses to absorb probable losses on existing loans that may become uncollectible. The Bancorp maintains this allowance by charging a provision for loan losses against its operating earnings. Customers Bancorp has included a detailed discussion of this process, as well as several tables describing its allowance for loan losses.

2015 Economic Outlook

U.S. real GDP is forecasted to grow 2.5% to 3.0% in each of the next two years, marking the strongest two-year period since the middle of the 2001-2007 economic expansion. Growth in the U.S. is expected to be broad-based with much of the improvement coming from a stronger labor market. It is expected that employers will continue to add an average of 210,000 employees per month and that the unemployment rate will remain below 6.0% in 2015. At the same time, inflation is expected to drift closer to the Fed's explicit target of 2.0%.

Consumer Spending is expected to benefit the most from a stronger labor market. Consumption will be supported by better household balance sheets, stronger income growth and lower gasoline prices. GDP should also be boosted by larger fixed investments by business. In recent quarters, businesses have begun to shift away from share buybacks, dividends and mergers and acquisitions and replaced those outlays with fixed investments. A potential risk to business fixed investments is the recent decline in oil prices. A sustained decline in the price of oil could have a material impact to business outlays. Slower economic growth for many of America's trading partners and a strong dollar mean that trade will likely detract from U.S. real GDP for a second straight year.

Against this favorable backdrop, it is expected that the Federal Reserve will begin raising its short-term rate around the middle of 2015. Some economists believe that the upper end of the Fed Funds Target Rate will be at 1.0% by the end of 2015 and 2.75% by the end of 2016.

While the outlook in the U.S. remains optimistic, fears of a slowdown in the rest of the world could have a negative impact on the U.S. economy. While the rest of the world continues to take steps to increase growth, the U.S. continues to churn along in a positive direction. In the Bancorp's market area, management sees continued moderate (2.00% to 3.00%) growth in 2015, the housing market continuing to improve and unemployment remaining at current levels or slightly improving during the year. Management is seeing improvement in loan demand in the Bancorp's commercial and industrial, multi-family and commercial real estate loan portfolios and expects to increase lending in the coming year. There continues to be some uncertainty in the political and external environments in 2015, and it is likely that these challenging conditions will continue over the next few years. Overall, the Bancorp's management is optimistic that 2015 will show a continuation of the improving economic environment experienced in 2014.

Table of Contents

Results of Operations

The following discussion of Customers Bancorp's consolidated results of operations should be read in conjunction with its consolidated financial statements, including the accompanying notes. Also see "CRITICAL ACCOUNTING POLICIES" and "NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES AND BASIS OF PRESENTATION" for information concerning certain significant accounting policies and estimates applied in determining reported results of operations.

For the years ended December 31, 2014 and 2013

Net income available to common shareholders increased \$10.5 million (32.2%) to \$43.2 million for the year ended December 31, 2014, compared to \$32.7 million for the year ended December 31, 2013. The increased net income resulted from increases in net interest income of \$48.1 million and non-interest income of \$2.4 million, partly offset by increases in provision for loan losses of \$12.5 million, non-interest expense of \$24.9 million, and tax expense of \$2.6 million.

Net interest income increased \$48.1 million (46.3%) during 2014 to \$151.9 million, compared to \$103.9 million during 2013 principally due to an increase in the average balance of interest earnings assets of \$2.0 billion (from \$3.3 billion in 2013 to \$5.3 billion in 2014), offset in part by a decline in the net interest margin (tax equivalent) of 27 basis points (from 3.14% in 2013 to 2.87% in 2014). The growth in average interest earning assets was principally driven by increases in multi-family and other commercial loan products. The decrease in net interest margin results from a combination of changed market conditions, including decreased market interest rates and increased competition on loans, and product mix, as secured multi-family loans yield less than other commercial products and was our primary growth area.

Provision for loan losses increased \$12.5 million during 2014 to \$14.7 million, compared to \$2.2 million during 2013. The increase in the provision for loan losses during 2014 was primarily attributable to significant organic loan growth in the held-for-investment loan portfolio, resulting in approximately \$10.1 million of provision expense during 2014, and a reduced benefit expected to be collected from the FDIC as collections on covered loans improved and the loss sharing arrangements for the non-single family loans approach their contractual maturity, resulting in approximately \$4.6 million of provision expense during 2014.

Non-interest income increased \$2.4 million during 2014 to \$25.1 million compared to \$22.7 million during 2013. The increase in 2014 was attributed to the \$2.3 million increase in gains on sales of loans as the Bank began selling excess multi-family loan originations, \$1.9 million increase in gains on sales of investment securities as the Bank shortened the duration of its investment portfolio, a \$1.2 million increase in bank owned life insurance income as the number of insured employees increased, and a \$0.9 million increase in mortgage loan and banking income as the Bank continues to develop that business, offset primarily by a decrease in the mortgage warehouse transactional fees of \$4.7 million. Non-interest expense increased \$24.9 million during 2014 to \$98.9 million compared to \$74.0 million during 2013. Expenses increased in 2014 principally for salaries and employee benefits as staffing levels grew to support the growing business (up \$10.9 million), assessments for FDIC insurance and Pennsylvania shares tax increased as the Bank grew (up \$6.2 million), professional services related to loan workout, litigation and other general regulatory matters (up \$2.2 million), occupancy expense (up \$2.2 million) as our need for space grew, other real estate owned resolution expenses as we work through problem properties (up \$2.2 million), and technology, communications and bank operations expense (up \$1.5 million) as a result of our growth. The increase was offset in by a provision for loss contingency recorded in 2013 of \$2.0 million.

Income tax expense increased \$2.6 million during 2014 to \$20.2 million compared to \$17.6 million during 2013. The increased income tax expense was driven primarily from increased taxable income in 2014 (up \$13.1 million to \$63.4 million), offset in part by a \$1.5 million benefit that resulted from a return to provision and deferred tax analysis performed in third quarter 2014.

For the years ended December 31, 2013 and 2012

Net income available to common shareholders increased \$8.9 million (37.3%) to \$32.7 million for the year ended December 31, 2013, compared to \$23.8 million for the year ended December 31, 2012. The increased net income resulted from a \$31.8 million increase in net interest income and a \$12.0 million decrease in the provision for loan losses, offset by decreases in non-interest income of \$6.3 million, an increase in non-interest expense of \$23.4 million

and a \$5.3 million increase in income tax expense.

The increased net interest income of \$31.8 million (44.1%) for the year ended December 31, 2013 to \$103.9 million compared to \$72.0 million for the year ended December 31, 2012 resulted principally from an increase in average loan balances (loans held for sale and loans receivable) of \$974.0 million to \$2.8 billion, offset in part by a 39 basis point decrease in average yields

Table of Contents

on loans to 4.26% net with a 22 basis point decrease in the cost of funding. The growth in average loans was principally in loans to mortgage bankers to fund warehouse lines and multi-family and other commercial real estate loans. The decrease in yield results from a combination of changed market conditions, including increased competition for loans, and product mix, as secured multi-family loans yield less than other commercial products and was our primary growth area.

During 2013, the provision for loan losses was \$2.2 million, a decrease of \$12.0 million from a provision of \$14.3 million during 2012. The decrease in the provision for loan losses in 2013 resulted primarily from (i) \$7.5 million increase in the provision recorded in 2012 due to the re-estimation of cash flows related to purchased-credit-impaired loans, (ii) \$2.6 million reduction in the provision during 2013 due to better sustained performance of the Bancorp's commercial (including multi-family) and residential mortgage loan portfolios, (iii) \$0.3 million net reduction in the provision, including the effect of a write-down of the FDIC receivable balance in 2013 upon final payoff of covered loans which previously had a specific allowance, and (iv) approximately \$1.6 million net reduction in the provision due to generally decreased delinquencies and improved asset quality and market conditions partially offset by an increase in the provision for asset growth during 2013.

Non-interest income declined \$6.3 million in the year ended December 31, 2013 to \$22.7 million compared to \$29.0 million for the year ended December 31, 2012. The decrease in 2013 is attributed to the \$7.7 million decrease in gains on sales of investment securities, offset in part by the launching of the mortgage banking business (generating \$1.1 million of income) and increased investment in bank-owned life insurance (generating an increase in income of \$1.1 million).

Non-interest expense increased \$23.4 million during the year ended December 31, 2013 to \$74.0 million compared to \$50.7 million during the year ended December 31, 2012. Expenses increased in 2013 compared to 2012 principally for salaries and employee benefits as staffing levels grew to support the growing business (up \$11.6 million), assessment for FDIC insurance and other regulatory fees as the bank grew and other costs were incurred (\$2.5 million), professional services for loan workout, litigation, and development of materials to respond to regulatory inquiries increased reflecting growth and more complex issues (\$2.1 million), occupancy as the business expansion into new markets and increased activity in existing markets required additional facilities (\$2.0 million), and a provision for loss contingency as a result of a fraud perpetrated on a loan to fund a residential mortgage warehouse line of credit (\$2.0 million).

Income tax expense increased \$5.3 million in 2013 to \$17.6 million compared to \$12.3 million in 2012. The increased income tax expense was driven primarily from the increase in taxable income in 2013 compared to 2012 (up \$14.2 million to \$50.3 million) and a 1.0% increase in the effective tax rate to 35.0% from 34.0% due to an increase in pre-tax book income.

Table of Contents

NET INTEREST INCOME

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

	For the Year ended December 31,								
	2014			2013			2012		
	Average balance	Interest income or expense	Average yield or cost	Average balance	Interest income or expense	Average yield or cost	Average balance	Interest income or expense	Average yield or cost
(amounts in thousands)									
Assets									
Interest-earning deposits	\$228,668	\$577	0.25 %	\$190,298	\$482	0.25 %	\$138,475	\$352	0.25 %
Investment securities, taxable (A)	451,932	10,386	2.30	260,862	6,314	2.42	224,075	6,663	2.97
Investment securities, non-taxable (A)	—	—	—	—	—	—	1,642	68	4.16
Loans held for sale	911,594	30,801	3.38	992,421	38,140	3.84	423,886	15,950	3.76
Loans receivable	3,656,891	146,388	4.00	1,842,310	82,580	4.48	1,436,805	70,510	4.91
Other interest earning assets	66,669	2,275	3.41	27,095	640	2.36	21,140	271	1.28
Total interest-earning assets	5,315,754	190,427	3.58	3,312,986	128,156	3.87	2,246,023	93,814	4.18
Non-interest-earning assets	227,045			142,350			79,280		
Total assets	\$5,542,799			\$3,455,336			\$2,325,303		
Liabilities									
Interest checking	\$62,840	361	0.57	\$45,613	191	0.42	36,701	193	0.52
Money market deposit accounts	1,712,896	10,391	0.61	1,106,457	7,619	0.69	853,658	7,404	0.87
Other savings	40,795	172	0.42	31,741	152	0.48	22,947	133	0.58
Certificates of deposit	1,403,774	13,530	0.96	1,251,709	13,058	1.04	935,208	13,346	1.43
Total interest-bearing deposits	3,220,305	24,454	0.76	2,435,520	21,020	0.86	1,848,514	21,076	1.14
Borrowings	1,268,205	14,050	1.11	278,297	3,281	1.18	100,484	685	0.68
Total interest-bearing liabilities	4,488,510	38,504	0.86	2,713,817	24,301	0.90	1,948,998	21,761	1.12
Non-interest-bearing deposits	620,385			385,187			180,722		
Total deposits and borrowings	5,108,895		0.75	3,099,004		0.78	2,129,720		1.02
Other non-interest-bearing liabilities	17,905			11,779			7,948		
Total liabilities	5,126,800			3,110,783			2,137,668		
Shareholders' Equity	415,999			344,553			187,635		

Edgar Filing: EQUUS TOTAL RETURN, INC. - Form 10-K

Total liabilities and shareholders' equity	\$5,542,799	\$3,455,336	\$2,325,303	
Net interest earnings	151,923	103,855	72,053	
Tax-equivalent adjustment (C)	405	244	131	
Net interest earnings	\$152,328	\$104,099	\$72,184	
Interest spread	2.83 %	3.09 %	3.16 %	
Net interest margin (D)	2.86	3.13	3.21	
Net interest margin tax equivalent (C)(D)	2.87	3.14	3.21	

(A) For presentation in this table, balances and the corresponding average rates for investment securities are based upon historical cost, adjusted for amortization of premiums and accretion of discounts.

(B) Includes non-accrual loans, the effect of which is to reduce the yield earned on loans, and deferred loan fees.

(C) Full tax equivalent basis, using a 35% statutory tax rate to approximate interest income as a taxable asset.

Excluding the adjustment to interest income for the change in accounting estimate on purchased-credit-impaired (D) loans of \$4.5 million, net interest margin and net interest margin tax equivalent are 3.05% for the twelve months ended December 31, 2012.

Certain amounts reported in the 2013 and 2012 financial statements have been reclassified to conform to the 2014 (E) presentation. These reclassifications did not significantly impact the Bancorp's financial position or results of operations.

Table of Contents

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

	2014 vs. 2013			2013 vs. 2012		
	Increase (decrease) due to change in			Increase (decrease) due to change in		
	Rate	Volume	Total	Rate	Volume	Total
(amounts in thousands)						
Interest income:						
Interest earning deposits	\$(2	) \$97	\$95	\$(2	) \$131	\$129
Investment securities, taxable	(335	) 4,407	4,072	(1,347	) 998	(349
Investment securities, non-taxable	—	—	—	(34	) (34	) (68
Loans held for sale	(4,384	) (2,955	) (7,339	) 348	21,843	22,191
Loans receivable	(9,683	) 73,491	63,808	(6,511	) 18,581	12,070
Other interest earning assets	382	1,253	1,635	277	92	369
Total interest income	(14,022	) 76,293	62,271	(7,269	) 41,611	34,342
Interest expense:						
Interest checking	84	86	170	(43	) 42	(1
Money market deposit accounts	(996	) 3,768	2,772	(1,710	) 1,926	216
Savings	(20	) 40	20	(26	) 45	19
Certificates of deposit	(1,040	) 1,512	472	(4,130	) 3,840	(290
Total interest bearing deposits	(1,972	) 5,406	3,434	(5,909	) 5,853	(56
Borrowings	(210	) 10,979	10,769	757	1,839	2,596
Total interest expense	(2,182	) 16,385	14,203	(5,152	) 7,692	2,540
Net interest income	\$(11,840	) \$59,908	\$48,068	\$(2,117	) \$33,919	\$31,802

For the years ended December 31, 2014 and 2013

Net interest income for the year ended December 31, 2014 was \$151.9 million, an increase of \$48.1 million, or 46.3%, when compared to net interest income for the year ended December 31, 2013 of \$103.9 million. This increase in net interest income was primarily attributable to an increase of \$1.8 billion in average loans receivable, principally in multi-family and other commercial loans.

The key measure of net interest income is net interest margin. While the Bancorp's net interest margin decreased to 2.87% for the year ended December 31, 2014 from 3.14% for the year ended December 31, 2013, the impact on net interest income was secondary to the significant increases in loan volume.

For the years ended December 31, 2013 and 2012

Net interest income for the year ended December 31, 2013 was \$103.9 million, an increase of \$31.8 million, or 44.1%, when compared to net interest income for the year ended December 31, 2012 of \$72.1 million. This increase in net interest income was primarily attributable to an increase of \$568.5 million in average loans held for sale, principally loans to mortgage bankers to fund inventory, and an increase of \$405.5 million in average loans held receivable, driven by increased average balances in commercial and multi-family loans.

The key measure of net interest income is net interest margin. While the Bancorp's net interest margin decreased to 3.13% for the year ended December 31, 2013 from 3.21% for the year ended December 31, 2012, the impact on net interest income was secondary to the significant increases in loan volume.

Table of Contents

PROVISION FOR LOAN LOSSES

For more information about our provision and allowance for loan losses methodology and our loss experience, see “Credit Risk” and “Asset Quality” herein and “NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES AND BASIS OF PRESENTATION.”

Customers Bancorp maintains its allowance for loan losses through a provision for loan losses charged as an expense on the consolidated statements of income. The loan portfolio is reviewed quarterly to evaluate the outstanding loans and to measure both the performance of the portfolio and the adequacy of the allowance for loan losses. The allowance for loan losses is estimated as of the end of each quarter and compared to the balance recorded in the general ledger net of charge-offs and recoveries. The allowance is adjusted to the estimated allowance for loan losses balance via a charge (or debit) to the provision for loan losses.

For the years ended December 31, 2014 and 2013

At December 31, 2014, approximately 0.7 % of the total loan portfolio was covered under loss sharing agreements with the FDIC. Reductions in estimated cash flows on the covered loans are taken as additional provisions, and a corresponding receivable due from the FDIC is recorded as a reduction to the provision for loan losses for the portion anticipated to be recovered under the loss sharing agreements.

During 2014, the provision for loan losses was \$14.7 million, an increase of \$12.5 million from a provision of \$2.2 million during 2013. The increase in the provision for loan losses during 2014 was primarily attributable to significant organic loan growth in the held-for-investment loan portfolio, resulting in approximately \$10.1 million of provision expense during 2014, and a reduced benefit expected to be collected from the FDIC as collections on covered loans improved and the loss sharing arrangements for the non-single family loans approach their contractual maturity, resulting in approximately \$4.7 million of provision expense during 2014.

For the years ended December 31, 2013 and 2012

At December 31, 2013, approximately 2.1% of the total loan portfolio was covered under loss sharing agreements with the FDIC. Reductions in estimated cash flows on the covered loans are taken as additional provisions, and a corresponding receivable due from the FDIC is recorded as a reduction to the provision for loan losses for the portion anticipated to be recovered under the loss sharing agreements.

During 2013, the provision for loan losses was \$2.2 million, a decrease of \$12.0 million from a provision of \$14.3 million during 2012. The decrease in the provision for loan losses in 2013 resulted primarily from (i) \$7.5 million increase in the provision recorded in 2012 due to the re-estimation of cash flows related to purchased-credit-impaired loans, (ii) \$2.6 million reduction in the provision during 2013 due to better sustained performance of the Bancorp’s commercial (including multi-family) and residential mortgage loan portfolios, (iii) \$0.3 million net reduction in the provision, including the effect of a write-down of the FDIC receivable balance, in 2013 upon final payoff of covered loans which previously had a specific allowance, and (iv) approximately \$1.6 million net reduction in the provision due to generally decreased delinquencies and improved asset quality and market conditions, partially offset by an increase in the provision for asset growth during 2013.

Table of Contents

NON-INTEREST INCOME

The chart below shows the various components of non-interest income for each of the years ended December 31, 2014, 2013 and 2012.

	Years Ended December 31,		
	2014	2013	2012
	(in thousands)		
Mortgage warehouse transactional fees	\$8,233	\$12,962	\$12,289
Bank-owned life insurance	3,702	2,482	1,332
Gains on sales of investment securities	3,191	1,274	9,017
Gains on sales of loans	3,125	852	357
Mortgage loan and banking income	2,048	1,142	—
Deposit fees	801	675	481
Other	4,026	3,316	5,482
Total non-interest income	\$25,126	\$22,703	\$28,958

For the years ended December 31, 2014 and 2013

Non-interest income increased \$2.4 million during 2014 to \$25.1 million compared to \$22.7 million during 2013. The increase in 2014 was attributed to the \$2.3 million increase in gains on sales of loans as the Bank began selling excess multi-family loan originations, \$1.9 million increase in gains on sales of investment securities as the Bank shortened the duration of the investment portfolio, a \$1.2 million increase in bank owned life insurance income as the number of insured employees increased, and a \$0.9 million increase in mortgage loan and banking income as Customers continues to develop that business, offset primarily by a decrease in the mortgage warehouse transactional fees of \$4.7 million.

For the years ended December 31, 2013 and 2012

Non-interest income declined \$6.3 million in the year ended December 31, 2013 to \$22.7 million compared to \$29.0 million for the year ended December 31, 2012. The decrease in 2013 is attributed to the \$7.7 million decrease in gains on sales of investment securities, offset in part by the launching of the mortgage banking business (generating \$1.1 million of income) and increased investment in bank-owned life insurance (generating an increase in income of \$1.1 million). Also, 2012 other non-interest income includes a benefit of \$4.5 million resulting from an increased estimate of cash flows to be received from the FDIC for future losses on covered loans.

Table of Contents

NON-INTEREST EXPENSE

The below chart shows the various components of non-interest expense for each of the years ended December 31, 2014, 2013, and 2012.

	Years Ended December 31,		
	2014	2013	2012
	(in thousands)		
Salaries and employee benefits	\$46,427	\$35,493	\$23,846
FDIC assessments, taxes, and regulatory fees	11,812	5,568	3,037
Occupancy	11,010	8,829	6,816
Professional services	7,748	5,548	3,468
Technology, communication and bank operations	5,856	4,330	2,805
Other real estate owned	3,601	1,365	(85)
Loan workout	1,706	2,245	2,243
Advertising and promotion	1,325	1,274	1,219
Loss contingency	—	2,000	—
Stock offering expenses	—	—	1,437
Other	9,429	7,372	5,865
Total non-interest expenses	\$98,914	\$74,024	\$50,651

For the years ended December 31, 2014 and 2013

Non-interest expense was \$98.9 million for the year ended December 31, 2014, which was an increase of \$24.9 million over non-interest expense of \$74.0 million for the year ended December 31, 2013.

Salaries and employee benefits, which represent the largest component of non-interest expense, increased \$10.9 million (30.8%) to \$46.4 million for the year ended December 31, 2014 from \$35.5 million for the year ended December 31, 2013. The primary reason for this increase was due to the increase in the number of employees from 383 full-time equivalents at December 31, 2013 to 422 full-time equivalents at December 31, 2014 and a full year of expense for the growth of employees in 2013 as we increased the number of team members to support our growing commercial loan, multi-family/commercial real estate, and mortgage banking businesses and the related administrative support functions.

FDIC assessments, taxes and regulatory fees increased by \$6.2 million to \$11.8 million for the year-ended December 31, 2014 from \$5.6 million for the year-ended December 31, 2013 due to increased assets subject to the FDIC assessment, higher regulatory fees and higher Pennsylvania bank shares tax expense as a result of the growth of the Bank.

Occupancy expense increased \$2.2 million, rising to \$11.0 million for the year-ended December 31, 2014 from \$8.8 million for the year-ended December 31, 2013 as a result of a full year of facilities expense from expansion into new markets during 2013.

Professional services expense increased \$2.2 million, to \$7.7 million for the year ended December 31, 2014 from \$5.5 million for the year-ended December 31, 2013 due to higher legal and consulting expenses in 2014 related to regulatory filings and other regulatory and legal matters as well as general growth of the Bank.

Technology communication and bank operations increased \$1.5 million, rising to \$5.9 million for the year ended December 31, 2014 from \$4.3 million for the year-ended December 31, 2013 related to the increased number of employees and increased technology improvements to meet the needs of a larger Bank.

Larger expenses classified in other expense include loan origination expenses, supplies, director fees, shareholder relations, sponsorships, and business development expenses. Generally these expenses increased as a direct result of the growth of the Bank.

For the years ended December 31, 2013 and 2012

Non-interest expense was \$74.0 million for the year ended December 31, 2013, which was an increase of \$23.4 million over non-interest expense of \$50.7 million for the year ended December 31, 2012.

Table of Contents

Salaries and employee benefits, which represent the largest component of non-interest expense, increased \$11.6 million (48.8%) to \$35.5 million for the year ended December 31, 2013 from \$23.8 million for the year ended December 31, 2012. The primary reason for this increase was due to the increase in the number of employees from 242 full-time equivalents at December 31, 2012 to 383 full-time equivalents at December 31, 2013. This was directly related to the need for additional employees to support our organic growth and the expansion into new markets. Specifically, the increased headcount is needed to support our growing commercial loan, multi-family/commercial real estate, and mortgage banking businesses and the related administrative support.

Occupancy expense increased \$2.0 million, rising to \$8.8 million for the year-ended December 31, 2013 from \$6.8 million for the year-ended December 31, 2012. The increase was related to building the infrastructure to support our growth as well as the cost of expansion into new markets.

FDIC assessments, taxes and regulatory fees increased \$2.5 million to \$5.6 million for the year-ended December 31, 2013 from \$3.0 million for the year-ended December 31, 2012. The primary reasons for this increase were related to higher Pennsylvania bank shares tax expense that resulted from legislative changes to the tax calculation, deposit premiums and other regulatory and filing fees.

Professional services expense increased \$2.1 million, to \$5.5 million for the year-ended December 31, 2013 from \$3.5 million for the year-ended December 31, 2012. This increase was primarily attributable to higher legal and consulting expenses in 2013 related to regulatory filings and other matters, including responding to alleged Fair Lending violations.

Technology communication and bank operations increased \$1.5 million, rising to \$4.3 million for the year-ended December 31, 2013 from \$2.8 million for the year-ended December 31, 2012. The primary reason for this increase was related to building the infrastructure to support the growth through increased technology improvements and upgrades as well as the costs related to expanding of technological platforms into new markets. This corresponds with our philosophy of “high touch, high tech”, whereby we provide an exceptional level of customer service supported by state-of-the-art technology.

In March 2013, a suspected fraud was discovered in the Bank’s loans held-for-sale portfolio. Total loans involved in this fraud initially appeared to be \$5.2 million. The Bank determined that an aggregate of \$1.0 million of the loans were not involved in the fraud, and these loans were subsequently sold during 2013. In addition, the Bank recovered \$1.5 million in cash from the alleged perpetrator in 2013. During 2013, a loss contingency expense of \$2.0 million was provided, resulting in a net amount of \$0.7 million classified in other assets as of December 31, 2013.

Other expenses increased \$1.2 million to \$7.0 million for the year-ended December 31, 2013, compared to \$5.8 million for the year-ended December 31, 2012. The increase was primarily attributed to the \$1.2 million increase in loan origination and servicing fees to \$2.1 million for the year-ended December 31, 2013, compared to \$0.9 million for the year-ended December 31, 2012.

INCOME TAXES

For the years ended December 31, 2014 and 2013

The income tax expense and effective tax rate include both federal and state income taxes. In 2014, income tax expense was \$20.2 million with an effective tax rate of 31.83%, compared to an expense of \$17.6 million and a rate of 35.00% for 2013. Income tax expense was driven primarily by net income before taxes of \$63.4 million and \$50.3 million, for the twelve months ended December 31, 2014, and December 31, 2013, respectively. In 2014, income tax expense was offset by a tax benefit from bank-owned life insurance of \$1,269,000, or a 2.04% tax rate reduction. In 2013, income tax expense was offset by a tax benefit from bank-owned life insurance of \$869,000, or a 1.73% rate reduction. In addition to the bank-owned life insurance benefit, 2014 was affected by other tax benefits of \$1,821,000, or a 2.88% tax rate deduction which included a \$1,526,000 benefit from a return to provision and deferred tax analysis performed in the third quarter of 2014.

For the years ended December 31, 2013 and 2012

The income tax expense and effective tax rate include both federal and state income taxes. In 2013, income tax expense was \$17.6 million with an effective tax rate of 35.00%, compared to an expense of \$12.3 million and a rate of 34.00% for 2012. Income tax expense was driven primarily by net income before taxes of \$50.3 million and \$36.1 million, for the twelve months ended December 31, 2013, and December 31, 2012, respectively. In 2013, income tax

expense was offset by a tax benefit from bank-owned life insurance of \$869,000, or a 1.73% tax rate reduction. In 2012, income tax expense was offset by a tax benefit from bank owned life insurance of \$466,000, or a 1.29% tax rate reduction.

Table of Contents

For additional information regarding the Bancorp's income taxes, refer to "NOTE 15 – INCOME TAXES".

FINANCIAL CONDITION**GENERAL**

Total assets were \$6.8 billion at December 31, 2014. This represented a \$2.6 billion, or 64.3% increase from \$4.2 billion at December 31, 2013. The major change in our financial position occurred as the result of the growth in loans receivable, which increased by 74.9% or \$1.8 billion to \$4.3 billion at December 31, 2014, from \$2.5 billion at December 31, 2013.

The main driver of the increase in assets was primarily from the expansion of the commercial loan portfolio.

Multi-family loans increased by \$1.1 billion (100.0%) to \$2.2 billion at December 31, 2014 from \$1.1 billion at December 31, 2013 not including \$99.8 million of multi-family loans held for sale at December 31, 2014. Commercial real estate loans increased by \$396.1 million (52.5%) to \$1.1 billion from \$753.6 million at December 31, 2013.

Additionally, commercial and industrial loans increased by \$246.1 million (83.0%) to \$542.7 million at December 31, 2014 from \$296.6 million at December 31, 2013. Loans held for sale increased by \$687.9 million (92.0%) to \$1.4 billion at December 31, 2014 from \$747.6 million at December 31, 2013.

Total liabilities were \$6.4 billion at December 31, 2014. This represented a \$2.6 billion, or 69.4%, increase from \$3.8 billion at December 31, 2013. The increase in total liabilities was due to a higher level of deposits in 2014, compared to 2013. Total deposits grew by \$1.6 billion (53.1%), to \$4.5 billion at December 31, 2014 from \$3.0 billion at December 31, 2013. Deposits are obtained primarily from within the Bank's geographic service area and through wholesale and broker networks. These wholesale and network sources provide low-cost funding alternatives to retail deposits and diversify to the Bank's sources of funds. The growth in retail deposits was primarily due to exceptional sales execution, despite lower interest rates in 2014. Additional funding for asset growth was obtained through FHLB advances which increased by \$911.5 million to \$1.6 billion at December 31, 2014 from \$706.5 million at December 31, 2013.

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

	December 31, 2014	2013
(amounts in thousands)		
Cash and cash equivalents	\$371,023	\$233,068
Investment securities, available for sale	416,685	497,573
Loans held for sale (includes \$1,335,668 and \$747,593, respectively at fair value)	1,435,459	747,593
Loans receivable	4,312,173	2,465,078
Total loans receivable, net of the allowance for loan losses	4,281,241	2,441,080
Total assets	6,825,370	4,153,173
Total deposits	4,532,538	2,959,922
Federal funds purchased	—	13,000
FHLB advances	1,618,000	706,500
Other borrowings	88,250	63,250
Subordinated debt	110,000	2,000
Total liabilities	6,382,225	3,766,550
Total shareholders' equity	443,145	386,623
Total liabilities and shareholders' equity	6,825,370	4,153,173

CASH AND DUE FROM BANKS

Cash and due from banks consists mainly of vault cash and cash items in the process of collection. These balances totaled \$62.7 million at December 31, 2014. This represents a \$2.0 million increase from \$60.7 million at December 31, 2013. These balances vary from day to day, primarily due to variations in customers' deposits with the Bank.

Table of Contents**INTEREST-EARNING DEPOSITS**

Interest earning deposits consist mainly of deposits at the Federal Reserve Bank of Philadelphia. These deposits totaled \$308.3 million at December 31, 2014, which is a \$135.9 million increase from \$172.4 million at December 31, 2013. This balance varies from day to day, depending on several factors, such as variations in customers' deposits with the Bank and the payment of checks drawn on customers' accounts.

INVESTMENT SECURITIES

The investment securities portfolio is an important source of interest income and liquidity. It consists of U.S. Treasury, government agency and mortgage-backed securities (guaranteed by an agency of the United States government and non-agency guaranteed), municipal securities, domestic corporate debt, asset-backed securities, and marketable equity securities. In addition to generating revenue, the investment portfolio is maintained to manage interest rate risk, provide liquidity, provide collateral for other borrowings and diversify the credit risk of earning assets. The portfolio is structured to maximize net interest income, given changes in the economic environment, liquidity position and balance sheet mix.

At December 31, 2014, investment securities were \$416.7 million compared to \$497.6 million at December 31, 2013. The decrease was primarily the result of the sale of securities to strategically reduce interest rate risk by shortening the duration of the investment securities' term.

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

The following table sets forth the amortized cost of the investment securities at the last three fiscal year ends:

	December 31, 2014	2013	2012
(amounts in thousands)			
Available for Sale:			
Mortgage-backed securities (1)	\$376,854	\$461,988	\$102,449
Corporate notes (2)	15,000	25,000	25,000
Equity securities (3)	23,074	23,074	6
	\$414,928	\$510,062	\$127,455

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

(2) Includes subordinated debt issued by other bank holding companies.

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

For financial reporting purposes, available-for-sale securities are carried at fair value.

The following table sets forth information about the maturities and weighted-average yield of the securities portfolio. Yields are not reported on a tax-equivalent basis.

Table of Contents

December 31, 2014

	Amortized Cost						Fair Value
	< 1yr	1 -5 years	5 -10 years	After 10 years	No Specific Maturity	Total	Total
	(dollars in thousands)						
Available for Sale							
Mortgage-backed securities	\$—	\$—	\$—	\$—	\$376,854	\$376,854	\$377,311
Yield	—	—	—	—	2.29	% 2.29	% —
Corporate notes	—	—	15,000	—	—	15,000	15,104
Yield	—	—	5.58	% —	—	5.58	% —
Equity securities	—	—	—	—	23,074	23,074	24,270
Yield	—	—	—	—	—	% —	% —
Total	\$—	\$—	\$15,000	\$—	\$399,928	\$414,928	\$416,685
Weighted Average Yield	—	% —	% 5.58	% —	% 2.29	% 2.28	% —

The mortgage-backed securities in the portfolio were issued by Fannie Mae, Freddie Mac, and Ginnie Mae and contain guarantees for the collection of principal and interest on the underlying mortgages. The corporate notes in the portfolio are high-quality investments in financial service industry companies

LOANS

Existing lending relationships are primarily with small businesses and individual consumers primarily in Bucks, Berks, Chester, Montgomery, Delaware, and Philadelphia Counties, Pennsylvania; Camden and Mercer Counties, New Jersey; and Westchester County and New York City, New York; and the New England area. The loans to mortgage banking companies portfolio is nation-wide. The loan portfolio is primarily comprised of loans to support mortgage banking companies' funding needs, multi-family/commercial real estate, construction, and commercial and industrial loans. The Bank continues to focus on small business loans to grow its commercial lending efforts, establish a specialty lending business, and expand its consumer lending products, as outlined below:

Commercial Lending

The Bank's commercial lending is divided into four groups: Business Banking, Small Business Banking, Multi-family, and Commercial real estate. This grouping is designed to allow for greater resource deployment, higher standards of risk management, strong asset quality, lower interest rate risk and higher productivity levels.

The commercial lending group focuses on companies with annual revenues ranging from \$5 million to \$50 million, which typically have credit requirements between \$0.5 million and \$10 million.

The small business banking platform originates loans, including Small Business Administration loans, through the branch network sales force and a team of dedicated Small Business relationship managers. The support administration of this platform is centralized including risk management, product management, marketing, performance tracking and overall strategy. Credit and sales training has been established for the Bank's sales force, ensuring that it has small business experts in place providing appropriate financial solutions to the small business owners in its communities. A division approach focuses on industries that offer high asset quality and are deposit rich to drive profitability.

In 2009, the Bank launched its lending to mortgage banking businesses products, which primarily provides financing to mortgage bankers for residential mortgage originations from loan closing until sale in the secondary market. Many providers of liquidity in this segment exited the business in 2009 during a period of excessive market turmoil. The Bank saw an opportunity to provide liquidity to this business segment at attractive spreads. There was also the opportunity to attract escrow deposits and to generate fee income in this business.

Table of Contents

The goal of the lending to mortgage banking businesses lending group is to provide liquidity to mortgage companies. These loans are primarily used by mortgage companies to fund their pipelines from closing of individual mortgage loans until their sale into the secondary market. The residential loans are taken as collateral for the Bank's loans. As of December 31, 2014, loans in the warehouse lending portfolio totaled \$1.3 billion and are designated as held for sale. The goal of the Bank's multi-family lending product is to build a portfolio of high-quality multi-family loans within the Bank's covered markets, while cross selling other products and services. This product primarily targets refinancing existing loans with other banks using conservative underwriting and provides purchase money for new acquisitions by borrowers. The primary collateral for these loans is a first lien mortgage on the multi-family property, plus an assignment of all leases related to such property. As of December 31, 2014, the Bank had multi-family loans of \$2.2 billion outstanding, making up approximately 38.8% of the Bank's total loan portfolio, compared to \$1.1 billion, or approximately 33.1% of the total loan portfolio at December 31, 2013.

As of December 31, 2014, the Bank had \$5.3 billion in commercial loans outstanding, composing approximately 92.5% of its total loan portfolio, which includes loans held for sale, compared to \$2.9 billion, composing approximately 90.2% at December 31, 2013.

Consumer Lending

The Bank provides home equity and residential mortgage loans to customers. Underwriting standards for home equity lending are conservative and lending is offered to solidify customer relationships and grow relationship revenues in the long term. This lending is important in the Bank's efforts to grow total relationship revenues for its consumer households. As of December 31, 2014, the Bank had \$432.2 million in consumer loans outstanding, or 7.5% of the Bank's total loan portfolio, which includes loans held for sale. The Bank plans to expand its product offerings in real estate secured consumer lending.

Customers Bank has launched a community outreach program in Philadelphia to finance homeownership in urban communities. As part of this program, the Bank is offering an "Affordable Mortgage Product". This community outreach program is penetrating the underserved population, especially in low-and moderate income neighborhoods. As part of this commitment, a loan production office was opened in Progress Plaza, 1501 North Broad Street, Philadelphia, PA. The program includes homebuyer seminars that prepare potential homebuyers for homeownership by teaching money management and budgeting skills, including the financial responsibilities that come with having a mortgage and owning a home. The "Affordable Mortgage Product" is offered throughout Customers Bank's assessment areas.

The composition of loans held for sale was as follows:

	December 31, 2014 (in thousands)	2013	2012	2011	2010
Commercial Loans:					
Mortgage warehouse loans at fair value (1)	\$1,332,019	\$740,694	\$1,439,889	\$174,999	\$199,970
Multi-family loans at lower of cost or fair value	99,791	—	—	—	—
Total Commercial Loans Held for Sale	1,431,810	740,694	1,439,889	174,999	199,970
Consumer Loans:					
Residential mortgage loans at fair value	3,649	6,899	—	—	—
Loans held for sale	\$1,435,459	\$747,593	\$1,439,889	\$174,999	\$199,970

(1) Prior to 2012 the Bank had not elected the fair value option on Mortgage warehouse loans held for sale.

Table of Contents

During the fourth quarter of 2014, certain types of loans were reclassified due to their purpose and overall risk characteristics. Therefore, balances on certain loans and allowance for loan losses as of December 31, 2013 were reclassified to conform to the December 31, 2014 presentation.

The composition of loans receivable (excluding loans held for sale) was as follows:

	December 31, 2014 (in thousands)	2013	2012	2011	2010
Commercial:					
Multi-family	\$2,127,034	\$1,063,459	\$362,689	\$70,945	\$—
Commercial real estate	1,132,072	724,752	437,696	244,106	144,849
Commercial and industrial	540,430	292,937	114,615	109,986	35,942
Construction	56,669	31,314	25,709	10,732	13,387
Mortgage warehouse (b)	—	—	9,565	619,318	186,113
Total Commercial Loans	3,856,205	2,112,462	950,274	1,055,087	380,291
Consumer:					
Residential real estate	285,003	145,188	110,008	53,646	28,964
Manufactured housing	126,731	139,471	153,429	104,565	102,924
Home equity / other	1,541	2,144	2,072	2,208	1,581
Total Consumer Loans	413,275	286,803	265,509	160,419	133,469
Total loan receivable not covered under FDIC loss sharing agreements	4,269,480	2,399,265	1,215,783	1,215,506	513,760
Commercial:					
Commercial real estate	17,585	28,839	51,636	61,128	75,245
Commercial and industrial	2,235	3,658	11,718	13,798	22,876
Construction	6,705	11,603	19,845	24,873	38,280
Multi-family	372	600	647	—	—
Total Commercial Loans	26,897	44,700	83,846	99,799	136,401
Consumer:					
Residential real estate	12,392	18,732	19,952	22,465	23,822
Home equity / other	2,892	3,293	3,729	4,012	4,662
Total Consumer Loans	15,284	22,025	23,681	26,477	28,484
Total loan receivable covered under FDIC loss sharing agreements (a)	42,181	66,725	107,527	126,276	164,885
Unearned origination costs, net	4,311,661	2,465,990	1,323,310	1,341,782	678,645
Allowance for loan losses	512	(912)	1,157	(389)	327
Loans receivable, net	(30,932)	(23,998)	(25,837)	(15,032)	(15,129)
	\$4,281,241	\$2,441,080	\$1,298,630	\$1,326,361	\$663,843

(a) Covered loans receivable acquired from the former USA Bank and ISN Bank are covered under the FDIC loss sharing agreements over a five to ten year period which begin to expire in 2015 depending upon the type of loan.

(b) During the third quarter of 2012, the Bancorp elected the fair value option for certain warehouse lending transactions originated after July 1, 2012. The documentation on the loans was modified to a purchase with agreement to resell contract. As such, qualified warehouse lending transactions on its balance sheet at December 31, 2013 and 2012, were accounted for at fair value and classified as held for sale. Warehouse lending transactions on the Bancorp's balance sheet at December 31, 2011 were classified as loans receivable not covered

under FDIC loss sharing agreements.

Loans to mortgage bank businesses and certain residential loans expected to be sold are classified as loans held for sale. Loans held for sale totaled \$1.4 billion and \$747.6 million at December 31, 2014 and 2013, respectively. Loans held for sale are not included in the loan receivable amounts. The mortgage warehouse product line provides financing to mortgage companies nationwide from the time of the home purchase or refinancing of a mortgage loan through the sale of the loan by the mortgage

Table of Contents

originator into the secondary market, either through a repurchase facility or the purchase of the underlying mortgages. As a mortgage warehouse lender, we provide a form of financing to mortgage bankers by purchasing for resale the underlying residential mortgages on a short-term basis under a master repurchase agreement. We are subject to the risks associated with such lending, including, but not limited to, the risks of fraud, bankruptcy and default of the mortgage banker or of the underlying residential borrower, any of which could result in credit losses. The mortgage warehouse lending employees monitor these mortgage originators by obtaining financial and other relevant information to reduce these risks during the lending period.

Loans receivable, net, increased by \$1.8 billion to \$4.3 billion at December 31, 2014 from \$2.4 billion at December 31, 2013. The increase in Loans receivable, net, was also attributable to higher balances for multi-family, commercial real estate, and commercial and industrial loans which increased \$1.1 billion, \$396.1 million, and \$246.1 million, respectively from December 31, 2013. The multi-family, commercial real estate and commercial and industrial loan balance is increasing due to the focus on this element of the Bank's organic growth strategy. Offsetting these increases in part was the loan runoff for purchased-credit-impaired and covered loans.

The following table sets forth certain categories of loans receivable* as of December 31, 2014, in terms of contractual maturity date:

	Within one year	After one but within five years	After five years	Total
	(in thousands)			
Types of Loans:				
Construction	\$7,207	\$14,698	\$41,469	\$63,374
Commercial real estate	32,478	512,365	604,814	1,149,657
Multi-family	11	1,266,938	860,457	2,127,406
Commercial and industrial	131,424	230,178	181,063	542,665
Total	\$171,120	\$2,024,179	\$1,687,803	\$3,883,102
Amount of such loans with:				
Predetermined rates	\$36,013	\$1,716,479	\$1,117,602	\$2,870,094
Floating or adjustable rates	135,107	307,700	570,201	1,013,008
Total	\$171,120	\$2,024,179	\$1,687,803	\$3,883,102

* Includes covered and non-covered loans.

CREDIT RISK

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

The provision for loan losses was \$14.7 million, \$2.2 million, and \$14.3 million for the years ended December 31, 2014, 2013 and 2012, respectively. The allowance for loan losses maintained for loans receivable (excludes loans held for sale as estimable credit losses are embedded in the fair values at which the loans are reported) was \$30.9 million, or 0.7% of total non-covered loans, at December 31, 2014, and \$24.0 million, or 1.0% of total non-covered loans, at December 31, 2013. The coverage ratio declined during 2014 largely due to the decrease in non-performing loans as a result of net-charge-offs on loans resolved or transferred to other real estate owned, and the growth of the multi-family loan portfolio which draws only a 40 bps reserve level due to its historical payment experience. Net charge-offs were \$3.1 million for the year ended December 31, 2014, a decrease of \$3.8 million compared to the \$6.9 million for the year ending December 31, 2013. The Bank had approximately \$42.2 million in loans that were covered under loss share arrangements with the FDIC as of December 31, 2014 and \$66.7 million as of December 31, 2013. Customers

Bank considers the covered loans in estimating the allowance for loan losses and considers recovery of estimated credit losses from the FDIC in the FDIC indemnification asset.

Table of Contents

The chart below depicts the Bancorp's allowance for loan losses, excluding the effects of the FDIC receivable, for the periods indicated.

	December 31,								
	2014	2013	2012	2011	2010				
	(dollars in thousands)								
Balance of the allowance at the beginning of the year	\$23,998	\$25,837	\$15,032	\$15,129	\$10,032				
Loan charge-offs (1)									
Construction	895	2,096	2,507	1,179	1,214				
Commercial real estate	2,197	3,358	2,462	5,775	964				
Commercial and industrial	1,155	1,387	522	2,543	1,699				
Residential real estate	667	410	649	109	1,366				
Home equity / other	33	87	26	55	22				
Total Charge-offs (2)	4,947	7,338	6,166	9,661	5,265				
Loan recoveries									
Construction	13	—	4	2	—				
Commercial real estate	1,026	42	63	94	—				
Commercial and industrial	511	391	514	11	6				
Residential real estate	265	2	5	—	9				
Home equity / other	8	9	114	7	—				
Total Recoveries	1,823	444	700	114	15				
Total net charge-offs	3,124	6,894	5,466	9,547	5,250				
Provision for loan losses (3)	10,058	5,055	16,271	9,450	10,397				
Transfer (4)	—	—	—	—	(50	)			
Balance of the allowance for loan losses at the end of the year	\$30,932	\$23,998	\$25,837	\$15,032	\$15,129				
Net charge-offs as a percentage of average non-covered loans	0.09	% 0.38	% 0.43	% 1.13	% 1.00	%			

(1) Charge-offs on purchased-credit-impaired loans that are pooled are not recognized until the pool matures.

(2) The large charge-offs in 2011 were related to loans acquired in the 2010 FDIC assisted transactions and the Legacy portfolio.

The 2014, 2013, 2012 and 2011 provision amounts excludes the (cost)/benefit of the FDIC loss share arrangements of \$(4.7) million, \$2.8 million, \$2.0 million, and \$2.0 million respectively. There are no comparable amounts for 2010.

(4) In 2010, Customers Bancorp had a reserve of \$50,000 for unfunded commitments previously included in the allowance for loan losses. The reserve for unfunded loan commitments was reclassified to other liabilities.

The allowance for loan losses is based on a periodic evaluation of the loan portfolio and is maintained at a level that management considers adequate to absorb potential losses. All commercial loans are assigned credit risk ratings, based upon an assessment of the borrower, the structure of the transaction and the available collateral and/or guarantees. All loans are monitored regularly by the responsible officer, and the risk ratings are adjusted when considered appropriate. The risk assessment allows management to identify problem loans timely. Management considers a variety of factors, and recognizes the inherent risk of loss that always exists in the lending process. Management uses a disciplined methodology to estimate the appropriate level of allowance for loan losses. Management's methodology to estimate an aggregate reserve is described in "NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES AND BASIS OF PRESENTATION." See "Asset Quality" for further discussion of the allowance for loan losses.

The Bank's methodology includes an evaluation of loss potential from individual problem credits, as well as a general reserve for the portfolio considering anticipated specific and general economic factors that may positively or adversely affect collectability. This assessment includes a review of changes in the composition and volume of the loan portfolio, overall portfolio quality and past loss experience, review of specific problem loans, current economic conditions that may affect borrowers' ability to repay, and other factors that may warrant consideration in estimating the reserve. In addition, the Bancorp's internal auditors, loan review, and various regulatory agencies periodically review the adequacy of the allowance as

Table of Contents

an integral part of their work responsibilities or examination process. Customers Bancorp may be asked to recognize additions or reductions to the allowance for loan losses based on their judgments of information available at the time of their examination.

In the covered loan table, many of the Bank's commercial and industrial loans have been classified as covered real estate. Approximately 75-80% of the Bank's commercial real estate, commercial and residential construction, consumer residential and commercial and industrial loan types have real estate as collateral (collectively, "the real estate portfolio"). The Bank's lien position on the real estate collateral will vary on a loan-by-loan basis and will change as a result of changes in the value of the collateral. Current appraisals providing current value estimates of the property are received when the Bank's credit group determines that the facts and circumstances have significantly changed since the date of the last appraisal, including that real estate values have deteriorated. The credit committee and loan officers review loans that are fifteen or more days delinquent and all non-accrual loans on a periodic basis. In addition, loans where the loan officers have identified a "borrower of interest" are discussed to determine if additional analysis is necessary to apply the risk rating criteria properly. The risk ratings for the real estate loan portfolio are determined based upon the current information available, including but not limited to discussions with the borrower, updated financial information, economic conditions within the geographic area and other factors that may affect the cash flow of the loan. On a quarterly basis, if necessary, the collateral values or discounted cash flow models are used to determine the estimated fair value of the underlying collateral for the quantification of a specific reserve for impaired loans. Appraisals used within this evaluation process do not typically age more than two years before a new appraisal is obtained. For loans where real estate is not the primary source of collateral, updated financial information is obtained, including accounts receivable and inventory aging reports and relevant supplemental financial data to determine the fair value of the underlying collateral.

These evaluations, however, are inherently subjective as they require material estimates, including, among others, the amounts and timing of expected future cash flows on impaired loans, estimated losses in the loan portfolio, and general amounts for historical loss experience, economic conditions, uncertainties in estimating losses and inherent risks in the various credit portfolios, all of which may be susceptible to significant change. Pursuant to ASC 450 Contingencies and ASC 310-40 Troubled Debt Restructurings by Creditors, impaired loans, consisting of non-accrual and restructured loans, are considered in the methodology for determining the allowance for credit losses. Impaired loans are generally evaluated based on the expected future cash flows or the fair value of the underlying collateral (less estimated costs to sell) if principal repayment is expected to come from the sale or operation of such collateral. The following table shows how the allowance for loan losses was allocated among the various loan portfolios outstanding as of December 31, 2014, 2013, and 2012, respectively. This allocation was based on management's specific review of the credit risk of the outstanding loan portfolios in each category as well as historical trends.

	December 31, 2014		2013		2012		
	Allowance for loan losses	Percent of Loans in each category to total loans (a)	Allowance for loan losses	Percent of Loans in each category to total loans (a)	Allowance for loan losses	Percent of Loans in each category to total loans (a)	
	(dollars in thousands)						
Construction	\$1,047	3.4	% \$2,385	9.9	% \$3,991	15.4	%
Commercial real estate	13,572	43.9	% 11,478	47.8	% 13,645	52.9	%
Multi-family	8,493	27.5	% 4,227	17.6	% 1,794	6.9	%
Commercial and industrial	4,746	15.3	% 2,674	11.2	% 1,477	5.7	%
Residential real estate	2,698	8.7	% 2,490	10.4	% 3,233	12.5	%
Home equity / other	114	0.4	% 130	0.5	% 154	0.6	%
Mortgage warehouse	—	—	% —	—	% 71	0.3	%

Edgar Filing: EQUUS TOTAL RETURN, INC. - Form 10-K

Manufactured housing	262	0.8	%	614	2.6	%	750	2.9	%
Residual Reserve	—	—	%	—	—	%	722	2.8	%
	\$30,932	100.0	%	\$23,998	100.0	%	\$25,837	100.0	%

Table of Contents

	December 31, 2011	Percent of Loans in each category to total loans (a)	2010	Percent of Loans in each category to total loans	
	Allowance for loan losses		Allowance for loan losses		
	(dollars in thousands)				
Construction	\$4,656	31.0	% \$2,126	14.1	%
Commercial real estate	5,447	36.2	% 6,280	41.5	%
Multi-family	1,583	10.5	% —	—	%
Commercial and industrial	1,441	9.6	% 1,663	11.0	%
Residential real estate	844	5.6	% 3,988	26.3	%
Home equity / other	77	0.5	% 11	0.1	%
Mortgage warehouse	929	6.2	% 465	3.1	%
Manufactured housing	1	—	% —	—	%
Residual Reserve	54	0.4	% 596	3.9	%
	\$15,032	100.0	% \$15,129	100.0	%

(a) Total loans include covered and non-covered loans in 2014, 2013, 2012, and 2011. No covered loans were held prior to 2010.

Table of Contents**ASSET QUALITY**

The Bank divides its loan portfolio into two categories to analyze and understand loan activity and performance: loans that were originated, and loans that were acquired. The Bank further divides originated loans into two categories: those originated prior to the current underwriting standards in 2009 and those originated subject to those standards post 2009, and purchased loans into two categories: those purchased at a credit discount, and those not acquired with credit discount. Management believes that this additional information provides for a better understanding of the risk in the portfolio and the various types of reserves that are available to absorb loan losses that may arise in future periods. Credit losses from originated loans are absorbed by the allowance for loan loss reserves. Credit losses from acquired loans are absorbed by the allowance for loan losses, nonaccretable difference fair value marks, and cash reserves, as described below. The allowance for loan losses is to absorb only those losses estimated to have been incurred after acquisition, whereas the fair value mark and cash reserves absorb losses estimated to have been embedded in the acquired loans at acquisition. This schedule includes both loans held for sale and loans held for investment.

Asset Quality at December 31, 2014

Loan Type	Total Loans	Current	30-90 Days	Greater than 90 Days and Accruing	Non-accrual/ NPL (a)	OREO (b)	NPA (a)+(b)	NPL to Loan Type (%)	NPA to Loans + OREO (%)
	(dollars in thousands)								
Legacy Loans									
Legacy	\$54,075	\$50,322	\$1,100	\$—	\$2,653	\$4,958	\$7,611	4.91 %	12.89 %
TDRs	1,060	998	—	—	62	—	62	5.85 %	5.85 %
Total Legacy Loans	55,135	51,320	1,100	—	2,715	4,958	7,673	4.92 %	12.77 %
Multi-Family	2,122,473	2,122,473	—	—	—	—	—	0.00 %	0.00 %
Commercial Real Estate	1,027,184	1,025,330	—	—	1,854	—	1,854	0.18 %	0.18 %
Commercial & Industrial	466,653	465,746	—	—	907	335	1,242	0.19 %	0.27 %
Residential	160,225	159,572	492	—	161	—	161	0.10 %	0.10 %
Construction	56,510	56,510	—	—	—	—	—	0.00 %	0.00 %
Home equity / other	576	567	—	—	9	—	9	1.56 %	1.56 %
TDR's	576	576	—	—	—	—	—	0.00 %	0.00 %
Total Originated Loans	3,834,197	3,830,774	492	—	2,931	335	3,266	0.08 %	0.09 %
Acquired Loans									
Covered	30,282	25,371	665	—	4,246	9,445	13,691	14.02 %	34.46 %
Non-covered	332,045	320,459	6,219	4,388	979	633	1,612	0.29 %	0.48 %
TDR's Covered	532	532	—	—	—	—	—	0.00 %	0.00 %
TDRs Non-Covered	2,853	1,886	105	—	862	—	862	30.21 %	30.21 %
Total Acquired Loans	365,712	348,248	6,989	4,388	6,087	10,078	16,165	1.66 %	4.30 %
Acquired PCI Loans									
Covered	11,367	3,933	—	7,434	—	—	—	0.00 %	0.00 %
Non-Covered	45,250	38,951	655	5,644	—	—	—	0.00 %	0.00 %
Total Acquired PCI Loans	56,617	42,884	655	13,078	—	—	—	0.00 %	0.00 %
Unearned Origination Fees	512	512	—	—	—	—	—		

Edgar Filing: EQUUS TOTAL RETURN, INC. - Form 10-K

Total Loans Receivable	4,312,173	4,273,738	9,236	17,466	11,733	15,371	27,104	0.27	%	0.63	%
Total Loans Held for Sale	1,435,459	1,435,459	—	—	—	—	—				
Total Portfolio	\$5,747,632	\$5,709,197	\$9,236	\$17,466	\$11,733	\$15,371	\$27,104	0.20	%	0.47	%

67

Table of Contents

Asset Quality at December 31, 2014 (continued)

Loan Type	Total Loans	NPL	ALL	Cash Reserve	Total Credit Reserves	Reserves to Loans (%)	Reserves to NPLs (%)		
New Century Orig. Loans									
Legacy	\$54,075	\$2,653	\$1,546	\$—	\$1,546	2.86	%	58.27	%
TDRs	1,060	62	30	—	30	2.83	%	48.39	%
Total Legacy Loans	55,135	2,715	1,576	—	1,576	2.86	%	58.05	%
Multi-Family									
Commercial Real Estate	1,027,184	1,854	7,610	—	7,610	0.74	%	410.46	%
Commercial & Industrial	466,653	907	3,418	—	3,418	0.73	%	376.85	%
Residential	160,225	161	1,171	—	1,171	0.73	%	727.33	%
Construction	56,510	—	424	—	424	0.75	%	n/a	
Home equity / other	576	9	8	—	8	1.39	%	88.89	%
TDR's	576	—	—	—	—	0.00	%	n/a	
Total Originated Loans	3,834,197	2,931	21,122	—	21,122	0.55	%	720.64	%
Acquired Loans									
Covered	30,282	4,246	603	—	603	1.99	%	14.20	%
Non-covered	332,045	979	617	3,042	3,659	1.10	%	373.75	%
TDR's Covered	532	—	—	—	—	0.00	%	n/a	
TDRs Non-Covered	2,853	862	—	—	—	0.00	%	0.00	%
Total Acquired Loans	365,712	6,087	1,220	3,042	4,262	1.17	%	70.02	%
Acquired PCI Loans									
Covered	11,367	—	1,669	—	1,669	14.68	%	n/a	
Non-Covered	45,250	—	5,345	—	5,345	11.81	%	n/a	
Total Acquired PCI Loans	56,617	—	7,014	—	7,014	12.39	%	n/a	
Unearned Origination Fees	512								
Total Loans Held for Investment	4,312,173	11,733	30,932	3,042	33,974	0.79	%	289.56	%
Total Loans Held for Sale	1,435,459	—	—	—	—	0.00	%	n/a	
Total Portfolio	\$5,747,632	\$11,733	\$30,932	\$3,042	\$33,974	0.59	%	289.56	%

Originated Loans

Originated loans (excluding held-for-sale loans) totaled \$3.8 billion, or 67.7%, of total loans at December 31, 2014, compared to \$2.1 billion, or 64.2%, at December 31, 2013. Of the total originated loans at December 31, 2014, \$3.8 billion, or 98.6%, were originated post 2009, when the new management team adopted new underwriting standards that management believes better limits risks of loss. Only \$2.9 million, or 0.08%, of the post 2009 loans were non-performing at December 31, 2014. Of the total originated loans at December 31, 2013, \$2.0 billion, or 96.3%, were originated post 2009. Only \$0.5 million, or 0.03%, of the post 2009 loans were non-performing at December 31, 2013. The post 2009 originated loans were supported by an allowance for loan losses of \$21.1 million (0.55% of post 2009 originated loans) and \$10.7 million (0.54% of post 2009 originated loans), respectively, at December 31, 2014 and December 31, 2013.

Legacy loans declined \$20.9 million to \$55.1 million at December 31, 2014, compared to \$76.0 million at December 31, 2013. Non-performing Legacy loans also declined to \$2.7 million at December 31, 2014 from \$10.2 million at December 31, 2013 as the Bank continued to workout the losses in this portfolio. The Legacy originated loans were supported by an allowance for loan losses of \$1.6 million (2.86% of Legacy loans) and \$2.4 million (3.21% of Legacy loans), respectively, at December 31, 2014 and December 31, 2013.

Acquired Loans

At December 31, 2014, Customers Bank reported \$0.4 billion of acquired loans, which was 7.4% of total loans, compared to \$0.4 billion, or 12.6%, of total loans at December 31, 2013. Non-performing acquired loans totaled \$6.1 million at December 31, 2014 and \$8.5 million at December 31, 2013. When loans are acquired, they are recorded on the balance sheet at fair value. Acquired loans include purchased portfolios, FDIC failed-bank acquisitions, and unassisted acquisitions. Of the manufactured housing loans purchased from Tammac prior to 2012, \$70.6 million were supported by a \$3.0 million cash reserve at December

Table of Contents

31, 2014, compared to \$74.7 million supported by a cash reserve of \$3.1 million at December 31, 2013. The cash reserve was created as part of the purchase transaction to absorb losses and is maintained in a demand deposit account at the Bank. All current losses and delinquent interest are absorbed by this reserve. For the manufactured housing loans purchased in 2012, Tammac has an obligation to pay the Bank the full payoff amount of the defaulted loan, including any principal, unpaid interest, or advances on the loans, once the borrower vacates the property. At December 31, 2014, \$47.5 million of these loans were outstanding, compared to \$53.5 million at December 31, 2013. Many of the acquired loans were purchased at a discount. The price paid considered management's judgment as to the credit and interest rate risk inherent in the portfolio at the time of purchase. Every quarter, management reassesses the risk and adjusts the cash flow forecast to incorporate changes in the credit outlook. Generally, a decrease in forecasted cash flows for a purchased loan will result in a provision for loan losses, and absent charge-offs, an increase in the allowance for loan losses. Acquired loans have a significantly higher percentage of non-performing loans than loans originated after September 2009. Management acquired these loans with the expectation that non-performing loan levels would be elevated, and therefore incorporated that expectation into the price paid. There is a Special Assets Group that focuses on workouts for these acquired non-performing assets. Total acquired loans were supported by reserves (allowance for loan losses and cash reserves) of \$11.3 million (2.67% of total acquired loans) and \$13.9 million (3.43% of total acquired loans), respectively, at December 31, 2014 and December 31, 2013.

Held-for-Sale Loans

At December 31, 2014, loans held for sale were \$1.4 billion, or 25.0%, of the total loan portfolio, compared to \$0.7 billion, or 23.3% of the total loan portfolio at December 31, 2013. The loans held-for-sale portfolio at December 31, 2014 included \$1.3 billion of loans to mortgage banking businesses, \$99.8 million of multi-family loans and \$3.6 million of residential mortgage loans, compared to \$740.7 million of loans to mortgage banking businesses and \$6.9 million of residential mortgages loans at December 31, 2013. Held-for-sale loans are carried on our balance sheet at either fair value (due to the election of the fair value option) or the lower of cost or fair value. An allowance for loan losses is not recorded on loans that are held for sale.

The Bank manages its credit risk through the diversification of the loan portfolio and the application of policies and procedures designed to foster sound credit standards and monitoring practices. While various degrees of credit risk are associated with substantially all investing activities, the lending function carries the greatest degree of potential loss. At December 31, 2014 and December 31, 2013, non-performing loans to total loans were 0.20% and 0.60%, respectively. Total reserves to non-performing loans were 289.6% and 152.9%, respectively, at December 31, 2014 and December 2013.

The tables below set forth non-covered non-performing loans and non-performing assets and asset quality ratios:

	December 31, 2014 (in thousands)	2013	2012	2011	2010
Loans 90+ days delinquent still accruing	\$4,388	\$3,772	\$1,966	\$—	\$5
Non-accrual loans	7,487	13,513	22,347	29,633	22,242
OREO	5,926	5,312	4,005	7,316	1,906
Non-performing non-covered assets	\$13,413	\$18,825	\$26,352	\$36,949	\$24,148

Table of Contents

	December 31,							
	2014	2013	2012	2011	2010			
Non-accrual non-covered loans to total non-covered loans	0.18	% 0.56	% 1.84	% 2.44	% 4.33			%
Non-performing non-covered assets to total non-covered assets	0.31	% 0.78	% 2.16	% 3.02	% 4.68			%
Non-accrual non-covered loans and 90+ days delinquent to total non-covered assets	0.28	% 0.72	% 1.99	% 2.42	% 4.31			%
Allowance for loan losses to (1):								
Total non-covered loans	0.56	% 0.62	% 1.20	% 1.24	% 2.94			%
Non-performing non-covered loans	319.44	% 109.16	% 65.26	% 50.73	% 68.02			%

Excludes the impact of purchased-credit-impaired loans and their related allowance for loan losses of \$7.0 million (1) for 2014, \$9.2 million for 2013, and \$11.3 million for 2012. There was no related allowance for loan losses for 2011 and 2010. There were no purchased-credit-impaired loans in the portfolio in 2009.

The table below sets forth types of non-covered loans that were non-performing at December 31, 2014, 2013, 2012, 2011 and 2010.

	December 31,				
	2014	2013	2012	2011	2010
	(in thousands)				
Construction	\$—	\$2,049	\$2,423	\$5,630	\$4,673
Residential real estate	849	969	1,669	1,643	1,125
Commercial real estate	3,450	9,924	17,770	19,535	15,739
Commercial and industrial	2,257	123	288	2,785	705
Manufactured housing	931	448	141	—	—
Consumer and other	—	—	56	40	—
Total non-performing loans	\$7,487	\$13,513	\$22,347	\$29,633	\$22,242

The Bank seeks to manage credit risk through the diversification of the loan portfolio and the application of credit underwriting policies and procedures designed to foster sound credit standards and monitoring practices. While various degrees of credit risk are associated with substantially all investing activities, the lending function carries the greatest degree of potential loss.

Asset quality assurance activities include careful monitoring of borrower payment status and the periodic review of borrower current financial information to ensure ongoing financial strength and borrower cash flow viability. The Bank has established credit policies and procedures, seeks the consistent application of those policies and procedures across the organization, and adjusts policies as appropriate for changes in market conditions and applicable regulations.

Problem Loan Identification and Management

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

The Bank assigns a special mention rating to loans that have potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may, at some future date, result in the deterioration of the

repayment prospects for the loan and our credit position. At December 31, 2014 and 2013, special mention loans were \$34.6 million and \$27.7 million, respectively.

Table of Contents

Risk ratings are not established for home equity loans, consumer loans, and installment loans, mainly because these portfolios consist of a larger number of homogenous loans with smaller balances. Instead, these portfolios are evaluated for risk mainly based on aggregate payment history, through the monitoring of delinquency levels and trends.

A regular reporting and review process is in place to provide for proper portfolio oversight and control, and to monitor those loans identified as problem credits by management. This process is designed to assess our progress in working toward a solution, and to assist in determining an appropriate specific allowance for possible losses. All loan work-out situations involve the active participation of management and are reported regularly to the Board. When a loan becomes delinquent 90 days or more, or earlier if considered appropriate, the loan is assigned to Customers' Special Asset Group ("SAG") for workout or other resolution.

Loan charge-offs are determined on a case-by-case basis. Loans are generally charged off when principal is likely to be unrecoverable and after appropriate collection steps have been taken. Loan charge-offs are proposed by the SAG and approved by the Board of Directors.

Loan policies and procedures are reviewed internally for possible revisions and changes on a regular basis. In addition, these policies and procedures, together with the loan portfolio, are reviewed on a periodic basis by various regulatory agencies and by our internal, external and loan review auditors, as part of their examination and audit procedures.

Troubled Debt Restructurings (TDRs)

At December 31, 2014 and 2013, there were \$5.0 million and \$4.6 million, respectively, in loans reported as TDRs. TDRs are considered impaired loans in the calendar year of their restructuring and are evaluated to determine whether they should be placed on non-accrual status. In subsequent years, a TDR may be returned to accrual status if it satisfies a minimum six-month performance requirement; however, it will remain classified as an impaired loan. Generally, Customers Bank requires sustained performance for nine months before returning a TDR to accrual status. Modification of purchased-credit-impaired loans that are accounted for within loan pools in accordance with the accounting standards for purchased-credit-impaired loans do not result in the removal of these loans from the pool even if modifications would otherwise be considered a TDR. Accordingly, as each pool is accounted for as a single asset with a single composite interest rate and an expectation of cash flows, modifications of loans within such pools are not TDRs.

TDR modifications primarily involve interest rate concessions, extensions of term, deferrals of principal, and other modifications. Other modifications typically reflect other nonstandard terms which the Bancorp would not offer in non-troubled situations. During the years ended December 31, 2014 and 2013, respectively, loans aggregating \$1.1 million and \$1.2 million were modified in troubled debt restructurings. TDR modifications of loans within the commercial and industrial category were primarily interest rate concessions, deferrals of principal and other modifications; modifications of commercial real estate loans were primarily deferrals of principal, extensions of term and other modifications; and modifications of residential real estate loans were primarily interest rate concessions and deferrals of principal. As of December 31, 2014 and 2013, there were no commitments to lend additional funds to debtors whose terms have been modified in troubled debt structuring.

There were no valuation losses at the time of the troubled debt restructuring and the TDR had no impact on the allowance for loan losses. During the twelve- month period ending December 31, 2014, six TDR loans defaulted with a total recorded investment of \$0.4 million. During the twelve-month period ending December 31, 2013, five TDR loans defaulted with a total recorded investment of \$0.4 million. Since these loans were included in the loan portfolio that is subject to the cash reserve, they will be removed from the loan portfolio when they become ninety days past due; accordingly, there were no defaulted TDR loans at December 31, 2014 and 2013.

All loans modified in troubled debt restructurings are considered impaired and measured for impairment. The nature and extent of impairment of TDRs, including those which have experienced a subsequent default, is considered in the determination of an appropriate level of allowance for loan losses. There were no specific allowances resulting from TDR modifications during 2014 and 2013.

Table of Contents

Non-performing loans and assets covered under FDIC loss sharing agreements

The tables below set forth non-accrual covered loans and non-performing covered assets covered under FDIC loss sharing agreements excluding purchased-credit-impaired loans.

	December 31, 2014	2013	2012
	(in thousands)		
Non-accrual covered loans	\$4,246	\$5,650	\$10,504
Covered other real estate owned	9,445	6,953	4,109
Total non-performing covered assets	\$13,691	\$12,603	\$14,613

The table below sets forth the types of covered loans that were non-performing excluding purchased-credit-impaired loans.

	December 31, 2014	2013	2012
	(in thousands)		
Construction	\$2,325	\$3,382	\$5,244
Residential real estate	1,006	564	1,358
Commercial real estate	615	1,691	3,712
Commercial and industrial	165	2	100
Home equity / other	135	11	90
Total non-performing covered loans	\$4,246	\$5,650	\$10,504

FDIC LOSS SHARING RECEIVABLE

As of December 31, 2014, \$42.2 million, or 0.7%, of outstanding loans, and \$ 9.4 million, or 61.5% of other real estate assets, were covered under loss share agreements with the FDIC in which the FDIC has agreed to reimburse us for 80% of all losses incurred in connection with those assets. We estimated the FDIC reimbursement that will result from losses or expenses incurred as we dispose of covered loans and other real estate assets, and included qualifying incurred expenses, we recorded the total as a receivable from the FDIC. The FDIC loss sharing receivable was approximately \$2.3 million and \$10.0 million as of December 31, 2014 and 2013, respectively. Increases in the FDIC indemnification asset reflect an estimated decrease in cash flows on a covered loan, and a decrease in the indemnification asset reflects an increase in the estimated cash flows of a covered loan, and the change in estimated collections is presented net in the provision for loan losses.

ACCRUED INTEREST RECEIVABLE

Accrued interest receivable increased by \$6.8 million, or 81.8%, to \$15.2 million at December 31, 2014 from \$8.4 million at December 31, 2013. This increase was primarily associated with the increase in total loans receivable of \$1.8 billion to \$4.3 billion at December 31, 2014 from \$2.5 billion at December 31, 2013.

PREMISES AND EQUIPMENT AND OTHER ASSETS

Our premises and equipment, net of accumulated depreciation, was \$10.8 million and \$11.6 million at December 31, 2014 and 2013, respectively. Leasehold improvements and furniture and equipment purchases and back office contributed \$0.3 million to the increase. Technology equipment contributed \$1.0 million due to the increase of additional technology facilities and employees.

Customers Bank's restricted stock holdings at December 31, 2014 and December 31, 2013 were \$82.0 million and \$42.4 million, respectively. These consist of stock of the Federal Reserve Bank, Federal Home Loan Bank and Atlantic Central Bankers Bank, and are required as part of our relationship with these banks.

Table of Contents

Other assets at December 31, 2014 and December 31, 2013 were \$52.9 million and \$41.0, respectively. Activity that contributed to the increase of \$11.9 million included \$6.2 million of cash pledged for interest rate swaps, \$3.8 million increase in value of interest rate swaps and \$1.4 million of technology infrastructure related to BankMobile that was capitalized.

BOLI purchases of \$30.5 million during 2014 contributed to the increase in our BOLI cash surrender value of \$138.7 million at December 31, 2014 from \$104.4 million at December 31, 2013. BOLI is used by the Bank as tax-free funding for employee benefits. Included in BOLI on the balance sheet is the cash surrender value of the Supplemental Executive Retirement Plan ("SERP") balance of \$2.8 million and \$2.3 million at December 31, 2014 and 2013, respectively.

DEPOSITS

The Bank offers a variety of deposit accounts, including checking, savings, money market deposit accounts ("MMDA") and time deposits. Deposits are obtained primarily from our geographic service area. Total deposits grew to \$4.5 billion at December 31, 2014, an increase of \$1.6 billion, or 53.1%, from \$3.0 billion at December 31, 2013. Note that \$1.1 billion of the deposits were brokered deposits with the remaining generated from the retail network and listing services. We experienced growth in retail deposits due to exceptional sales behaviors, despite continued low interest rates in 2014.

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

	December 31, 2014	2013	2012
	(in thousands)		
Demand, non-interest bearing	\$546,436	\$478,103	\$219,687
Demand, interest bearing	71,202	58,013	37,260
Savings, including MMDA	2,203,237	1,298,468	1,003,985
Time, \$100,000 and over	1,043,265	797,322	708,487
Time, other	668,398	328,016	471,399
Total deposits	\$4,532,538	\$2,959,922	\$2,440,818

Time deposits of \$100,000 or more were \$1.0 billion at December 31, 2014 compared to \$797.3 million at December 31, 2013, an increase of \$245.9 million or 30.9%. We experienced growth in retail deposits, despite lower interest rates in 2014. Non-interest bearing demand deposits totaled \$546.4 million at December 31, 2014, up from \$478.1 million at December 31, 2013. These accounts include deposits of students made pursuant to a program serviced by a third party on behalf of the Bank. Deposits of students were flat at \$232.7 million as of December 31, 2014 and \$232.8 million as of December 31, 2013. These deposits are seasonal, peaking in the fall and mid-winter and lowest in the summer.

Average deposit balances by type and the associated average rate paid are summarized below:

	For the Year ended December 31,		2013		2012	
	2014		2013		2012	
	Average Balance	Average Rate Paid	Average Balance	Average Rate Paid	Average Balance	Average Rate Paid
	(dollars in thousands)					
Demand deposits	\$620,385	0.00	% \$385,175	0.00	% \$180,719	0.00
Interest-bearing demand deposits	62,840	0.61	45,613	0.52	36,701	0.52
Savings, including MMDA	1,753,691	0.42	1,138,200	0.68	876,605	0.86
Time deposits	1,403,774	0.96	1,251,707	1.04	935,207	1.43
Total	\$3,840,690		\$2,820,695		\$2,029,232	

Table of Contents

At December 31, 2014, the scheduled maturities of time deposits greater than \$100,000 were as follows:

	December 31, (in thousands)
3 months or less	\$188,976
Over 3 through 6 months	264,206
Over 6 through 12 months	236,626
Over 12 months	353,457
Total	\$1,043,265

FHLB ADVANCES and OTHER BORROWINGS

Borrowed funds from various sources are generally used to supplement deposit growth and meet other operating needs. The Bank strategically views the short term FHLB advances as funding the loans to mortgage companies national business.

Short-term debt

Short-term debt was as follows:

	December 31, 2014			2013			2012		
(amounts in thousands)	Amount	Rate		Amount	Rate		Amount	Rate	
FHLB advances	\$1,298,000	0.29	%	\$611,500	0.26	%	\$411,000	0.25	%
Federal funds purchased	—	—	%	13,000	0.48	%	5,000	0.20	%
Total short-term borrowings	\$1,298,000			\$624,500			\$416,000		

For additional information on the Company's short-term debt, refer to "NOTE 11 – BORROWINGS."

Long-term debt

The contractual maturities of fixed-rate long-term FHLB advances are as noted below.

	December 31, 2014			2013		
(amounts in thousands)	Amount	Rate		Amount	Rate	
2015	\$—	—	%	\$50,000	0.37	%
2016	85,000	0.59		35,000	0.66	
2017	180,000	1.21		5,000	3.08	
2018	55,000	1.61		5,000	3.31	
	\$320,000			\$95,000		

Senior notes

On June 26, 2014, Customers Bancorp, Inc. closed a private placement transaction in which it issued \$25.0 million of 4.625% senior notes due 2019. Interest is paid semi-annually in arrears in June and December. The notes are unsecured obligations of the Bancorp and rank equally with all of its secured and unsecured senior indebtedness. In July and August 2013, the Bancorp issued \$63.3 million in aggregate principal amount of senior notes due 2018. The notes bear interest at 6.375% per year which is payable on March 15, June 15, September 15, and December 15.

Table of Contents

Subordinated debt

On June 26, 2014, Customers Bank closed a private placement transaction in which it issued \$110.0 million of fixed-to-floating rate subordinated notes due 2029. The subordinated notes bear interest at an annual fixed rate of 6.125% until June 26, 2024, and interest is paid semiannually. From June 26, 2024, the subordinated notes will bear an annual interest rate equal to three-month LIBOR plus 344.3 basis points until maturity on June 26, 2029. Customers Bank has the ability to call the subordinated notes, in whole or in part, at a redemption price equal to 100% of the principal balance at certain times on or after June 26, 2024.

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

SHAREHOLDERS' EQUITY

Shareholders' equity increased by \$56.5 million to \$443.1 million at December 31, 2014, from \$386.6 million at December 31, 2013. The increase in equity was primarily the result of net income for 2014 of \$43.2 million and a decrease in unrealized losses (net of taxes) on available-for-sale securities of \$9.3 million.

In May 2014, the Bancorp's Board of Directors declared a 10% stock dividend to all shareholders of record as of May 27, 2014. This special dividend was paid on June 30, 2014 in the form of an aggregate of 2.4 million additional shares of Common Stock.

During 2014 the Bancorp issued 91,457 shares of Common Stock, 52,770 shares were issued to directors in lieu of meeting retainer fees, 34,414 shares were issued under share-based compensation arrangements and 4,273 shares under the employee stock purchase plan.

During 2013, the Bancorp:

- sold 6.2 million shares of new issue Voting Common Stock to the public at a price of \$16.75 per share. The net proceeds after deducting underwriting discounts and commissions and offering expenses were \$97.5 million;
- converted 3.7 million shares of Class B Non-Voting Common Stock into 3.7 million shares of Voting Common Stock;
- authorized a stock repurchase plan in which the Bancorp could acquire up to 5% of its current outstanding shares at prices not to exceed a 20% premium over the current book value. The repurchase program may be suspended, modified or discontinued at any time, and the Bancorp has no obligation to repurchase any amount of its Common Stock under the program;
- repurchased 0.5 million shares under the stock repurchase program discussed above;
- issued 23,413 shares of Common Stock under share-based compensation arrangements;
- issued 31,904 shares of Class B Non-Voting Common Stock and 14,869 shares of Voting Common Stock upon exercise of outstanding warrants; and
- repurchased warrants to purchase 17,227 shares of voting Common Stock and 17,227 shares of Class B Non-Voting stock.

During 2012, the Bancorp:

- sold 7.1 million shares of common stock in private offerings. The proceeds, net of offering costs, were \$94.6 million; and
- announced that, due to market conditions, it had postponed its initial public offering of Voting Common Stock. Costs related to this postponed offering in the amount of \$1.4 million were expensed and are a component of non-interest expenses.

For additional details relating to changes in the Bancorp's shareholders' equity, refer to the "Consolidated Statements of Changes in Shareholders Equity" presented in Part II, Item 8. Financial Statements and Supplementary Data of this Form 10-K.

LIQUIDITY AND CAPITAL RESOURCES

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

Table of Contents

The Bank's investment portfolio provides periodic cash flows through regular maturities and amortization, and can be used as collateral to secure additional liquidity funding. Our principal sources of funds are proceeds from stock issuance, deposits, debt issuance, principal and interest payments on loans, and other funds from operations. Borrowing arrangements are maintained with the Federal Home Loan Bank and the Federal Reserve Bank of Philadelphia to meet short-term liquidity needs. As of December 31, 2014 and 2013, our borrowing capacity with the Federal Home Loan Bank was \$3.2 billion and \$1.6 billion, respectively, of which \$1.3 billion and \$611.5 million, respectively, was used in short-term borrowings. As of December 31, 2014 and 2013, our borrowing capacity with the Federal Reserve Bank of Philadelphia was \$62.7 million and \$92.3 million, respectively.

Net cash flows used in operating activities were \$543.5 million for the twelve months ended December 31, 2014, compared to net cash flows provided by operating activities of \$722.0 million for the twelve months ended December 31, 2013. Origination of loans held for sale in excess of the proceeds from the sales of loans contributed \$585.1 million to cash flows used in operating activities during 2014. Proceeds from loans held for sale in excess of the originations of loans contributed \$689.6 million to cash flows provided by operating activities during 2013. Investing activities used net cash flows of \$1.9 billion for the twelve months ended December 31, 2014. Purchases less proceeds from sales of investment securities provided \$97.5 million which was offset by a net increase in loans of \$1.8 billion. For the twelve months ended December 31, 2013, net cash flows used in investing activities were \$1.6 billion.

Financing activities provided \$2.6 billion for the twelve months ended December 31, 2014, as increases in cash from deposits provided \$1.6 billion. In addition, increases in short-term and FHLB term borrowings of \$633.5 million and \$265.0 million, respectively, provided sufficient cash flows to support operating and investing activities. Additionally, \$133.1 million in net proceeds were raised by private placement subordinated and senior debt offerings in 2014.

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

CAPITAL ADEQUACY

The Board of Governors of the Federal Reserve System has adopted risk-based capital and leverage ratio requirements for bank holding companies like the Bancorp and banks like Customers Bank that are members of the Federal Reserve System. The Pennsylvania Department of Banking and Securities also sets minimum capital requirements. At December 31, 2014 and 2013, the Bancorp met each of our minimum capital requirements. Management believes that the Bancorp meets the regulatory "well capitalized" criteria as of December 31, 2014. Banking regulators have discretion to establish an institution's classification based on other factors, in addition to the institution's numeric capital levels.

Management is not aware of any developments that have occurred and that could, or would be reasonably likely to, cause the Bancorp's classification to be reduced below a level of "well capitalized" for regulatory purposes. The Bancorp's capital classification is determined pursuant to "prompt corrective action" regulations, and to determine levels of deposit insurance assessments, and may not constitute an accurate representation of our overall financial condition or prospects.

Table of Contents

The following table summarizes the required capital ratios and the corresponding regulatory capital positions of the Bancorp and Customers Bank for the periods or dates indicated:

	Actual			For Capital Adequacy Purposes			To Be Well Capitalized Under Prompt Corrective Action Provisions		
(Dollars in thousands)	Amount	Ratio		Amount	Ratio		Amount	Ratio	
As of December 31, 2014:									
Total capital (to risk weighted assets)									
Customers Bancorp, Inc.	\$578,644	11.09	%	\$417,473	8.0	%	N/A	N/A	
Customers Bank	\$621,894	11.98	%	\$415,141	8.0	%	\$518,926	10.0	%
Tier 1 capital (to risk weighted assets)									
Customers Bancorp, Inc.	\$437,712	8.39	%	\$208,737	4.0	%	N/A	N/A	
Customers Bank	\$480,963	9.27	%	\$207,570	4.0	%	\$311,356	6.0	%
Tier 1 capital (to average assets)									
Customers Bancorp, Inc.	\$437,712	6.69	%	\$261,622	4.0	%	N/A	N/A	
Customers Bank	\$480,963	7.39	%	\$260,462	4.0	%	\$325,577	5.0	%
As of December 31, 2013:									
Total capital (to risk weighted assets)									
Customers Bancorp, Inc.	\$411,527	13.21	%	\$249,196	8.0	%	N/A	N/A	
Customers Bank	\$435,432	14.11	%	\$246,936	8.0	%	\$308,670	10.0	%
Tier 1 capital (to risk weighted assets)									
Customers Bancorp, Inc.	\$387,529	12.44	%	\$124,598	4.0	%	N/A	N/A	
Customers Bank	\$411,434	13.33	%	\$123,468	4.0	%	\$185,202	6.0	%
Tier 1 capital (to average assets)									
Customers Bancorp, Inc.	\$387,529	10.11	%	\$153,310	4.0	%	N/A	N/A	
Customers Bank	\$411,434	10.81	%	\$152,191	4.0	%	\$190,239	5.0	%

Capital Ratios

The Bank continued to build capital during 2014. In general, in the past few years, capital growth has been achieved by earnings and increases in capital from sales of common stock.

The Bank is unaware of any current recommendations by the regulatory authorities which, if they were to be implemented, would have a material effect on our liquidity, capital resources, or operations.

The maintenance of appropriate levels of capital is an important objective of our Asset and Liability Management process. Through our initial capitalization and our subsequent offerings, we believe we have continued to maintain a strong capital position.

Effective January 1, 2015, Customers Bancorp and Customers Bank became subject to new capital requirements as detailed earlier in this document. Management has reviewed these new calculations and requirements, and expects to comply with the requirements when they become effective.

Table of Contents**OFF-BALANCE SHEET ARRANGEMENTS**

The Bank is involved with financial instruments and other commitments with off-balance sheet risks. Financial instruments with off-balance sheet risks are incurred in the normal course of business to meet the financing needs of our customers. These financial instruments include commitments to extend credit, including unused portions of lines of credit, and standby letters of credit. Those instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized on the balance sheets.

With commitments to extend credit, exposures to credit loss in the event of non-performance by the other party to the financial instrument is represented by the contractual amount of those instruments. The same credit policies are used in making commitments and conditional obligations as for on-balance sheet instruments. Since they involve credit risk similar to extending a loan, they are subject to the Bank's Credit Policy and other underwriting standards.

As of December 31, 2014 and 2013, the following off-balance sheet commitments, financial instruments and other arrangements were outstanding:

	December 31,	
	2014	2013
	(in thousands)	
Commitments to fund loans	\$231,294	\$202,809
Unfunded commitments to fund mortgage warehouse loans	713,619	905,442
Unfunded commitments under lines of credit	430,995	177,457
Letters of credit	36,206	29,116
Other unused commitments	7,685	8,010

Commitments to fund loans, unfunded commitments to fund mortgage warehouse loans, unfunded commitments under lines of credit and letters of credit are agreements to extend credit to or for the benefit of a customer in the ordinary course of our business.

Commitments to fund loans and unfunded commitments under lines of credit may be obligations of ours as long as there is no violation of any condition established in the contract. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. We evaluate each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if we deem it necessary upon extension of credit, is based on management's credit evaluation. Collateral held varies but may include personal or commercial real estate, accounts receivable, inventory and equipment.

Mortgage warehouse loan commitments are agreements to purchase mortgage loans from mortgage bankers that agree to purchase the loans back in a short period of time or to sell to third party mortgage originators. These commitments generally fluctuate monthly as existing loans are repurchased by the mortgage bankers and new loans are purchased by the Bank.

Outstanding letters of credit written are conditional commitments issued by us to guarantee the performance of a customer to a third party. Letters of credit may obligate us to fund draws under those letters of credit whether or not a customer continues to meet the conditions of the extension of credit. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers.

Table of Contents**CONTRACTUAL OBLIGATIONS**

The following table sets forth contractual obligations and other commitments representing required and potential cash outflows as of December 31, 2014. Interest on subordinated notes, FHLB long-term advances, and senior notes was calculated using then current contractual interest rates.

	Total	Within one year	After one but within three years	After three but within five years	More than five years
(amounts in thousands)					
Operating leases	\$21,835	\$3,574	\$ 6,740	\$ 5,587	\$5,934
Benefit plan commitments	4,500	300	600	600	3,000
Contractual maturities of time deposits	1,711,663	976,051	636,771	98,841	0
Subordinated notes	110,000	0	0	0	110,000
Interest on subordinated notes	101,070	6,738	13,476	13,476	67,380
Loan commitments	1,375,908	1,056,862	65,519	116,369	137,158
FHLB long-term advances	320,000	0	265,000	55,000	0
Interest on FHLB long-term advances	5,322	3,552	592	1,178	0
Senior notes	88,250	0	63,250	25,000	0
Interest on senior notes	20,230	5,188	10,377	4,665	0
Other commitments (1)	7,685	0	0	7,685	0
Standby letters of credit	36,206	28,292	1,500	6,414	0
Total	\$3,802,669	\$2,080,557	\$ 1,063,825	\$ 334,815	\$323,472

(1) Represents a commitment expiring in approximately three years that is subject to unscheduled requests for payment.

NEW ACCOUNTING PRONOUNCEMENTS

For information about the impact that recently adopted or issued accounting guidance will have on us, refer to "NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES AND BASIS OF PRESENTATION".

Table of Contents

Item 7A. Quantitative and Qualitative Disclosure About Market Risk

Interest Rate Sensitivity

The largest component of our net income is net interest income, and the majority of our financial instruments are interest rate sensitive assets and liabilities with various terms and maturities. One of the primary objectives of management is to maximize net interest income while minimizing interest rate risk. Interest rate risk is derived from timing differences in the repricing of assets and liabilities, loan prepayments, deposit withdrawals, and differences in lending and funding rates. Our Asset/Liability Committee actively seeks to monitor and control the mix of interest rate sensitive assets and interest rate sensitive liabilities.

We use two complementary methods to analyze and measure interest rate sensitivity as part of the overall management of interest rate risk. They are income simulation modeling and estimates of economic value of equity. The combination of these two methods provides a reasonably comprehensive summary of the levels of interest rate risk of our exposure to time factors and changes in interest rate environments.

Income simulation modeling is used to measure our interest rate sensitivity and manage our interest rate risk. Income simulation considers not only the impact of changing market interest rates upon forecasted net interest income, but also other factors such as yield curve relationships, the volume and mix of assets and liabilities, customer preferences and general market conditions.

Through the use of income simulation modeling, we have estimated the net interest income for the year ending December 31, 2014, based upon the assets, liabilities and off-balance sheet financial instruments in existence at December 31, 2013. We have also estimated changes to that estimated net interest income based upon interest rates rising or falling immediately (“rate shocks”). Rate shocks assume that all interest rates increase or decrease immediately. The following table reflects the estimated percentage change in estimated net interest income for the year ending December 31, 2014, resulting from changes in interest rates.

Net change in net interest income

Rate Shocks	% Change	
Up 3%	(6.3	)%
Up 2%	(1.4	)%
Up 1%	1.4	%
Down 1%	—	%
Down 2%	(1.9	)%
Down 3%	(4.4	)%

The net changes in net interest income in all scenarios are within Customers Bank’s interest rate risk policy guidelines. Economic Value of Equity (“EVE”) estimates the discounted present value of asset and liability cash flows. Discount rates are based upon market prices for comparable assets and liabilities. Upward and downward rate shocks are used to measure volatility of EVE in relation to a constant rate environment. This method of measurement primarily evaluates the longer term repricing risks and options in Customers Bank’s balance sheet. The following table reflects the estimated EVE at risk and the ratio of EVE to EVE adjusted assets at December 31, 2014, resulting from shocks to interest rates.

Rate Shocks	From base	
Up 3%	(30.0	)%
Up 2%	(15.0	)%
Up 1%	(3.1	)%
Down 1%	(9.6	)%
Down 2%	(18.3	)%
Down 3%	(11.1	)%

The matching of assets and liabilities may also be analyzed by examining the extent to which such assets and liabilities are interest rate sensitive and by monitoring a bank’s interest rate sensitivity “gap.” An asset or liability is said to be interest rate

Table of Contents

sensitive within a specific time period if it will mature or reprice within that time period. The interest rate sensitivity gap is defined as the difference between the amount of interest earning assets maturing or repricing within a specific time period and the amount of interest bearing liabilities maturing or repricing within that time period.

The following table sets forth the amounts of interest-earning assets and interest-bearing liabilities outstanding at December 31, 2014 that are anticipated, based upon certain assumptions, to reprice or mature in each of the future time periods shown. Except as stated below, the amount of assets and liabilities shown that reprice or mature during a particular period were determined in accordance with the earlier of term to repricing or the contractual maturity of the asset or liability. The table sets forth an approximation of the projected repricing of assets and liabilities at December 31, 2014 on the basis of contractual maturities, anticipated prepayments, and scheduled rate adjustments within a three-month period and subsequent selected time intervals. The loan amounts in the table reflect principal balances expected to be repaid and/or repriced as a result of contractual amortization and anticipated prepayments of adjustable and fixed rate loans, and as a result of contractual-rate adjustments on adjustable-rate loans.

Balance Sheet Gap

Analysis at

December 31, 2014

	3 months or less (dollars in thousands)	3 to 6 months	6 to 12 months	1 to 3 years	3 to 5 years	Over 5 years	Total
Assets							
Interest earning							
deposits and federal funds sold	\$308,276	\$—	\$—	\$—	\$—	\$61,046	\$369,322
Investment securities	16,606	16,862	33,684	115,432	85,425	206,407	474,416
Loans (a)	2,228,332	232,401	337,453	1,206,119	1,139,264	573,131	5,716,700
Total interest-earning assets	2,553,214	249,263	371,137	1,321,551	1,224,689	840,584	6,560,438
Non interest-earning assets	—	—	—	—	—	224,430	224,430
Total assets	2,553,214	249,263	371,137	1,321,551	1,224,689	1,065,014	\$6,784,868
Liabilities							
Other							
interest-bearing deposits	\$2,165,612	\$—	\$—	\$—	\$—	\$108,827	\$2,274,439
Time deposits	335,768	314,626	356,057	615,786	89,393	33	1,711,663
Other borrowings	1,282,998	—	25,002	260,000	50,000	—	1,618,000
Subordinated debt	0	—	—	—	—	110,000	110,000
Total interest-bearing liabilities	3,784,378	314,626	381,059	875,786	139,393	218,860	5,714,102
Non-interest-bearing liabilities	—	—	—	—	—	587,467	587,467
Shareholders' equity	—	—	—	—	—	483,299	483,761
Total liabilities and shareholders' equity	3,784,378	314,626	381,059	875,786	139,393	1,289,626	\$6,785,330
Interest sensitivity gap	\$(1,231,164)	\$(65,363)	\$(9,922)	\$445,765	\$1,085,296	\$(224,612)	

Edgar Filing: EQUUS TOTAL RETURN, INC. - Form 10-K

Cumulative interest sensitivity gap												
Cumulative interest sensitivity gap to total assets	(18.1	)%	(19.1	)%	(19.3	)%	(12.7	)%	3.3	%	0.0	%
Cumulative interest-earning assets to cumulative interest-bearing liabilities	67.5	%	68.4	%	70.8	%	83.9	%	104.1	%	114.8	%

(a) Including loans held for sale

As shown above, we have a negative cumulative gap (cumulative interest sensitive assets are lower than cumulative interest sensitive liabilities) within the next year, which generally indicates that an increase in rates may lead to a decrease in net interest income, and a decrease in rates may lead to an increase in net interest income. Interest rate sensitivity gap analysis measures whether assets or liabilities may reprice but does not capture the ability to reprice or the range of potential repricing on assets or liabilities. Thus indications based on a negative or positive gap position need to be analyzed in conjunction with other interest rate risk management tools.

Management believes that the assumptions and combination of methods utilized in evaluating estimated net interest income are reasonable. However, the interest rate sensitivity of our assets, liabilities and off-balance sheet financial instruments, as well as the estimated effect of changes in interest rates on estimated net interest income, could vary substantially if different assumptions are used or actual experience differs from the assumptions used in the model.

Table of Contents

Item 8. Financial Statements and Supplementary Data

Financial Statements for the three years ended

December 31, 2014, 2013 and 2012

INDEX TO CUSTOMERS BANCORP, INC. FINANCIAL STATEMENTS

<u>Report of Independent Registered Public Accounting Firm</u>	<u>83</u>
<u>Report of Independent Registered Public Accounting Firm on Internal Controls</u>	<u>84</u>
<u>Report of Independent Registered Public Accounting Firm</u>	<u>85</u>
<u>Consolidated Balance Sheets as of December 31, 2014 and 2013</u>	<u>86</u>
<u>Consolidated Statements of Income for the years ended December 31, 2014, 2013 and 2012</u>	<u>87</u>
<u>Consolidated Statements of Comprehensive Income for the years ended December 31, 2014, 2013 and 2012</u>	<u>88</u>
<u>Consolidated Statements of Changes In Shareholders' Equity for the years ended December 31, 2014, 2013 and 2012</u>	<u>89</u>
<u>Consolidated Statements of Cash Flows for the years ended December 31, 2014, 2013 and 2012</u>	<u>90</u>
<u>Notes to Consolidated Financial Statements for the years ended December 31, 2014, 2013 and 2012</u>	<u>92</u>

Table of Contents

Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders

Customers Bancorp, Inc.

We have audited the accompanying consolidated balance sheets of Customers Bancorp, Inc. and Subsidiaries (the “Bancorp”) as of December 31, 2014 and 2013, and the related consolidated statements of income, comprehensive income, changes in shareholders’ equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Bancorp’s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). 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. An audit also includes 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 Customers Bancorp, Inc. and Subsidiaries as of December 31, 2014 and 2013, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Bancorp’s internal control over financial reporting as of December 31, 2014, based on criteria established in Internal Control – Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated February 27, 2015 expressed an unqualified opinion on the effectiveness of the Bancorp's internal controls over financial reporting.

/s/ BDO USA, LLP

Philadelphia, Pennsylvania

February 27, 2015

Table of Contents

Report of Independent Registered Public Accounting Firm on Internal Controls

Board of Directors and Shareholders

Customers Bancorp, Inc.

We have audited Customers Bancorp, Inc. and Subsidiaries' (the "Bancorp") internal control over financial reporting as of December 31, 2014, based on criteria established in Internal Control – Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission (the "COSO criteria"). The Bancorp's management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Responsibility for Financial Statements and Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Bancorp's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Customers Bancorp, Inc. and Subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2014, based on the COSO criteria.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Customers Bancorp, Inc. and Subsidiaries as of December 31, 2014 and 2013 and the related consolidated statement of income, comprehensive income, changes in shareholders' equity, and cash flow for the years, then ended and our report dated February 27, 2015 expressed an unqualified opinion thereon.

/s/ BDO USA, LLP

Philadelphia, Pennsylvania

February 27, 2015

Table of Contents

Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders

Customers Bancorp, Inc.

We have audited the accompanying consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows of Customers Bancorp, Inc. and Subsidiaries for the year ended December 31, 2012. These consolidated financial statements are the responsibility of the Bancorp's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the results of Customers Bancorp, Inc. and Subsidiaries' operations and their cash flows for the year ended December 31, 2012 in conformity with accounting principles generally accepted in the United States of America.

/s/ Baker Tilly Virchow Krause, LLP

Allentown, Pennsylvania

March 18, 2013

Table of Contents

CUSTOMERS BANCORP, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(dollars in thousands, except share data)

	December 31, 2014	2013
ASSETS		
Cash and due from banks	\$62,746	\$60,709
Interest earning deposits	308,277	172,359
Cash and cash equivalents	371,023	233,068
Investment securities available for sale, at fair value	416,685	497,573
Loans held for sale (includes \$1,335,668 and \$747,593, respectively at fair value)	1,435,459	747,593
Loans receivable	4,312,173	2,465,078
Allowance for loan losses	(30,932)	(23,998)
Total loans receivable, net of allowance for loan losses	4,281,241	2,441,080
FHLB, Federal Reserve Bank, and other restricted stock	82,002	42,424
Accrued interest receivable	15,205	8,362
FDIC loss sharing receivable	2,320	10,046
Bank premises and equipment, net	10,810	11,625
Bank-owned life insurance	138,676	104,433
Other real estate owned	15,371	12,265
Goodwill and other intangibles	3,664	3,676
Other assets	52,914	41,028
Total assets	\$6,825,370	\$4,153,173
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Deposits:		
Demand, non-interest bearing	\$546,436	\$478,103
Interest bearing	3,986,102	2,481,819
Total deposits	4,532,538	2,959,922
Federal funds purchased	—	13,000
FHLB advances	1,618,000	706,500
Other borrowings	88,250	63,250
Subordinated debt	110,000	2,000
Accrued interest payable and other liabilities	33,437	21,878
Total liabilities	6,382,225	3,766,550
Commitments and contingencies (NOTES 17 and 21)		
Shareholders' equity:		
Preferred stock, no par value or as set by the board; 100,000,000 shares authorized, none issued	—	—
Common stock, par value \$1.00 per share; 200,000,000 shares authorized; 27,277,789 and 24,756,411 shares issued as of December 31, 2014 and 2013; 26,745,529 and 24,224,151 shares outstanding as of December 31, 2014 and 2013	27,278	24,756
Additional paid in capital	355,822	307,231
Retained earnings	68,421	71,008
Accumulated other comprehensive loss, net	(122)	(8,118)
Treasury stock, at cost (532,260 shares as of December 31, 2014 and 2013)	(8,254)	(8,254)
Total shareholders' equity	443,145	386,623
Total liabilities and shareholders' equity	\$6,825,370	\$4,153,173
See accompanying notes to the consolidated financial statements.		

Table of Contents

CUSTOMERS BANCORP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(dollars in thousands, except share data)

	For the Year Ended December 31,		
	2014	2013	2012
Interest income:			
Loans receivable, including fees	\$ 146,388	\$ 82,580	\$ 70,510
Loans held for sale	30,801	38,140	15,950
Investment securities	10,386	6,314	6,731
Other	2,852	1,122	623
Total interest income	190,427	128,156	93,814
Interest expense:			
Deposits	24,454	21,020	21,076
Other borrowings	5,342	2,024	10
FHLB advances	5,194	1,192	606
Subordinated debt	3,514	65	69
Total interest expense	38,504	24,301	21,761
Net interest income	151,923	103,855	72,053
Provision for loan losses	14,747	2,236	14,270
Net interest income after provision for loan losses	137,176	101,619	57,783
Non-interest income:			
Mortgage warehouse transactional fees	8,233	12,962	12,289
Bank-owned life insurance	3,702	2,482	1,332
Gains on sales of investment securities	3,191	1,274	9,017
Gains on sales of loans	3,125	852	357
Mortgage loan and banking income	2,048	1,142	—
Deposit fees	801	675	481
Other	4,026	3,316	5,482
Total non-interest income	25,126	22,703	28,958
Non-interest expense:			
Salaries and employee benefits	46,427	35,493	23,846
FDIC assessments, taxes, and regulatory fees	11,812	5,568	3,037
Occupancy	11,010	8,829	6,816
Professional services	7,748	5,548	3,468
Technology, communication and bank operations	5,856	4,330	2,805
Other real estate owned	3,601	1,365	(85)
Loan workout	1,706	2,245	2,243
Advertising and promotion	1,325	1,274	1,219
Loss contingency	—	2,000	—
Stock offering expenses	—	—	1,437
Other	9,429	7,372	5,865
Total non-interest expense	98,914	74,024	50,651
Income before income tax expense	63,388	50,298	36,090
Income tax expense	20,174	17,604	12,272
Net income	\$ 43,214	\$ 32,694	\$ 23,818
Basic earnings per common share (1)	\$ 1.62	\$ 1.34	\$ 1.61
Diluted earnings per common share (1)	1.55	1.30	1.57

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

June 30, 2014.

See accompanying notes to the consolidated financial statements.

Table of Contents

CUSTOMERS BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(in thousands)

	For the Year Ended December 31,		
	2014	2013	2012
Net income	\$43,214	\$32,694	\$23,818
Unrealized gains (losses) on securities:			
Unrealized gains (losses) on available-for-sale securities arising during the period (1)	17,437	(12,853)	) 2,522
Income tax effect (1)	(6,103)	) 4,499	(883)
Less: reclassification adjustments for gains on securities included in net income	(3,191)	) (1,274)	) (9,017)
Income tax effect	1,117	446	3,156
Unrealized holding gains on available-for-sale securities transferred from the held-to-maturity category into the available-for-sale category	—	—	8,509
Income tax effect	—	—	(2,978)
Net unrealized gains (losses) on securities	9,260	(9,182)	) 1,309
Unrealized losses on cash flow hedges:			
Unrealized losses on cash flow hedges arising during the period	(1,945)	) —	—
Income tax effect	681	—	—
Net unrealized losses on cash flow hedges	(1,264)	) —	—
Other comprehensive income (loss), net of income tax effect	7,996	(9,182)	) 1,309
Comprehensive income	\$51,210	\$23,512	\$25,127

(1) Includes immaterial gains or losses on foreign currency items for the years ended December 31, 2014 and 2013. There were no foreign currency items for the year ended December 31, 2012. See accompanying notes to the consolidated financial statements.

Table of Contents

CUSTOMERS BANCORP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

For the years ended December 31, 2014, 2013 and 2012

(dollars in thousands)

	Shares of Common Stock	Common Stock	Additional Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total
Balance, January 1, 2012	11,347,683	\$11,395	\$122,602	\$14,496	\$ (245)	\$ (500)	\$147,748
Net income				23,818			23,818
Other comprehensive income					1,309		1,309
Share-based compensation expense			2,014				2,014
Issuance of common stock, net of costs of \$4,970	7,111,819	7,112	87,474				94,586
Balance, December 31, 2012	18,459,502	18,507	212,090	38,314	1,064	(500)	269,475
Net Income				32,694			32,694
Other comprehensive loss					(9,182)		(9,182)
Share-based compensation expense			3,368				3,368
Public offering of common stock, net of costs of \$5,994	6,179,104	6,179	91,328				97,507
Exercise and redemption of warrants	46,773	47	217				264
Issuance of common stock under share-based-compensation arrangements	23,413	23	228				251
Repurchase of shares	(484,641)					(7,754)	(7,754)
Balance, December 31, 2013	24,224,151	24,756	307,231	71,008	(8,118)	(8,254)	386,623
Net income				43,214			43,214
Other comprehensive income					7,996		7,996
Stock dividend	2,429,375	2,429	43,364	(45,801)			(8)
Share-based compensation expense			4,209				4,209
Exercise of warrants	546	1	5				6
Issuance of common stock under share-based-compensation arrangements	91,457	92	1,013				1,105
Balance, December 31, 2014	26,745,529	\$27,278	\$355,822	\$68,421	\$ (122)	\$ (8,254)	\$443,145

See accompanying notes to the consolidated financial statements.

Table of Contents

CUSTOMERS BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	For the Year Ended December 31,		
	2014	2013	2012
Cash Flows from Operating Activities			
Net income	\$43,214	\$32,694	\$23,818
Adjustments to reconcile net income to net cash (used in) provided by operating activities:			
Provision for loan losses, net of change to FDIC receivable	14,747	2,236	14,270
Loss contingency	—	2,000	—
Provision for depreciation and amortization	3,604	3,129	2,024
Share-based compensation expense	5,237	3,368	2,014
Deferred taxes	(6,187)	) 2,210	(3,731)
Net amortization of investment securities premiums and discounts	821	475	3,062
Gain on sale of investment securities	(3,191)	) (1,274)	) (9,017)
Gain on sale of mortgages and other loans	(5,344)	) (852)	) (357)
Origination of loans held for sale	(18,138,339)	) (20,670,866)	) (13,410,485)
Proceeds from the sale of loans originated as held for sale	17,553,196	21,360,465	12,145,595
Net increase in FDIC loss sharing receivable	(2,409)	) (1,610)	) (3,838)
Accretion of fair value discounts	(273)	) (912)	) (240)
Loss on sales of other real estate owned	966	732	1,228
Valuation and other adjustments to other real estate owned	1,979	839	295
Earnings on investment in bank-owned life insurance	(3,702)	) (2,482)	) (1,458)
Increase in accrued interest receivable and other assets	(16,423)	) (15,091)	) (9,587)
Increase in accrued interest payable and other liabilities	9,606	6,974	4,346
Net Cash (Used in) Provided by Operating Activities	(542,498)	) 722,035	(1,242,061)
Cash Flows from Investing Activities			
Purchases of investment securities available for sale	(164,940)	) (542,110)	) (114,049)
Proceeds from maturities, calls and principal repayments on investment securities available for sale	49,195	25,109	31,420
Proceeds from sales of investment securities available for sale	213,249	135,193	309,221
Proceeds from maturities, calls and principal repayments on investment securities held to maturity	—	—	50,968
Net (increase) decrease in loans	(1,814,196)	) (1,008,410)	) 61,202
Purchase of loan portfolios	(309,927)	) (164,033)	) (63,246)
Proceeds from sale of loans held for investment	162,724	11,624	4,502
Net purchases of bank-owned life insurance	(30,465)	) (45,465)	) (25,465)
Net purchases of FHLB, Federal Reserve Bank, and other restricted stock	(39,578)	) (12,261)	) (8,345)
Reimbursements from the FDIC on loss sharing agreements	5,446	6,726	6,573
Purchases of bank premises and equipment	(1,419)	) (3,894)	) (2,713)
Proceeds from sales of other real estate owned	7,991	9,506	12,062
Net Cash (Used in) Provided by Investing Activities	(1,921,920)	) (1,588,015)	) 262,130
Cash Flows from Financing Activities			
Net increase in deposits	1,572,648	519,179	857,791
Net increase in short-term borrowed funds	633,500	208,500	91,000
Proceeds from long-term FHLB borrowings	265,000	35,000	49,000
Proceeds from issuance of long-term debt, net	133,142	60,336	—

Edgar Filing: EQUUS TOTAL RETURN, INC. - Form 10-K

Repayment of subordinated debt	(2,000	) —	—
Exercise and redemption of warrants	6	264	—
Purchase of treasury stock	—	(7,754	) —
Net proceeds from issuance of common stock	77	97,507	94,586
Net Cash Provided by Financing Activities	2,602,373	913,032	1,092,377
Net Increase in Cash and Cash Equivalents	137,955	47,052	112,446
Cash and Cash Equivalents – Beginning	233,068	186,016	73,570
Cash and Cash Equivalents – Ending	\$371,023	\$233,068	\$186,016
(continued)			

90

Table of Contents

CUSTOMERS BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)
(in thousands)

	For the Year Ended December 31,		
	2014	2013	2012
Supplementary Cash Flow Information			
Interest paid	\$37,580	\$24,157	\$21,709
Income taxes paid	29,843	9,815	19,366
Non-cash Items:			
Transfer of loans to other real estate owned	\$14,042	\$15,003	\$10,457
Transfer of loans from held for investment to held for sale	164,681	—	—
Transfer of loans from held for sale to held for investment	18,826	—	—
Transfer of held-to-maturity securities to available for sale	—	—	268,671
See accompanying notes to the consolidated financial statements.			

Table of Contents

CUSTOMERS BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 – DESCRIPTION OF THE BUSINESS

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

The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States (“U.S. GAAP”) and pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”).

Customers Bancorp, Inc. and its wholly owned subsidiaries, Customers Bank and non-bank subsidiaries, serve residences and businesses in Southeastern Pennsylvania (Bucks, Berks, Chester, Philadelphia and Delaware Counties), Rye, New York (Westchester County), Hamilton, New Jersey (Mercer County), Boston, Massachusetts, Providence, Rhode Island and Manhattan, New York. In 2011, the Bancorp purchased Berkshire Bancorp, Inc. In 2010, Customers Bank acquired two banks, USA Bank and ISN Bank, in FDIC assisted transactions that expanded its footprint into central New Jersey and southeast New York. The Bank has 14 branches and provides commercial banking products, primarily loans and deposits. Customers Bank provides loan products to customers through its loan production offices in Boston, Massachusetts, Providence, Long Island, Manhattan, New York and Philadelphia, Pennsylvania. The Bancorp also provides liquidity to residential mortgage originators nationwide through commercial loans to mortgage companies. Customers Bank is subject to regulation of the Pennsylvania Department of Banking and Securities and the Federal Reserve Bank and is periodically examined by those regulatory authorities.

NOTE 2 – ACQUISITION ACTIVITY

Acquisition of Loan Portfolios

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

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

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES AND BASIS OF PRESENTATION

Basis of Presentation

The accounting and reporting policies of the Bancorp are in conformity with accounting principles generally accepted in the United States of America and predominant practices of the banking industry. The preparation of financial statements requires management to make estimates and assumptions that affect the reported balances of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of the allowance for loan losses, credit deterioration and expected cash flows of purchased-credit-impaired loans, FDIC indemnification asset, the valuation of deferred tax assets, determination of other-than-temporary impairment losses on securities, the fair value of financial instruments, and annual goodwill impairment analysis.

Certain amounts reported in the 2013 and 2012 financial statements have been reclassified to conform to the 2014 presentation. These reclassifications did not significantly impact the Bancorp’s financial position or results of operations.

Table of Contents

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the parent company and its wholly owned subsidiaries: Customers Bank, CB Green Ventures Pte Ltd. and CUBI India Ventures Pte Ltd. Customers Bank includes the accounts of its wholly owned subsidiary CIC, Inc. All significant intercompany balances and transactions have been eliminated in consolidation.

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand, amounts due from banks, interest-bearing deposits with banks with a maturity date of three months or less and is recorded at cost. The carrying value of cash and cash equivalents is a reasonable estimate of their approximate fair value.

Restrictions on Cash and Amounts due from Banks

Customers Bank is required to maintain average balances on hand or with the Federal Reserve Bank. At December 31, 2014 and 2013, these reserve balances were \$61.2 million and \$50.1 million, respectively.

Investment Securities

Customers Bank acquires securities, largely mortgage-backed securities, to effectively utilize cash and capital and to generate earnings. Security transactions are recorded as of the trade date. Securities are classified at the time of acquisition as available for sale, held to maturity, or trading, and their designation determines their accounting as follows:

Available for sale: Investments securities classified as available for sale are those debt and equity securities that the Bancorp intends to hold for an indefinite period of time but not necessarily to maturity. Investment securities available for sale are carried at fair value. Unrealized gains or losses are reported as increases or decreases in accumulated other comprehensive income, net of the related deferred tax effect. Realized gains or losses, determined on the basis of the cost of the specific securities sold, are included in earnings and recorded at the trade date. Premiums and discounts are recognized in interest income using the interest method over the terms of the securities.

Held to maturity: Investment securities classified as held to maturity are those debt securities that the Bancorp has both the intent and ability to hold to maturity regardless of changes in market conditions, liquidity needs, or changes in general economic conditions. These securities are carried at cost, adjusted for the amortization of premium and accretion of discount, computed by a method which approximates the interest method over the terms of the securities. There are no securities classified as held to maturity as of December 31, 2014 or 2013.

Trading: Investment securities classified as trading as those debt and equity securities that management intends to actively trade. These securities are carried at their current fair value, with changes in fair value reported in income. Customers Bank has not actively traded any securities.

For available-for-sale and held-to-maturity securities, management must periodically assess whether the securities are other than temporarily impaired. Other-than-temporary impairment means that management believes the security's reduction in value is due to factors that could include the issuer's inability to pay interest or dividends, its potential for default, and/or other factors. When a held-to-maturity or available-for-sale debt security is assessed for other-than-temporary impairment, management has to first consider (a) whether the Bancorp intends to sell the security, and (b) whether it is more likely than not that the Bancorp will be required to sell the security prior to recovery of its amortized cost basis.

If one of these circumstances applies to a security, an other-than-temporary impairment loss is recognized in the consolidated statements of income equal to the full amount of the decline in fair value below amortized cost. If neither of these circumstances applies to a security, but the Bancorp does not expect to recover the entire amortized cost, an other-than-temporary impairment has occurred that must be separated into two categories: (a) the amount related to credit loss, and (b) the amount related to other factors. In assessing the level of other-than-temporary impairment attributable to credit loss, management compares the present value of cash flows expected to be collected with the amortized cost basis of the security. The portion of the total other-than-temporary impairment related to credit loss is recognized in earnings (as the difference between the fair value and the present value of the estimated cash flows), while the amount related to other factors is recognized in other comprehensive income. The total other-than-temporary impairment loss is presented in the statement of income, less the portion recognized in other comprehensive income. When a debt security becomes other-than-temporarily impaired, its amortized cost basis is reduced to reflect the

portion of the total impairment related to credit loss.

Table of Contents

For marketable equity securities, the Bancorp considers the issuer's financial condition, capital strength and near term prospects to determine whether an impairment is temporary or other-than-temporary. The Bancorp also considers the volatility of a security's price in comparison to the market as a whole and any recoveries or declines in fair value subsequent to the balance sheet date. If management determines that the impairment is other-than-temporary, the entire amount of the impairment as of the balance sheet date is recognized in earnings even if the decision to sell the security has not been made. The fair value of the security becomes the new amortized cost basis of the investment and is not adjusted for subsequent recoveries in fair value.

Loan Accounting Framework

The accounting for a loan depends on management's strategy for the loan, and on whether the loan was credit impaired at the date of acquisition. The Bank accounts for loans based on the following categories:

Loans Held for Sale

Loans at Fair Value

Loans Receivable

Purchased loans

Loans receivable covered under Loss Sharing Agreements with the FDIC

The following provides a detailed discussion of the accounting for loans in these categories:

Loans Held for Sale and Loans at Fair Value

Loans originated by the Bank with the intent to sell in the secondary market are carried either at the lower of cost or fair value, determined in the aggregate, or at fair value, depending upon the election made at the time the loan is made. These loans are sold on a non-recourse basis with servicing released. Gains and losses on the sale of loans accounted for at lower of cost or fair value are recognized in earnings based on the difference between proceeds received and the carrying amount of the loans, inclusive of deferred origination fees and costs, if any. As a result of changes in events and circumstances or developments regarding management's view of the foreseeable future, loans not originated or acquired with the intent to sell may subsequently be designated as held for sale. These loans are transferred to the held-for-sale portfolio at the lower of amortized cost or fair value.

Loans originated by the Bank with the intent to sell for which fair value accounting is elected are marked to fair value with any difference between the proceeds received and the carrying amount of the loan recognized in earnings. No fees or costs related to such loans are deferred, so they do not affect the gain or loss calculation at the time of sale. Certain lending transactions documented under a Master Repurchase Agreement originated after July 1, 2012 are also carried at fair value based on an election of the fair value option. This election was in accordance with the parameters established by Accounting Standards Codification ("ASC ") 825-10-25, Financial Instruments-Overall-Recognition: The Fair Value Option. As a result of this election, these lending transactions are classified as "Loans held for sale" and are carried at fair value on the balance sheet with unrealized changes in fair value presented in earnings.

An allowance for loan losses is not maintained relative to loans classified as held for sale as either the lower cost or market or fair value has an embedded mark for credit losses.

Loans Receivable

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are stated at their outstanding unpaid principal balances, net of an allowance for loan losses and any deferred fees. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the yield (interest income) of the related loans using the level-yield method without anticipating prepayments. The Bank is generally amortizing these amounts over the contractual life of the loans.

The accrual of interest is generally discontinued when the contractual payment of principal or interest has become 90 days past due or when management has doubts about further collectability of principal or interest, even though the loan is currently performing. A loan may remain on accrual status if it is in the process of collection and is well secured. When a loan is placed on non-accrual status, unpaid interest credited to income is reversed. Interest received on non-accrual loans is applied against principal until all principal has been repaid. Thereafter, interest payments are recognized as income until all unpaid interest has

Table of Contents

been received. Generally, loans are restored to accrual status when the obligation is brought current and has performed in accordance with the contractual terms for a minimum of six months and the ultimate collectibility of the total contractual principal and interest is no longer in doubt.

Transfers of financial assets, including loan participations sold, are accounted for as sales when control over the assets has been surrendered (settlement date). Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Bank, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Purchased Loans

The Bancorp believes that the varying circumstances under which it purchases loans and the diverse quality of loans purchased should drive the decision as to whether loans in a portfolio should be deemed to be purchased-credit-impaired loans. Therefore, loan purchases are and will be evaluated on a case-by-case basis to determine the appropriate accounting treatment. Loans acquired that do not have evidence of credit deterioration at the purchase date are and will be accounted for in accordance with ASC 310-20, Nonrefundable Fees and Other Costs, and loans acquired with evidence of credit deterioration since origination and for which it is probable that all contractually required payments will not be collected are and will be accounted for in accordance with ASC 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality.

Loans that are purchased that do not have evidence of credit deterioration

Purchased performing loans are recorded at fair value and include credit and interest rate marks associated with acquisition accounting adjustments, as accounted for under the contractual cash flow method of accounting. The fair value adjustment is accreted as an adjustment to yield over the estimated contractual lives of the loans. There is no allowance for loan losses established at the acquisition date for the acquired performing loans. A provision for loan losses is recorded for any credit deterioration in these loans subsequent to acquisition.

Loans that are purchased that have evidence of credit deterioration since origination and for which it is probable that all contractually required payments will not be collected

For purchases of this type of loan, evidence of deteriorated credit quality may include past-due and non-accrual status, borrower credit scores and recent loan-to-value percentages.

The fair value of loans with evidence of credit deterioration is recorded net of a nonaccretable difference and accretable yield. The difference between contractually required payments at acquisition and the cash flows expected to be collected at acquisition is the nonaccretable difference, which is not included in the carrying amount of acquired loans. Subsequent to acquisition, estimates of cash flows expected to be collected are updated each reporting period based on updated assumptions regarding default rates, loss severities, and other factors that are reflective of current market conditions. Subsequent decreases to the expected cash flows will generally result in a provision for loan losses. Subsequent increases in cash flows result in a reversal of the provision for loan losses to the extent of prior charges, or a reclassification of the difference from nonaccretable to accretable with a positive impact on accretion of interest income in future periods. Further, any excess of cash flows expected at acquisition over the estimated fair value is referred to as the accretable yield and is recognized in interest income over the remaining life of the loan when there is a reasonable expectation about the amount and timing of those cash flows.

Purchased-credit-impaired loans acquired in the same fiscal quarter may be aggregated into one or more pools, provided that the loans have common risk characteristics. A pool is then accounted for as a single asset with a single composite interest rate and an aggregate expectation of cash flows. On a quarterly basis, the Bank re-estimates the total cash flows (both principal and interest) expected to be collected over the remaining life of each pool. These estimates incorporate assumptions regarding default rates, loss severities, the amounts and timing of prepayments and other factors that reflect then-current market conditions. If the timing and/or amounts of expected cash flows on purchased-credit-impaired loans were determined not to be reasonably estimable, no interest would be accreted and the loans would be reported as non-accrual loans; however, when the timing and amounts of expected cash flows for purchased-credit-impaired loans are reasonably estimable, interest is being accreted and the loans are being reported as performing loans.

Table of Contents

Loans Receivable Covered Under Loss Sharing Agreements

Loans acquired in the FDIC assisted transactions in 2010 from USA Bank and ISN Bank are subject to loss sharing agreements with the FDIC. These loans are referred to as “covered loans” and had outstanding balances of 42.2 million and 66.7 million as of December 31, 2014 and 2013, respectively.

Allowance for Loan Losses

The allowance for loan losses is established as losses are estimated to have occurred through provisions for loan losses charged against net interest income. Loans deemed to be uncollectible are charged against the allowance for loan losses, and subsequent recoveries, if any, are credited to the allowance. The allowance for loan losses is maintained at a level considered appropriate to absorb probable loan losses inherent in the loan portfolio as of the reporting date.

The Bank disaggregates its loan portfolio into groups for purposes of determining the allowance for loan losses.

The Bank’s portfolio groups include multi-family, commercial and industrial, commercial real estate, construction, residential real estate, mortgage warehouse, manufactured housing, consumer, and PCI loans. The Bank further disaggregates its residential real estate portfolio into two classes based upon certain risk characteristics; first mortgages and home equity. The remaining portfolio groups are also considered classes for purposes of monitoring and assessing credit quality based on certain risk characteristics. Additionally, within each loan group the acquired loans that are accounted for under ASC 310-10 are further segregated.

The total allowance for loan losses consists of an allowance for impaired loans, a general allowance for losses, and may also include residual non-specific reserve amounts. The allowance for loan losses is maintained at a level considered adequate to provide for losses that are estimated to have been incurred. Management performs a quarterly evaluation of the adequacy of the allowance, which is based on the Bank’s past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower’s ability to repay, the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions and other relevant factors. This evaluation is inherently subjective as it requires material estimates that may be susceptible to significant revision as more information becomes available. The Bank’s current methodology for determining the allowance for loan losses is based on historical loss rates, risk ratings, specific allocation on loans identified as impaired above specified thresholds and other qualitative adjustments.

The impaired loan component relates to loans for which it is likely that the Bank will be unable to collect all contractual principal and interest due. For such loans, an allowance is established when the (i) discounted cash flows, (ii) collateral value, or (iii) the impaired loan value is lower than the carrying value of the loan.

The general component of the reserve for loan losses covers pools of loans by loan class including commercial loans not considered impaired, as well as smaller balance homogeneous loans, such as residential real estate, home equity loans, home equity lines of credit and other consumer loans. These pools of loans are evaluated for loss exposure based upon loan risk ratings and historical loss rates for each of these categories of loans, adjusted for relevant qualitative factors. These qualitative risk factors include:

- Lending policies and procedures, including underwriting standards and historical-based loss/collection, charge-off, and recovery practices.
- National, regional, and local economic and business conditions as well as the condition of various market segments, including the value of underlying collateral for collateral dependent loans.
- Nature and volume of the portfolio and terms of loans.
- Experience, ability, and depth of lending management and staff.
- Volume and severity of past due, classified and non-accrual loans as well as trends and other loan modifications.
- Existence and effect of any concentrations of credit and changes in the level of such concentrations.

Each factor is assigned a value to reflect improving, stable or declining conditions based on management’s best judgment using relevant information available at the time of the evaluation.

A residual reserve may be maintained to cover uncertainties that could affect management’s estimate of probable losses. The residual reserve amount reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

Table of Contents

Commercial and industrial loans are underwritten after evaluating historical and projected profitability and cash flow to determine the borrower's ability to repay their obligation as agreed. Commercial and industrial loans are made primarily based on the identified cash flow of the borrower and secondarily on the underlying collateral supporting the loan facility. Accordingly, the repayment of a commercial and industrial loan depends primarily on the creditworthiness of the borrower (and any guarantors), while liquidation of collateral is a secondary and often insufficient source of repayment.

Construction loans are underwritten based upon a financial analysis of the developers and property owners and construction cost estimates, in addition to independent appraisal valuations. These loans will rely on the value associated with the project upon completion. These cost and valuation estimates may be inaccurate. Construction loans generally involve the disbursement of substantial funds over a short period of time with repayment substantially dependent upon the success of the completed project. Sources of repayment of these loans would be permanent financing upon completion or sales of developed property. These loans are closely monitored by onsite inspections and are considered to be of a higher risk than other real estate loans due to their ultimate repayment being sensitive to general economic conditions, availability of long-term financing, interest rate sensitivity, and governmental regulation of real property.

Commercial real estate and multi-family loans are subject to the underwriting standards and processes similar to commercial and industrial loans, in addition to those underwriting standards for real estate loans. These loans are viewed primarily as cash flow dependent and secondarily as loans secured by real estate. Repayment of these loans is generally dependent upon the successful operation of the property securing the loan or the principal business conducted on the property securing the loan. Commercial real estate and multi-family loans may be adversely affected by conditions in the real estate markets or the economy in general. Management monitors and evaluates commercial real estate and multi-family loans based on collateral and risk-rating criteria. The Bank also utilizes third-party experts to provide environmental and market valuations. The nature of commercial real estate and multi-family loans makes them more difficult to monitor and evaluate.

Residential real estate loans are secured by one to four dwelling units. This group is further divided into first mortgage and home equity loans. First mortgages have limited risk as they are originated at a loan to value ratio of 80% or less. Home equity loans have additional risks as a result of typically being in a second position or lower in the event collateral is liquidated.

Manufactured housing loans represent loans that are secured by the personal property where the borrower may or may not own the underlying real estate and therefore have a higher risk than a residential real estate loan.

Home equity / other consist of loans to individuals originated through the Bank's retail network and are typically unsecured or secured by personal property. Consumer loans have a greater credit risk than residential loans because of the difference in the underlying collateral, if any. The application of various federal and state bankruptcy and insolvency laws may limit the amount that can be recovered on such loans.

Delinquency monitoring is used to identify credit risks, and the general reserves are established based on the expected net charge-offs, adjusted for qualitative factors. Loss rates are based on the average net charge-off history by portfolio segment. Historical loss rates may be adjusted for significant factors that, in management's judgment, are necessary to reflect losses inherent in the portfolio. Factors that management considers in the analysis include the effects of the national and local economies; trends in the nature and volume of delinquencies, charge-offs and trends in non-accrual loans; changes in loan mix; risk management and loan administration; changes in the internal lending policies and credit standards and collection practices.

Charge-offs on the commercial and industrial, construction, multi-family and commercial real estate loan segments are recorded when management estimates that there are insufficient cash flows to repay the loan contractual obligation based upon financial information available and valuation of the underlying collateral. Additionally, the Bank takes into account the strength of any guarantees and the ability of the borrower to provide value related to those guarantees in determining the ultimate charge-off or reserve associated with any impaired loans. Accordingly, the Bank may charge-off a loan to a value below the net appraised value if it believes that an expeditious liquidation is desirable in the circumstance and it has legitimate offers or other indications of interest to support a value that is less than the net appraised value. Alternatively, the Bank may carry a loan at a value that is in excess of the appraised value if the Bank

has a guarantee from a borrower that the Bank believes has realizable value. In evaluating the strength of any guarantee, the Bank evaluates the financial wherewithal of the guarantor, the guarantor's reputation, and the guarantor's willingness and desire to work with the Bank. The Bank then conducts a review of the strength of a guarantee on a frequency established as the circumstances and conditions of the borrower warrant.

The Bank records a loan charge-off for the residential real estate, consumer, and manufactured housing loans after 120 days of delinquency or sooner when cash flows are determined to be insufficient for repayment. The Bank may also charge-off these loan types below the net appraised valuation if the Bank holds a junior mortgage position in a piece of collateral whereby the risk to acquiring control of the property through the purchase of the senior mortgage position is deemed to potentially increase

Table of Contents

the risk of loss upon liquidation due to the amount of time to ultimately market the property and the volatile market conditions. In such cases, the Bank may abandon its junior mortgage and charge-off the loan balance in full. Estimates of cash flows expected to be collected for PCI loans are updated each reporting period. If the Bank estimates decreases in expected cash flows to be collected after acquisition, the Bank charges the provision for loan losses and establishes an allowance for loan losses.

Credit Quality Factors

Commercial and industrial, multi-family, commercial real estate, residential real estate and construction loans are each assigned a numerical rating of risk based on an internal risk rating system. The risk rating indicates management's estimate of the credit quality and the rating is assigned at loan origination and reviewed on a periodic or on an "as needed" basis. Consumer and manufactured housing loans are evaluated based on the payment activity of the loan. Risk ratings are not established for home equity loans, consumer loans, manufactured housing loans, and installment loans, mainly because these portfolios consist of a larger number of homogenous loans with smaller balances. Instead, these portfolios are evaluated for risk mainly based on aggregate payment history (through the monitoring of delinquency levels and trends). For additional information about credit quality factor ratings refer to "NOTE 8 – "LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES."

Impaired Loans

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed.

Impairment is measured on a loan by loan basis for both covered and non-covered loans for commercial and construction loans by the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price or the fair value of the collateral if the loan is collateral dependent. The fair value of the collateral is measured based on the value of the collateral securing the loans, less cost to sell. Collateral may be in the form of real estate or business assets including equipment, inventory, and accounts receivable. The vast majority of Customers Bank's collateral is real estate. The value of real estate collateral is determined utilizing an income or market valuation approach based on an appraisal conducted by an independent, licensed appraiser outside of the Bank using observable market data. The value of business equipment is based upon an outside appraisal if deemed significant, or the net book value on the applicable business' financial statements if not considered significant using observable market data. Likewise, values for inventory and accounts receivable collateral are based on financial statement balances or aging reports.

Covered loans are subject to the Bank's internal and external credit review and monitoring that is applied to the non-covered loan portfolio. If credit deterioration is experienced subsequent to the initial acquisition as indicated above, such deterioration will be measured, and a provision for loan losses will be charged to earnings. These provisions will be offset by an increase to the FDIC loss sharing receivable for the estimated portion anticipated to be received from the FDIC.

Goodwill

Goodwill represents the excess of cost over the identifiable net assets of businesses acquired. Goodwill is recognized as an asset and is reviewed for impairment annually as of October 31 and between annual tests when events and circumstances indicate that impairment may have occurred. A qualitative factor test can be performed to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. If the results of the qualitative review indicate that it is unlikely (less than 50% probability) that the carrying value of the reporting unit is less than its fair value, no further evaluation needs to be performed. As part of its qualitative assessment, the Bancorp reviewed regional and national trends in current and expected economic conditions, examining indicators such as GDP growth, interest rates and unemployment rates. Customers Bank also considered its own historical performance, expectations

of future performance and other trends specific to the banking industry. Based on its qualitative assessment, the Bancorp determined that there was no impairment on the goodwill balance. There was 3.7 million of Goodwill at December 31, 2014 and December 31, 2013.

Table of Contents

FHLB, Federal Reserve Bank, and other restricted stock

FHLB, Federal Reserve Bank, and other restricted stock represents required investment in the capital stock of the Federal Home Loan Bank ("FHLB"), the Federal Reserve Bank, and Atlantic Central Bankers Bank and is carried at cost. Total restricted stock as of December 31, 2014 and 2013 was \$82.0 million and \$42.4 million, respectively. As of December 31, 2014 and 2013 there was \$71.6 million and \$32.1 million of FHLB stock, respectively.

Other Real Estate Owned

Real estate properties acquired through, or in lieu of, loan foreclosure are initially recorded at fair value less cost to sell at the date of foreclosure establishing a new cost basis. After foreclosure, valuations are periodically performed by management and the real estate is carried at the lower of its carrying amount or fair value less the cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in the statement of income. Certain other real estate owned that was acquired from USA Bank and ISN Bank or through the foreclosure of loans of those banks is subject to Loss Sharing Agreements with the FDIC. As of December 31, 2014 and December 31, 2013, other real estate owned subject Loss Sharing Agreements with the FDIC was \$9.4 million and \$7.0 million, respectively.

FDIC Loss Sharing Receivable

The FDIC loss sharing receivable is measured separately from the related covered assets because it is not contractually embedded in the assets and is not transferrable if the assets are sold. The FDIC loss sharing receivable was initially recorded at fair value, based on the discounted value of expected future cash flows under the loss share agreements. The difference between the present value and the undiscounted cash flows the Bank expects to collect from the FDIC is accreted into interest income over the life of the FDIC loss sharing receivable.

The FDIC loss sharing receivable is reviewed quarterly and adjusted for changes in expected cash flows based on recent performance and expectations for future performance of the covered portfolio. These adjustments are measured on the same basis as the related covered loans and covered other real estate owned. Increases in estimated cash flows on the covered assets will reduce the FDIC loss sharing receivable and decreases in estimated cash flows on the covered assets will increase the FDIC loss sharing receivable. Increases to the FDIC loss sharing receivable are recorded as a reduction to the provision for loan losses and decreases to the FDIC loss sharing receivable are recorded either as an increase to the provision for loan losses (to the extent an increase in the FDIC receivable balance was previously recorded as a reduction to the provision for loan losses) or recognized over the life of the loss share agreements.

Bank-Owned Life Insurance

Bank-owned life insurance policies insure the lives of officers of the Bank, and name the Bank as beneficiary. Non-interest income is generated tax-free (subject to certain limitations) from the increase in value of the policies' underlying investments made by the insurance company. The Bank is capitalizing on the ability to partially offset costs associated with employee compensation and benefit programs with the bank-owned life insurance.

Bank Premises and Equipment

Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed on the straight-line method over the estimated useful lives of the related assets. Leasehold improvements are amortized over the shorter of the term of the lease or estimated useful life, unless extension of the lease term is reasonably assured.

Treasury Stock

Common stock purchased for treasury is recorded at cost. No treasury stock has been reissued.

Income Taxes

The Bancorp accounts for income taxes under the liability method of accounting for income taxes. The income tax accounting guidance results in two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues. The Bancorp determines deferred income taxes using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur.

Table of Contents

A tax position is recognized if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more likely than not means a likelihood of more than 50 percent; the term upon examination includes resolution of the related appeals or litigation process. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances, and information available at the reporting date and is subject to management's judgment.

In assessing the realizability of federal or state deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income and prudent, feasible and permissible as well as available tax planning strategies in making this assessment. Based on the level of historical taxable income and projections for future taxable income over the periods in which the deferred tax assets are deductible as well as available tax planning strategies, management believes it is more likely than not that the Bancorp will realize the benefits of these deferred tax assets.

Share-Based Compensation

Customers Bancorp has four active share-based compensation plans. Share-based compensation accounting guidance requires that the compensation cost relating to share-based-payment transactions be recognized in financial statements. That cost is measured based on the grant-date fair value of the equity or liability instruments issued. Compensation cost for all share awards is calculated and recognized over the employees' service period, generally defined as the vesting period. For awards with cliff-vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award. The Black-Scholes model is used to estimate the fair value of stock options, while the market price of Customers Bancorp's common stock at the date of grant is used for restricted stock awards.

In 2014, the shareholders of the Bancorp approved an employee stock purchase plan. Since purchase price under the plan is 85% of (a 15% discount to) the fair market value of a share of common stock on the first day of each quarterly subscription period, the plan is considered to be a compensatory plan under current accounting guidance. Therefore, the entire amount of the discount is recognizable compensation expense.

Derivative Instruments and Hedging

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

As required by ASC 815, Customers Bancorp records all derivatives on the balance sheet at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative, whether Customers Bank has elected to designate a derivative in a hedging relationship and apply hedge accounting and whether the hedging relationship has satisfied the criteria necessary to apply hedge accounting. Derivatives designated and qualifying as a hedge of the exposure to changes in the fair value of an asset, liability, or firm commitment attributable to a particular risk, such as interest rate risk, are considered fair value hedges. Derivatives designated and qualifying as a hedge of the exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges. Derivatives may also be designated as hedges of the foreign currency exposure of a net investment in a foreign operation. Hedge accounting generally provides for the matching of the timing of gain or loss recognition on the hedging instrument with the recognition of the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk in a fair value hedge or the earnings effect of the hedged forecasted transactions in a cash flow hedge. The Bancorp may enter into derivative contracts that are intended to economically hedge certain of

its risks, even though hedge accounting does not apply or the Bancorp elects not to apply hedge accounting. Prior to first quarter 2014, none of Customer Bancorp's financial derivatives were designated in qualifying hedge relationships in accordance with the applicable accounting guidance. As such, all changes in fair value of the financial derivatives were

Table of Contents

recognized directly in earnings. In March 2014, Customers Bancorp entered into a \$150.0 million notional balance forward starting pay fixed interest rate swap to hedge the variable cash flows associated with the forecasted issuance of debt. The Bancorp documented and designated this swap as a cash flow hedge. The effective portion of changes in the fair value of financial derivatives designated and qualifying as cash flow hedges is recorded in Accumulated Other Comprehensive Income and is subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings. The ineffective portion of the change in fair value of the financial derivatives is recognized directly in earnings. Amounts reported in accumulated other comprehensive income related to financial derivatives will be reclassified to interest expense as interest payments are made on the Company's variable-rate debt. Customers Bancorp purchased credit derivatives with a notional balance of \$13.4 million to hedge the performance risk of one of its counterparties during first quarter 2014. These derivatives were not designated in hedge relationships for accounting purposes and are being recorded at their fair value, with fair value changes recorded directly in earnings.

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

Comprehensive Income

Comprehensive income (loss) consists of net income (loss) and other comprehensive income (loss). Other comprehensive income includes changes in unrealized gains and losses on securities available for sale arising during the period and reclassification adjustments for realized gains and losses on securities available for sale included in net income. Unrealized gains and losses on securities available for sale include a component for unrealized changes in foreign currency exchange rates relating to the Bancorp's investment in certain foreign equity securities. Other comprehensive income also includes the effective portion of changes in fair value of financial derivatives designated as qualifying as cash flow hedges. Cash flow hedge amounts classified as comprehensive income are subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings.

Earnings per Share

Basic earnings per share represents net income divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per share includes all potentially dilutive common shares outstanding during the period. Potential common shares that may be issued related to outstanding stock options, restricted stock units, and warrants are determined using the treasury stock method.

Segment Information

Customers Bancorp, Inc. has one reportable segment, "Community Banking." All of the Company's activities are interrelated, and each activity is dependent and assessed based on how each of the activities of the Company supports the others. For example, lending is dependent upon the ability of the Company to fund itself with deposits and borrowings while managing the interest rate and credit risk. Accordingly, all significant operating decisions are based upon analysis of the Bank as one segment or unit.

Accounting Changes

The Fair Value Option

We elected the fair value option for loans to provide liquidity to mortgage bankers under a Master Repurchase Agreement originated after July 1, 2012 in order to more accurately represent the short term nature of the transaction and its inherent credit risk. This adoption is in accordance with the parameters established by ASC 825-10-25, Financial Instruments-Overall-Recognition: The Fair Value Option. As a result of this election, new warehouse lending transactions are classified as "Loans held for sale" on the balance sheet. The interest income from the warehouse lending transactions are classified in "Interest Income – Loans held for sale" on the consolidated statements of income. An allowance for loan losses is not recorded for the warehouse lending transactions when measured at fair value since under ASC 825, the exit price (the repurchase price) for warehouse lending transactions considers the effect of expected credit losses.

We also elected to use fair value accounting for residential mortgage loans originated after October 1, 2013 with the intent to sell at time of origination. The accounting for the residential mortgage loans subject to this fair value election follows the

Table of Contents

accounting described for the warehouse loans also subject to the fair value accounting election. The unrealized fair value changes related to these loans are classified in “Mortgage loan and banking income” on the consolidated statements of income.

Change in Accounting Estimates

Estimates of cash flows from purchased credit-impaired (“PCI”) loans were revised during the third quarter of 2012 due to a conversion to a more sophisticated and precise loan valuation system. In accordance with the guidance in ASC 310-30, interest income is based on an acquired loan’s expected cash flows. Complex models are needed to calculate loan-level and/or pool level expected cash flows in accordance with ASC 310-30. The loan data analysis provided by the new software was determined to be a more precise quantification of future cash flows than the analysis that was previously calculated manually. Upon conversion to the new software, acquisition date loan values were loaded into the system and the new software calculated their fair values using its complex valuation model. Conversion to the new system was completed in September 2012. To adjust the acquisition date loan balances recorded on Customers Bank’s books to the amounts calculated by the new software, approximately \$4.5 million was recognized as reduction to the provision for loan losses in the third quarter of 2012. The revised valuation for the PCI acquisition date loan balances due to the conversion to the new software was accounted for prospectively as a change in accounting estimate.

When converting to the new software system, we were required to calculate the estimated cash flows from the various acquisition dates of the PCI loans through the date the software was implemented as it was impracticable to perform these calculations on a monthly or quarterly basis. In the third quarter of 2012, approximately \$4.5 million was recognized in interest income related to this change. The impact of the revised valuation of cash flows for the PCI loan activity due to the conversion to the new software was accounted for prospectively as a change in accounting estimate. Also during the third quarter of 2012, we re-estimated the cash flows for the PCI loans using current data. The re-estimated expected cash flows decreased from prior estimated cash flows. Consistent with ASC 310-10’s fundamental premise that a decrease in expected cash flows results in accrual of a loss contingency and should not result in a change in yield, we evaluated the adequacy of the allowance for loan losses for PCI loans and determined that an additional provision for loan losses of \$7.5 million was appropriate.

As a result of the changes in estimates, net income for the year ended December 31, 2012 increased by \$900,000, net of tax, and basic and diluted earnings increased by \$0.06 per share as adjusted for the 2014 stock dividend.

Recently Issued Accounting Standards and Updates

In November 2014, the FASB issued ASU 2014-16, Derivatives and Hedging (Subtopic 815-10): Determining Whether the Host contract in a Hybrid Financial Instrument in the Form of a Share is More Akin to Debt or to Equity. The guidance in this ASU requires entities that issue or invest in a hybrid financial instrument to separate an embedded derivative feature from a host contract and account for the feature as a derivative. In the case of derivatives embedded in a hybrid financial instrument that is issued in the form of a share, that criterion requires evaluating whether the nature of the host contract is more akin to debt or to equity and whether the economic characteristics and risks of the embedded derivative feature are clearly and closely related to the host contract. If the host contract is akin to equity, then equity-like features (for example, a conversion option) are considered clearly and closely related to the host contract and, thus, would not be separated from the host contract. If the host contract is akin to debt, then equity-like features are not considered clearly and closely related to the host contract. In the latter case, an entity may be required to separate the equity-like embedded derivative feature from the debt host contract if certain other criteria in Subtopic 815-15 are met. Similarly, debt-like embedded derivative features may require separate accounting from an equity-like host contract. The guidance in this ASU is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. The Bancorp does not expect this ASU to have a significant impact on its financial condition or results of operations.

In August 2014, the FASB issued ASU 2014-14, Receivables - Troubled Debt Restructurings by Creditors (Subtopic 310-40): Classification of Certain Government-Guaranteed Mortgage Loans upon Foreclosure. The guidance in this ASU affects creditors that hold government-guaranteed mortgage loans, including those guaranteed by the FHA and the VA. It requires that a mortgage loan be derecognized and a separate other receivable be recognized upon foreclosure if the following conditions are met:

1. The loan has a government guarantee that is not separable from the loan before foreclosure.
2. At the time of foreclosure, the creditor has the intent to convey the real estate property to the guarantor and make a claim on the guarantee, and the creditor has the ability to recover under that claim.

Table of Contents

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

Upon foreclosure, the separate other receivable should be measured based on the amount of the loan balance (principal and

interest) expected to be recovered from the guarantor. The guidance in this ASU was effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. The guidance may be applied using a prospective transition method in which a reporting entity applies the guidance to foreclosures that occur after the date of adoption, or a modified retrospective transition using a cumulative-effect adjustment (through a reclassification to a separate other receivable) as of the beginning of the annual period of adoption. Prior periods should not be adjusted. A reporting entity must apply the same method of transition as elected under ASU 2014-04. The adoption of this ASU did not have a significant impact on the Bancorp's financial condition or results of operations.

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

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

In June 2014, the FASB issued ASU 2014-11, Transfers and Servicing. The amendments in this update require that repurchase-to-maturity transactions be accounted for as secured borrowings consistent with the accounting for other repurchase agreements. In addition, the amendments require separate accounting for a transfer of a financial asset executed contemporaneously with a repurchase agreement with the same counterparty (a repurchase financing), which will result in secured borrowing accounting for the repurchase agreement. The amendments require an entity to disclose information about transfers accounted for as sales in transactions that are economically similar to repurchase agreements, in which the transferor retains substantially all of the exposure to the economic return on the transferred financial asset throughout the term of the transaction. In addition the amendments require disclosure of the types of collateral pledged in repurchase agreements, securities lending transactions, and repurchase-to-maturity transactions and the tenor of those transactions. The guidance in this ASU was effective for annual and interim periods beginning

after December 15, 2014. The adoption of this ASU did not have a significant impact on the Bancorp's financial condition or results of operations.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers. This ASU establishes a comprehensive revenue recognition standard for virtually all industries in U.S. GAAP, including those that previously followed industry-specific guidance such as the real estate and construction industries. The revenue standard's core principal is built on the contract between a vendor and a customer for the provision of goods and services. It attempts to depict the exchange of rights and obligations between the parties in the pattern of revenue recognition based on the consideration to which the vendor is entitled. To accomplish this, the standard requires five basic steps: (i) identify the contract with the customer, (ii) identify the performance obligations in the contract, (iii) identify the transaction price, (iv) allocate the transaction price to the performance obligations in the contract, (v) recognize revenue when (or as) the entity satisfies the performance obligation. Three basic transition methods are available - full retrospective, retrospective with certain practical expedients, and a cumulative effect approach. Under the cumulative effect alternative, an entity would apply the new revenue standard only to contracts that are

Table of Contents

incomplete under legacy U.S. GAAP at the date of initial application and recognize the cumulative effect of the new standard as an adjustment to the opening balance of retained earnings. The guidance in this ASU is effective for annual periods and interim reporting periods within those annual periods, beginning after December 15, 2016. The Bancorp does not expect this ASU to have a significant impact on its financial condition or results of operations. In January 2014, the FASB issued ASU 2014-04, Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure, a consensus of the FASB Emerging Issues Task Force. The guidance in this ASU clarifies that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. The ASU also requires additional related interim and annual disclosures. The guidance in this ASU was effective for annual and interim periods beginning after December 15, 2014. The adoption of this ASU did not have a significant impact on the Bancorp's financial condition or results of operations.

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

NOTE 4 – EARNINGS PER SHARE

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

	For the Year Ended December 31,		
	2014	2013	2012
(dollars in thousands, except per share data)			
Net income available to common shareholders	\$43,214	\$32,694	\$23,818
Weighted-average number of common shares outstanding – basic	26,719,626	24,485,078	14,758,036
Share-based compensation plans	968,671	464,054	275,771
Warrants	250,707	198,520	131,976
Weighted-average number of common shares – diluted	27,939,004	25,147,652	15,165,783
Basic earnings per share	\$1.62	\$1.34	\$1.61
Diluted earnings per share	1.55	1.30	1.57

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

	For the Year Ended December 31,		
	2014	2013	2012
Anti-dilutive securities:			
Share-based compensation awards	135,861	819,539	167,476
Warrants	118,745	118,745	129,946
Total anti-dilutive securities	254,606	938,284	297,422

Table of Contents

NOTE 5 - CHANGES IN ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS) BY COMPONENT (1)

The following tables present the changes in accumulated other comprehensive income (loss) by component for the years ended December 31, 2014 and 2013.

(amounts in thousands)	Unrealized Gains (Losses) on Available- for-sale Securities (2)	Unrealized Losses on Cash Flow Hedges	Total
Balance, January 1, 2013	\$1,064	\$—	\$1,064
Other comprehensive loss before reclassifications	(8,354	) —	(8,354
Amounts reclassified from accumulated other comprehensive income to net income (3)	(828	) —	(828
Net current-period other comprehensive loss	(9,182	) —	(9,182
Balance, December 31, 2013	(8,118	) —	(8,118
Other comprehensive income (loss) before reclassifications	11,334	(1,264	) 10,070
Amounts reclassified from accumulated other comprehensive income to net income (3)	(2,074	) —	(2,074
Net current-period other comprehensive income (loss)	9,260	(1,264	) 7,996
Balance, December 31, 2014	\$1,142	\$(1,264	) \$(122

(1) All amounts are net of tax. Amounts in parentheses indicate reductions to accumulated other comprehensive income.

(2) Includes immaterial gains or losses on foreign currency items.

(3) Reclassification amounts are reported as gains on sales of investment securities on the Consolidated Statements of Income.

NOTE 6 – INVESTMENT SECURITIES

The amortized cost and approximate fair value of investment securities are summarized as follows:

	December 31, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(in thousands)			
Available for Sale:				
Mortgage-backed securities (1)	\$376,854	\$2,805	\$(2,348	) \$377,311
Corporate notes (2)	15,000	104	—	15,104
Equity securities (3)	23,074	1,197	(1	) 24,270
Total	\$414,928	\$4,106	\$(2,349	) \$416,685
	December 31, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(in thousands)			
Available for Sale:				
Mortgage-backed securities (1)	\$461,988	\$207	\$(10,659	) \$451,536
Corporate notes (2)	25,000	344	(21	) 25,323

Edgar Filing: EQUUS TOTAL RETURN, INC. - Form 10-K

Equity securities (3)	23,074	—	(2,360	) 20,714
Total	\$510,062	\$551	\$(13,040	) \$497,573

105

Table of Contents

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

(2) Includes subordinated debt issued by other bank holding companies.

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

The following table shows proceeds from the sale of available-for-sale investment securities, gross gains, and gross losses on those sales of securities:

	For the Year Ended December 31,		
	2014	2013	2012
	(in thousands)		
Proceeds from sale of available-for-sale investment securities	\$213,249	\$135,193	\$309,221
Gross gains	\$3,191	\$1,274	\$9,017
Gross losses	—	—	—
Net gains	\$3,191	\$1,274	\$9,017

These gains and losses were determined using the specific identification method and were included in non-interest income.

The following table shows investment securities by stated maturity. Investment securities backed by mortgages have expected maturities that differ from contractual maturities because borrowers have the right to call or prepay, and are, therefore, classified separately with no specific maturity date:

	December 31, 2014	
	Available for Sale	
	Amortized Cost	Fair Value
	(in thousands)	
Due in one year or less	\$—	\$—
Due after one year through five years	—	—
Due after five years through ten years	15,000	15,104
Due after ten years	—	—
Mortgage-backed securities	376,854	377,311
Total debt securities	\$391,854	\$392,415

The Bancorp's investments' gross unrealized losses and fair value aggregated by investment category and length of time that individual securities that have been in a continuous unrealized loss position were as follows:

	December 31, 2014					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(in thousands)					
Available for Sale:						
Mortgage-backed securities (1)	\$60,388	\$(81)	\$80,426	\$(2,267)	\$140,814	\$(2,348)
Corporate notes	—	—	—	—	—	—
Equity securities	—	—	5	(1)	5	(1)
Total	\$60,388	\$(81)	\$80,431	\$(2,268)	\$140,819	\$(2,349)

Table of Contents

	December 31, 2013					
	Less than 12 months	Unrealized	12 months or more	Unrealized	Total	Unrealized
	Fair Value	Losses	Fair Value	Losses	Fair Value	Losses
	(in thousands)					
Available for Sale:						
Mortgage-backed securities (1)	\$425,623	\$(10,061)	\$5,274	\$(598)	\$430,897	\$(10,659)
Corporate notes	4,982	(18)	4,997	(3)	9,979	(21)
Equity securities (2)	20,714	(2,360)	—	—	20,714	(2,360)
Total	\$451,319	\$(12,439)	\$10,271	\$(601)	\$461,590	\$(13,040)

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

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

At December 31, 2014, there were eight available-for-sale investment securities in the less-than-twelve-month category and eighteen available-for-sale investment securities in the twelve-month-or-more category. The unrealized losses on the mortgage backed securities are guaranteed by government-sponsored entities and primarily relate to changes in market interest rates. All amounts are expected to be recovered when market prices recover or at maturity. The Company intends to hold these securities for the foreseeable future, and does not intend to sell the securities before the price recovers. Customers considers it more likely than not that it will not be required to sell the securities. Accordingly, Customers has concluded that the securities are not other-than-temporarily impaired as of December 31, 2014.

At December 31, 2014 and 2013, Customers Bank had pledged investment securities aggregating \$376.9 million and \$451.1 million fair value, respectively, as collateral against its borrowings primarily with the FHLB and a unused line of credit with another financial institution. These counterparties do not have the ability to sell or repledge these securities.

NOTE 7 – LOANS HELD FOR SALE

The composition of loans held for sale was as follows:

	December 31, 2014	2013
(in thousands)		
Commercial Loans:		
Mortgage warehouse loans at fair value	\$1,332,019	\$740,694
Multi-family loans at lower of cost or fair value	99,791	—
Total Commercial Loans Held for Sale	1,431,810	740,694
Consumer Loans:		
Residential mortgage loans at fair value	3,649	6,899
Loans held for sale	\$1,435,459	\$747,593

Effective September 30, 2014, Customers Bank transferred \$164.7 million of multi-family loans from loans receivable to held for sale because the Bank was actively marketing these loans and no longer had the intent to retain these loans in its portfolio. Effective December 31, 2014, Customers Bank transferred 18.8 million of these loans back to loans receivable because the Bank no longer has the intent to sell the loans. Customers Bank transferred these loans at their amortized cost, which was lower than the estimated fair value at the time of transfer.

Table of Contents

NOTE 8 – LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES

During the fourth quarter of 2014, certain types of loans were reclassified due to their purpose and overall risk characteristics. Therefore, balances on certain loans and allowance for loan losses as of December 31, 2013 were reclassified to conform to the December 31, 2014 presentation.

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

	December 31, 2014	2013
	(in thousands)	
Commercial:		
Multi-family	\$2,127,034	\$1,063,459
Commercial real estate	1,132,072	724,752
Commercial and industrial	540,430	292,937
Construction	56,669	31,314
Total Commercial Loans	3,856,205	2,112,462
Consumer:		
Residential real estate	285,003	145,188
Manufactured housing	126,731	139,471
Home equity / other	1,541	2,144
Total Consumer Loans	413,275	286,803
Total loan receivable not covered under FDIC loss sharing agreements	4,269,480	2,399,265
(1)		
Commercial:		
Commercial real estate	17,585	28,839
Commercial and industrial	2,235	3,658
Construction	6,705	11,603
Multi-family	372	600
Total Commercial Loans	26,897	44,700
Consumer:		
Residential real estate	12,392	18,732
Home equity / other	2,892	3,293
Total Consumer Loans	15,284	22,025
Total loan receivable covered under FDIC loss sharing agreements (1)	42,181	66,725
Total all loans	4,311,661	2,465,990
Deferred (fees) costs and unamortized premiums/(discounts), net	512	(912)
Allowance for loan losses	(30,932)	(23,998)
Loans receivable, net	\$4,281,241	\$2,441,080

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

Table of Contents

Non-Covered Loans

The following table summarizes non-covered loans by loan type and performance status as of December 31, 2014 and 2013:

	December 31, 2014						
	30-89 Days Past Due (1)	90 Or More Days Past Due (1)	Total Past Due Still Accruing (1)	Non- Accrual	Current (2)	Purchased- Credit- Impaired Loans (3)	Total Loans (4)
	(in thousands)						
Commercial real estate	\$—	\$—	\$—	\$3,450	\$1,101,119	\$27,503	\$1,132,072
Multi-family	—	—	—	—	2,124,448	2,586	2,127,034
Commercial and industrial	366	—	366	2,257	536,326	1,481	540,430
Construction	—	—	—	—	56,510	159	56,669
Residential real estate	1,226	—	1,226	849	273,565	9,363	285,003
Home equity / other	—	—	—	—	1,333	208	1,541
Manufactured housing (5)	6,324	4,388	10,712	931	111,072	4,016	126,731
Total	\$7,916	\$4,388	\$12,304	\$7,487	\$4,204,373	\$45,316	\$4,269,480
	December 31, 2013						
	30-89 Days Past Due (1)	90 Or More Days Past Due (1)	Total Past Due Still Accruing (1)	Non- Accrual	Current (2)	Purchased- Credit- Impaired Loans (3)	Total Loans (4)
	(in thousands)						
Commercial real estate	\$—	\$—	\$—	\$5,948	\$685,999	\$32,805	\$724,752
Multi-family	—	—	—	—	1,060,137	3,322	1,063,459
Commercial and industrial	10	—	10	4,564	284,767	3,596	292,937
Construction	—	—	—	1,584	29,482	248	31,314
Residential real estate	555	—	555	969	133,158	10,506	145,188
Home equity / other	—	—	—	—	1,728	416	2,144
Manufactured housing (5)	7,921	3,772	11,693	448	122,416	4,914	139,471
Total	\$8,486	\$3,772	\$12,258	\$13,513	\$2,317,687	\$55,807	\$2,399,265

(1) Includes past due loans that are accruing interest because collection is considered probable.

(2) Loans where next payment due is less than 30 days from the report date.

Purchased-credit-impaired loans aggregated into a pool are accounted for as a single asset with a single composite interest rate and an aggregate expectation of cash flows, and the past due status of the pools, or that of the individual loans within the pools, is not meaningful. Because of the credit impaired nature of the loans, the loans

(3) are recorded at a discount reflecting estimated future cash flows and the Bank recognizes interest income on each pool of loans reflecting the estimated yield and passage of time. Such loans are considered to be performing.

Purchased-credit-impaired loans that are not in pools accrete interest when the timing and amount of their expected cash flows are reasonably estimable, and are reported as performing loans.

(4) Amounts exclude deferred costs and fees, unamortized premiums and discounts, and the allowance for loan losses.

Manufactured housing loans purchased in 2010 are supported by cash reserves held at the Bank that are used to

(5) fund past-due payments when the loan becomes 90 days or more delinquent. Subsequent purchases are subject to varying provisions in the event of borrowers' delinquencies.

Table of Contents

Covered Loans

The following table summarizes covered loans by class and performance status as of December 31, 2014 and 2013:

	30-89 Days Past Due (1)	90 Days Or More Past Due (1)	Total Past Due Still Accruing (1)	Non- Accrual	Current (2)	Purchased- Credit- Impaired Loans (3)	Total Loans (4)
December 31, 2014							
	(in thousands)						
Commercial and industrial	\$518	\$ —	\$518	\$165	\$361	\$1,191	\$2,235
Multi-family	—	—	—	—	372	—	372
Commercial real estate	—	—	—	615	11,884	5,086	17,585
Construction	—	—	—	2,325	—	4,380	6,705
Residential real estate	—	—	—	1,006	10,782	604	12,392
Home equity / other	147	—	147	135	2,570	40	2,892
Total	\$665	\$ —	\$665	\$4,246	\$25,969	\$11,301	\$42,181
December 31, 2013							
	(in thousands)						
Commercial and industrial	\$178	\$ —	\$178	\$151	\$1,067	\$2,262	\$3,658
Commercial real estate	362	—	362	2,599	17,059	8,819	28,839
Multi-family	—	—	—	—	600	—	600
Construction	—	—	—	2,325	—	9,278	11,603
Residential real estate	90	—	90	564	14,107	3,971	18,732
Home equity / other	56	—	56	11	3,081	145	3,293
Total	\$686	\$ —	\$686	\$5,650	\$35,914	\$24,475	\$66,725

(1) Includes past due loans that are accruing interest because collection is considered probable.

(2) Purchased loans in FDIC assisted transactions with no evidence of credit deterioration since origination.

Purchased-credit-impaired loans aggregated into a pool are accounted for as a single asset with a single composite interest rate and an aggregate expectation of cash flows, and the past due status of the pools, or that of the individual loans within the pools, is not meaningful. Because of the credit impaired nature of the loans, the loans

(3) are recorded at a discount reflecting estimated future cash flows and the Bank recognizes interest income on each pool of loans reflecting the estimated yield and passage of time. Such loans are considered to be performing.

Purchased-credit-impaired loans that are not in pools accrete interest when the timing and amount of their expected cash flows are reasonably estimable, and are reported as performing loans.

(4) Amounts exclude deferred costs and fees, unamortized premiums and discounts, and the allowance for loan losses. Allowance for Loan Losses and FDIC Loss Sharing Receivable

Losses incurred on covered loans are eligible for partial reimbursement by the FDIC. Subsequent to the purchase date, the expected cash flows on the covered loans are subject to evaluation. Decreases in the present value of expected cash flows on the covered loans are recognized by increasing the allowance for loan losses with a related charge to the provision for loan losses. At the same time, the FDIC indemnification asset is increased reflecting an estimated future collection from the FDIC, which is recorded as a reduction to the provision for loan losses. If the expected cash flows on the covered loans increase such that a previously recorded impairment can be reversed, the Bancorp records a reduction in the allowance for loan losses (with a related credit to the provision for loan losses) accompanied by a

reduction in the FDIC receivable balance and a charge to the provision for loan losses. Increases in expected cash flows of covered loans and decreases in expected cash flows of the FDIC loss sharing receivable, when there are no previously recorded impairments, are considered together and recognized over the remaining life of the loans as interest income. The FDIC loss sharing receivable balance will be reduced through a charge to the provision for loan losses, with no offsetting reduction to the allowance for loan losses, as the FDIC loss sharing arrangements reach their contractual maturities and the estimated losses in the covered loans have not yet emerged or been realized in a final disposition event. The FDIC loss sharing arrangements for non-single family loans expire in third quarter 2015. The loss sharing arrangements for single family loans expire in third quarter 2020.

Table of Contents

The following table presents changes in the allowance for loans losses and the FDIC loss sharing receivable for the years ended December 31, 2014, 2013 and 2012.

	Allowance for Loan Losses		
	For The Year Ended December 31,		
	2014	2013	2012
	(in thousands)		
Beginning Balance	\$23,998	\$25,837	\$15,032
Provision for loan losses (1)	10,058	5,055	16,271
Charge-offs	(4,947	) (7,338	) (6,166
Recoveries	1,823	444	700
Ending Balance	\$30,932	\$23,998	\$25,837
	FDIC Loss Sharing Receivable		
	For The Year Ended December 31,		
	2014	2013	2012
	(in thousands)		
Beginning Balance	\$10,046	\$12,343	\$13,077
Increased (decreased) estimated cash flows (2)	(4,689	) 2,819	2,001
Other activity, net (a)	2,409	1,610	3,838
Cash receipts from FDIC	(5,446	) (6,726	) (6,573
Ending Balance	\$2,320	\$10,046	\$12,343
(1) Provision for loan losses	\$10,058	\$5,055	\$16,271
(2) Effect attributable to FDIC loss share arrangements	4,689	(2,819	) (2,001
Net amount reported as provision for loan losses	\$14,747	\$2,236	\$14,270

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

Table of Contents

Impaired Loans – Covered and Non-Covered

The following tables present a summary of impaired loans as of the years ended December 31, 2014 and 2013.

Purchased-credit-impaired loans are considered to be performing and are not included in the tables below.

	December 31, 2014				
	Recorded Investment Net of Charge Offs (in thousands)	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial and industrial	\$13,825	\$15,348	\$—	\$13,329	\$674
Commercial real estate	18,977	19,121	—	17,974	887
Construction	2,325	2,325	—	2,415	41
Home equity / other	21	21	—	26	—
Residential real estate	1,455	3,697	—	1,925	13
With an allowance recorded:					
Commercial and industrial	1,833	1,833	818	1,725	28
Commercial real estate	1,410	1,410	304	2,086	39
Construction	—	—	—	851	—
Home equity / other	114	114	32	82	1
Residential real estate	365	365	188	296	1
Total	\$40,325	\$44,234	\$1,342	\$40,709	\$1,684
	December 31, 2013				
	Recorded Investment Net of Charge Offs (in thousands)	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial and industrial	\$13,097	\$13,159	\$—	\$9,953	\$603
Commercial real estate	14,397	15,249	—	22,475	978
Construction	2,777	4,046	—	6,408	6
Home equity / other	—	—	—	90	8
Residential real estate	2,831	2,831	—	2,523	31
With an allowance recorded:					
Commercial and industrial	2,469	3,739	829	1,616	44
Commercial real estate	2,261	3,167	946	7,497	2
Construction	1,132	1,132	351	5,054	—
Home equity / other	64	64	17	48	5
Residential real estate	252	252	199	875	4
Total	\$39,280	\$43,639	\$2,342	\$56,539	\$1,681

Troubled Debt Restructurings

At December 31, 2014 and 2013, there were \$5.0 million and \$4.6 million, respectively, in loans categorized as troubled debt restructurings (“TDRs”). TDRs are reported as impaired loans in the calendar year of their restructuring and are evaluated to determine whether they should be placed on non-accrual status. In subsequent years, a TDR may be returned to accrual status if it satisfies a minimum six-month performance requirement; however, it will remain classified as impaired. Generally, the Bancorp requires sustained performance for nine months before returning a TDR to accrual status.

Modification of purchased-credit-impaired loans that are accounted for within loan pools in accordance with the accounting standards for purchased-credit-impaired loans do not result in the removal of these loans from the pool even if modifications would otherwise be

Table of Contents

considered a TDR. Accordingly, as each pool is accounted for as a single asset with a single composite interest rate and an aggregate expectation of cash flows, modifications of loans within such pools are not considered TDRs. The following is an analysis of loans modified in a troubled debt restructuring by type of concession at December 31, 2014 and 2013. There were no modifications that involved forgiveness of debt.

	December 31, 2014		
	TDRs in Compliance with Their Modified Terms and Accruing Interest (in thousands)	TDRs in Compliance with Their Modified Terms and Not Accruing Interest	Total
Extended under forbearance	\$460	\$—	\$460
Multiple extensions resulting from financial difficulty	—	—	—
Interest-rate reductions	231	389	620
Total	\$691	\$389	\$1,080
	December 31, 2013		
	TDRs in Compliance with Their Modified Terms and Accruing Interest (in thousands)	TDRs in Compliance with Their Modified Terms and Not Accruing Interest	Total
Extended under forbearance	\$—	\$—	\$—
Multiple extensions resulting from financial difficulty	—	—	—
Interest rate reductions	790	448	1,238
Total	\$790	\$448	\$1,238

The following tables provide by class the number of loans modified in troubled debt restructurings and recorded investments at December 31, 2014 and 2013.

	December 31, 2014		December 31, 2013	
	TDRs in Compliance with Their Modified Terms and Accruing Interest		TDRs in Compliance with Their Modified Terms and Not Accruing Interest	
	Number of Loans	Recorded Investment (dollars in thousands)	Number of Loans	Recorded Investment
Commercial and industrial	—	\$—	—	\$—
Commercial real estate	—	—	—	—
Construction	—	—	—	—
Manufactured housing	4	231	6	389
Residential real estate	—	—	—	—
Home equity / other	11	460	—	—
Total loans	15	\$691	6	\$389

Table of Contents

	December 31, 2013			
	TDRs in Compliance with Their Modified Terms and Accruing Interest		TDRs in Compliance with Their Modified Terms and Not Accruing Interest	
	Number of Loans	Recorded Investment (dollars in thousands)	Number of Loans	Recorded Investment
Commercial and industrial	—	\$—	—	\$—
Commercial real estate	—	—	—	—
Construction	—	—	—	—
Manufactured housing	8	758	5	448
Residential real estate	—	—	—	—
Home equity / other	1	32	—	—
Total loans	9	\$790	5	\$448

As of December 31, 2014 and 2013, there were no commitments to lend additional funds to debtors whose terms have been modified in TDRs.

For the year ended December 31, 2014 and 2013, the recorded investment of loans determined to be TDRs was \$1.1 million and \$1.2 million, respectively, both before and after restructuring. During the year ending December 31, 2014, six TDR loans defaulted with a recorded investment of \$0.4 million. During the year ending December 31, 2013, five TDR loans defaulted with a recorded investment of \$0.4 million. Since these loans were included in the loan portfolio that is subject to the cash reserve, they will be removed from the loan portfolio when they become ninety days past due.

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

Credit Quality Indicators

Commercial and industrial, commercial real estate, residential real estate and construction loans are based on an internally assigned risk rating system which are assigned at the loan origination and reviewed on a periodic or on an “as needed” basis. Consumer, mortgage warehouse, multi-family and manufactured housing loans are evaluated based on the payment activity of the loan.

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

The risk rating grades are defined as follows:

“1” – Pass/Excellent

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

ample coverage. The borrower typically reflects broad geographic and product diversification and has access to alternative financial markets.

Table of Contents

“2” – Pass/Superior

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

“3” – Pass/Strong

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

“4” – Pass/Good

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

“5” – Satisfactory

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

“6” – Satisfactory/Bankable with Care

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

“7” – Special Mention

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

“8” – Substandard

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

“9” – Doubtful

The Bank assigns a doubtful rating to loans that have all the attributes of a substandard rating with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The possibility of loss is extremely high, but because of certain important and reasonable specific pending factors that may work to the advantage of and strengthen the credit quality of the loan, its classification as an estimated loss is deferred until its more

Table of Contents

exact status may be determined. Pending factors may include a proposed merger or acquisition, liquidation proceeding, capital injection, perfecting liens on additional collateral or refinancing plans.

“10” – Loss

The Bank assigns a loss rating to loans considered uncollectible and of such little value that their continuance as an active asset is not warranted. Loss estimates in excess of 30% will result in a loss classification. Amounts classified as loss are immediately charged off.

Risk ratings are not established for home equity loans, consumer loans, and installment loans, mainly because these portfolios consist of a larger number of homogenous loans with smaller balances. Instead, these portfolios are evaluated for risk mainly based upon aggregate payment history through the monitoring of delinquency levels and trends and are classified as performing and nonperforming.

The following presents the credit quality tables as of December 31, 2014 and 2013 for the non-covered loan portfolio.

	December 31, 2014							
	Commercial and Industrial (in thousands)	Commercial Real Estate	Multi-family	Construction	Residential Real Estate	Home equity / other	Manufactured Housing	Total
Pass/Satisfactory	\$524,848	\$1,109,565	\$2,127,034	\$ 56,669	\$283,240	\$—	\$ —	\$4,101,356
Special Mention	13,238	16,002	—	—	243	—	—	29,483
Substandard	2,344	6,505	—	—	1,520	—	—	10,369
Performing (1)	—	—	—	—	—	1,541	115,088	116,629
Non-performing (2)	—	—	—	—	—	—	11,643	11,643
Total	\$540,430	\$1,132,072	\$2,127,034	\$ 56,669	\$285,003	\$1,541	\$ 126,731	\$4,269,480

	December 31, 2013							
	Commercial and Industrial (in thousands)	Commercial Real Estate	Multi-family	Construction	Residential Real Estate	Home equity / other	Manufactured Housing	Total
Pass/Satisfactory	\$277,491	\$703,636	\$1,062,411	\$ 29,701	\$142,588	\$—	\$ —	\$2,215,827
Special Mention	10,175	11,995	905	29	940	—	—	24,044
Substandard	5,271	9,121	143	1,584	1,660	—	—	17,779
Performing (1)	—	—	—	—	—	2,144	127,330	129,474
Non-performing (2)	—	—	—	—	—	—	12,141	12,141
Total	\$292,937	\$724,752	\$1,063,459	\$ 31,314	\$145,188	\$2,144	\$ 139,471	\$2,399,265

(1) Includes home equity, consumer, and other installment loans not subject to risk ratings.

(2) Includes loans that are past due and still accruing interest and loans on non-accrual status.

Table of Contents

The following presents the credit quality tables as of December 31, 2014 and 2013 for the covered loan portfolio.

	December 31, 2014						
	Commercial and Industrial	Commercial Real Estate	Multi-family	Construction	Residential Real Estate	Home equity / other	Total
Pass/Satisfactory	\$1,104	\$10,207	\$372	\$—	\$10,985	\$—	\$22,668
Special Mention	—	5,076	—	—	—	—	5,076
Substandard	1,131	2,302	—	6,705	1,407	—	11,545
Performing	—	—	—	—	—	2,610	2,610
Non-performing (1)	—	—	—	—	—	282	282
Total	\$2,235	\$17,585	\$372	\$6,705	\$12,392	\$2,892	\$42,181

	December 31, 2013						
	Commercial and Industrial	Commercial Real Estate	Multi-family	Construction	Residential Real Estate	Home equity / other	Total
Pass/Satisfactory	\$1,582	\$17,803	\$600	\$—	\$14,137	\$—	\$34,122
Special Mention	106	3,107	—	—	455	—	3,668
Substandard	1,970	7,929	—	11,603	4,140	—	25,642
Performing	—	—	—	—	—	3,226	3,226
Non-performing (1)	—	—	—	—	—	67	67
Total	\$3,658	\$28,839	\$600	\$11,603	\$18,732	\$3,293	\$66,725

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

The changes in the allowance for loan losses for the years ended December 31, 2014 and 2013 and the loans and allowance for loan losses by class and impairment method as of December 31, are presented in the tables that follow. The amounts presented below for the provision for loan losses do not include expected benefits resulting from the FDIC loss share arrangements for the covered loans.

Table of Contents

Twelve months ended December 31, 2014	Commercial and Industrial	Commercial Real Estate	Multi-family	Construction	Residential Real Estate	Manufactured Housing	Home equity / other	Total	
	(in thousands)								
Beginning Balance, January 1, 2014	\$2,674	\$11,478	\$4,227	\$ 2,385	\$2,490	\$ 614	\$130	\$23,998	
Charge-offs	(1,155)	(2,197)	—	(895)	(667)	—	(33)	(4,947)	
Recoveries	511	1,026	—	13	265	—	8	1,823	
Provision for loan losses	2,716	3,265	4,266	(456)	610	(352)	9	10,058	
Ending Balance, December 31, 2014	\$4,746	\$13,572	\$8,493	\$ 1,047	\$2,698	\$ 262	\$114	\$30,932	
Loans:									
Individually evaluated for impairment	\$15,658	\$20,387	\$—	\$ 2,325	\$1,820	\$—	\$135	\$40,325	
Collectively evaluated for impairment	524,335	1,096,681	2,124,820	56,510	285,608	122,715	4,050	4,214,719	
Loans acquired with credit deterioration	2,672	32,589	2,586	4,539	9,967	4,016	248	56,617	
	\$542,665	\$1,149,657	\$2,127,406	\$ 63,374	\$297,395	\$ 126,731	\$4,433	\$4,311,661	
Allowance for loan losses:									
Individually evaluated for impairment	\$818	\$304	\$—	\$—	\$188	\$—	\$32	\$1,342	
Collectively evaluated for impairment	3,766	8,336	8,493	424	1,436	92	28	22,575	
Loans acquired with credit deterioration	162	4,932	—	623	1,074	170	54	7,015	
	\$4,746	\$13,572	\$8,493	\$ 1,047	\$2,698	\$ 262	\$114	\$30,932	
Twelve months ended December 31, 2013	Commercial and Industrial	Commercial Real Estate	Multi-family	Construction	Residential Real Estate	Manufactured Housing	Home equity / other	Residual Reserve	Total
	(in thousands)								
Beginning Balance, January 1, 2013	\$1,548	\$13,644	\$1,795	\$3,991	\$3,233	\$750	\$154	\$722	\$25,837
Charge-offs	(1,387)	(3,358)	—	(2,096)	(410)	—	(87)	—	(7,338)
Recoveries	391	42	—	—	2	—	9	—	444

Edgar Filing: EQUUS TOTAL RETURN, INC. - Form 10-K

Provision for loan losses	2,122	1,150	2,432	490	(335	) (136	) 54	(722)	5,055
Ending Balance, December 31, 2013	\$2,674	\$11,478	\$4,227	\$2,385	\$2,490	\$614	\$130	\$—	\$23,998
Loans:									
Individually evaluated for impairment	\$15,566	\$16,658	\$—	\$3,909	\$3,083	\$—	\$64	\$—	\$39,280
Collectively evaluated for impairment	275,171	695,309	1,060,736	29,482	146,361	134,557	4,812	—	2,346,428
Loans acquired with credit deterioration	5,858	41,624	3,322	9,526	14,477	4,914	561	—	80,282
	\$296,595	\$753,591	\$1,064,058	\$42,917	\$163,921	\$139,471	\$5,437	\$—	\$2,465,990
Allowance for loan losses:									
Individually evaluated for impairment	\$829	\$946	\$—	\$351	\$199	\$—	\$17	\$—	\$2,342
Collectively evaluated for impairment	1,610	5,415	4,227	267	767	84	38	—	12,408
Loans acquired with credit deterioration	235	5,117	—	1,767	1,524	530	75	—	9,248
	\$2,674	\$11,478	\$4,227	\$2,385	\$2,490	\$614	\$130	\$—	\$23,998

The non-covered manufactured housing portfolio was purchased in August 2010. A portion of the purchase price may be used to reimburse the Bank under the specified terms in the Purchase Agreement for defaults of the underlying borrower and other specified items. At December 31, 2014 and 2013, funds available for reimbursement, if necessary, were \$3.0 million and \$3.1 million, respectively. Each quarter, these funds are evaluated to determine if they would be sufficient to absorb probable losses within the manufactured housing portfolio.

Table of Contents

The following table presents the changes in accretable yield related to purchased-credit-impaired loans:

	December 31,		
	2014	2013	2012
	(in thousands)		
Accretable yield balance, beginning of period	\$22,557	\$32,174	\$45,358
Accretion to interest income	(3,201)	) (6,213	) (11,723)
Reclassification from nonaccretable difference and disposals, net	(1,750	) (3,404	) (1,461)
Accretable yield balance, end of period	\$17,606	\$22,557	\$32,174

NOTE 9 – BANK PREMISES AND EQUIPMENT

The components of bank premises and equipment were as follows:

	Expected Useful Life	December 31,	
		2014	2013
		(in thousands)	
Leasehold improvements	3 to 25 years	\$11,680	\$11,507
Furniture, fixtures and equipment	5 to 10 years	4,504	4,353
IT equipment	3 to 5 years	4,696	3,740
Automobiles	5 to 10 years	174	172
		21,054	19,772
Accumulated depreciation		(10,244	) (8,147)
Total		\$10,810	\$11,625

Future minimum rental commitments under non-cancelable leases were as follows:

	December 31, 2014
	(in thousands)
2015	\$3,574
2016	3,475
2017	3,265
2018	3,038
2019	2,549
Subsequent to 2019	5,934
Total minimum payments	\$21,835

Rent expense, which includes reimbursements to the lessor for real estate taxes, was approximately \$3.1 million, \$2.5 million and \$2.1 million for the years ended December 31, 2014, 2013 and 2012, respectively. The Bancorp's leases are for land and branch or office space. A majority of the leases provide for the payment of taxes, maintenance, insurance and certain other expenses applicable to the leased premises. Many of the leases contain extension provisions and escalation clauses. These leases are generally renewable and may, in certain cases, contain renewal provisions and options to expand and contract space and terminate the leases at predetermined contractual dates. In addition, escalation clauses may exist, which are tied to a predetermined rate or may change based on a specified percentage increase or the Consumer Price Index.

Table of Contents

NOTE 10 – DEPOSITS

The components of deposits at December 31, 2014 and 2013 were as follows:

	December 31, 2014 (in thousands)	2013
Demand, non-interest bearing	\$546,436	\$478,103
Demand, interest bearing	71,202	58,013
Savings, including money market deposit accounts	2,203,237	1,298,468
Time, \$100,000 and over	1,043,265	797,322
Time, other	668,398	328,016
Total deposits	\$4,532,538	\$2,959,922

Time deposits scheduled maturities at December 31, 2014 were as follows:

	December 31, 2014 (in thousands)
2015	\$976,051
2016	438,340
2017	198,431
2018	53,927
2019	44,914
Total time deposits	\$1,711,663

The aggregate amount of demand deposit overdrafts that were reclassified as loans were \$0.8 million at December 31, 2014, compared to \$1.0 million as of December 31, 2013.

Included in the savings balances above were \$632.7 million and \$277.7 million of brokered money market deposits, respectively, as of December 31, 2014 and 2013. Also, included in time, other balances above were \$483.2 million and \$36.0 million of brokered time deposits, respectively, as of December 31, 2014 and 2013.

NOTE 11 – BORROWINGS

Short-term debt

Short-term debt at December 31, 2014 and 2013 was as follows:

	December 31, 2014		2013		
(amounts in thousands)	Amount	Rate	Amount	Rate	%
FHLB advances	\$1,298,000	0.29	% \$611,500	0.26	%
Federal funds purchased	—	—	13,000	0.48	
Total short-term debt	\$1,298,000		\$624,500		

Table of Contents

The following is a summary of additional information relating to the Bancorp's short-term debt:

	December 31, 2014	2013	2012	
(amounts in thousands)				
FHLB advances:				
Maximum outstanding at any month end	\$1,383,000	\$769,750	\$411,000	
Average balance during the year	898,396	120,309	74,336	
Weighted-average interest rate during the year	0.46	% 0.55	% 0.38	%
Federal funds purchased:				
Maximum outstanding at any month end	35,000	125,000	55,000	
Average balance during the year	13,312	32,351	4,336	
Weighted-average interest rate during the year	0.31	% 0.31	% 0.24	%
At December 31, 2014 and 2013, the Bank had aggregate availability under federal funds lines totaling \$95.0 million and \$35.0 million, respectively.				

Long-term debt

FHLB advances

The contractual maturities of long-term advances from the FHLB were as follows:

	December 31, 2014		2013		
(amounts in thousands)	Amount	Rate	Amount	Rate	
2015	\$—	—	% \$50,000	0.37	%
2016	85,000	0.59	35,000	0.66	
2017	180,000	1.21	5,000	3.08	
2018	55,000	1.61	5,000	3.31	
	\$320,000		\$95,000		

Of the \$320.0 million of long-term advances enumerated above, all but \$10.0 million are fixed rate.

The Bank had a total maximum borrowing capacity with the Federal Home Loan Bank of \$3.2 billion and with the Federal Reserve Bank of Philadelphia of \$62.7 million at December 31, 2014. The Bank had a total borrowing capacity with the Federal Home Loan Bank of \$1.6 billion and with the Federal Reserve Bank of Philadelphia of \$92.3 million at December 31, 2013. Amounts can be borrowed as short-term or long-term. As of December 31, 2014, advances under these arrangements were secured by certain assets, which included a blanket lien on securities of \$342.0 million and qualifying loans of Customers Bank of \$2.9 billion.

Senior notes

On June 26, 2014, the Bancorp closed a private placement transaction in which it issued \$25.0 million of 4.625% senior notes due 2019. Interest is paid semi-annually in arrears in June and December.

In July and August 2013, the Bancorp issued \$63.3 million in aggregate principal amount of senior notes due 2018. The notes bear interest at 6.375% per year which is payable on March 15, June 15, September 15, and December 15. The notes are unsecured obligations of the Bancorp and rank equally with all of its secured and unsecured senior indebtedness.

Subordinated debt

On June 26, 2014, Customers Bank closed a private placement transaction in which it issued \$110.0 million of fixed-to-floating rate subordinated notes due 2029. The subordinated notes bear interest at an annual fixed rate of 6.125% until June 26, 2024, and interest is paid semiannually. From June 26, 2024, the subordinated notes will bear an annual interest rate equal to three-month LIBOR plus 344.3 basis points until maturity on June 26, 2029. Customers Bank has the ability to call the subordinated

Table of Contents

notes, in whole or in part, at a redemption price equal to 100% of the principal balance at certain times on or after June 26, 2024.

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

NOTE 12 – SHAREHOLDERS’ EQUITY

In May 2014, the Bancorp announced that its Board of Directors had declared a 10% stock dividend to all shareholders of record as of May 27, 2014. This special dividend was paid on June 30, 2014 in the form of an aggregate of 2,429,375 additional shares.

In November 2013, the Bancorp announced that its Board of Directors had authorized a stock repurchase plan in which it could acquire up to 5% of its current outstanding shares at prices not to exceed a 20% premium over the current book value. The repurchase program may be suspended, modified or discontinued at any time, and the Bancorp has no obligation to repurchase any amount of its common stock under the program. There was no stock repurchased during 2014 or 2013.

At December 31, 2014, there were warrants outstanding to purchase 635,274 shares of the Bancorp’s common stock. At December 31, 2013, there were warrants outstanding to purchase 635,820 shares of the Bancorp’s common stock. The purchase prices at December 31, 2014 and 2013 ranged from \$9.55 per share to \$73.01 per share.

NOTE 13 – EMPLOYEE BENEFIT PLANS

401(k) Plan

Customers Bank has a 401(k) profit sharing plan whereby eligible team members may contribute amounts up to the annual IRS statutory contribution limit. Customers Bank provides a matching contribution equal to 50% of the first 6% of the contribution made by the team member. Employer contributions for the years ended December 31, 2014, 2013, and 2012 were \$1.0 million, \$0.6 million, and \$0.3 million, respectively.

Supplemental Executive Retirement Plans

Customers Bank entered into a supplemental executive retirement plan (SERP) with its Chairman and Chief Executive Officer that provides annual retirement benefits for a 15-year period upon the later of his reaching the age of 65 or when he terminates employment. The SERP is a defined-contribution type of deferred compensation arrangement that is designed to provide a target annual retirement benefit of \$300,000 per year for 15 years starting at age 65, based on an assumed constant rate of return of 7% per year, but that level of retirement benefit is not guaranteed by the Bank, and the ultimate retirement benefit can be less than or greater than the target. The Bank intends to fund its obligations under the SERP with the increase in cash surrender value of a life insurance policy on the life of the Chairman and Chief Executive Officer which is owned by the Bank. The present value of the amount owed as of December 31, 2014 was \$3.6 million and was included in other liabilities.

NOTE 14 – SHARE-BASED COMPENSATION PLANS

Summary

During 2010, the shareholders of Customers Bank approved the 2010 Stock Option Plan (“2010 Plan”), and during 2012, the shareholders of Customers Bancorp approved the 2012 Amendment and Restatement of the Customers Bancorp, Inc. Amended and Restated 2004 Incentive Equity and Deferred Compensation Plan (“2004 Plan”). The purpose of these plans is to promote the success and enhance the value of the Bancorp by linking the personal interests of the members of the Board of Directors and employees, officers, and executives of Customers Bank to those of the shareholders of the Bancorp and by providing such individuals with an incentive for outstanding performance in order to generate superior returns to shareholders of the Bancorp. The 2010 Plan and 2004 Plan are intended to provide flexibility to the Bancorp in its ability to motivate, attract, and retain the services of members of the Board of Directors, and employees, officers, and executives of Customers Bank. Stock options and restricted stock units normally vest on the third or fifth anniversary of the grant date provided the grantee remains employed by the Bancorp or continues to serve on the Board. With respect to stock options granted under the 2010 Plan, vested options shall be exercisable only when the Bancorp’s fully diluted tangible book value will have increased by 50% from the date of grant. Certain share-based awards provide for accelerated vesting if there is a change in control (as defined in the Plans). No stock options may be exercisable for more than 10 years from the date of grant.

Table of Contents

The 2010 and 2004 Plans are administered by the Compensation Committee of the Board of Directors. The 2010 Plan provides exclusively for the grant of stock options, some or all of which may be structured to qualify as Incentive Stock Options, to employees, officers and executives. The maximum number of shares of common stock which may be issued under the 2010 Plan is 3,666,667 shares. The 2004 Plan provides for the grant of options, some or all of which may be structured to qualify as Incentive Stock Options if granted to employees, stock appreciation rights, restricted stock, restricted stock units, and unrestricted stock to employees, officers, executives, and members of the Board of Directors. The maximum number of shares of common stock which may be issued under the 2004 Plan is 2,750,000 shares. At December 31, 2014, the aggregate number of shares of common stock available for grant under these plans was 2,510,117 shares.

On January 1, 2011, the Bancorp initiated a Bonus Recognition and Retention Program ("BRRP"). This is a restricted stock unit plan. Employees eligible to participate in the BRRP include the Chief Executive Officer and other management and highly compensated employees as determined by the Compensation Committee in its sole discretion. Under the BRRP, a participant may elect to defer not less than 25%, nor more than 50%, of his or her bonus payable with respect to each year of participation. Shares of Voting Common Stock having a value equal to the portion of the bonus deferred by a participant are allocated to an annual deferral account, and a matching amount equal to an identical number of shares of common stock is also allocated to the annual deferral account. A participant becomes 100% vested in the annual deferral account on the fifth anniversary date of the initial funding of the account, provided he or she remains continuously employed by the Bancorp from the date of funding to the anniversary date.

Vesting is accelerated in the event of involuntary termination other than for cause, retirement at or after age 65, death, termination on account of disability, or a change in control of the Bancorp. Participants were first eligible to make elections under the BRRP with respect to their bonuses for 2011 which were payable in the first quarter of 2012. The BRRP does not provide for a specific number of shares to be reserved; by its terms, the award of restricted stock units under this plan is limited by the amount of cash bonuses paid to the participants in the plan. At December 31, 2014, restricted stock units outstanding under this plan totaled 170,429.

Share-based compensation expense relating to stock options and restricted stock units is recognized on a straight-line basis over the vesting periods of the awards and is a component of salaries and employee benefits expense. Total share-based compensation expense for 2014, 2013, and 2012 was 5.2 million, 3.4 million, and 2.0 million, respectively. At December 31, 2014, there was \$9.3 million of unrecognized compensation cost related to all non-vested share-based compensation awards. This cost is expected to be recognized through December 2017.

In 2014, the shareholders of Customers Bancorp approved the 2014 Employee Stock Purchase Plan (the "ESPP"). The ESPP is intended to encourage team member participation in the ownership and economic progress of the Bancorp. This plan is intended to qualify as an employee stock purchase plan within the meaning of the Internal Revenue Code and is administered by the Compensation Committee of the Board of Directors.

Under the ESPP, team members may elect to purchase shares of the Bancorp's common stock through payroll deduction. Since the purchase price under the plan is 85% of (a 15% discount to) the fair market value of a share of common stock on the first day of each quarterly subscription period, the Bancorp's ESPP is considered to be a compensatory plan under current accounting guidance. Therefore, the entire amount of the discount is recognizable compensation expense. ESPP expense for 2014 was \$12.0 thousand.

Table of Contents

Stock Options

The Bancorp estimated the fair value of each option on the date of grant using the Black-Scholes option pricing model. The risk-free interest rate was based upon the zero-coupon Treasury rates in effect on the grant date of the options. Expected volatility was based upon limited historical information because the Bancorp's common stock has only been traded since February 2012. Expected life was management's estimate which took into consideration the five-year vesting requirement and the fact that there have been no exercises since 2010. The following table presents the weighted-average assumptions used and the resulting weighted-average fair value of an option.

	2014	2013	2012	
Weighted-average risk-free interest rate	2.16	% 1.42	% 1.15	%
Expected dividend yield	—	% —	% —	%
Weighted-average expected volatility	18.00	% 13.77	% 17.47	%
Weighted-average expected life (in years)	7.00	7.00	6.98	
Weighted-average fair value of each option granted	\$4.52	\$3.17	\$3.04	

The following summarizes stock option activity for the year ended December 31, 2014:

	Number of Shares	Weighted- average Exercise Price	Weighted- average Remaining Contractual Term in Years	Aggregate Intrinsic Value
(dollars in thousands, except Weighted-average Exercise Price)				
Outstanding, January 1, 2014	3,051,939	\$12.42		
Issued	130,978	17.78		
Forfeited	(12,650)	) 17.72		
Expired	(2,200)	) 27.95		
Outstanding, December 31, 2014	3,168,067	\$12.61	7.20	\$21,735
Exercisable at December 31, 2014	13,683	\$16.67	2.53	\$65

A summary of the status of the Bancorp's non-vested options at December 31, 2014 and changes during the year ended December 31, 2014 is as follows:

	Options	Weighted- average exercise price
Non-vested at January 1, 2014	3,036,056	\$12.42
Granted	130,978	17.78
Forfeited	(12,650)	) 17.72
Non-vested at December 31, 2014	3,154,384	12.59

Restricted Stock Units

The fair value of restricted stock units granted under the 2004 Plan is determined based on the market price of the Bancorp's common stock on the date of grant. The fair value of restricted stock units granted under the BRRP is measured as of the date on which such portion of the bonus would have been paid but for the deferral.

In February 2012, the Compensation Committee recommended and the Board of Directors approved a restricted stock reward program that has two vesting requirements. The first requirement is that the recipient remains an employee or director through December 31, 2016. The second requirement is that the Bancorp's Voting Common Stock will have traded at a price greater than \$17.18 per share (adjusted for any stock splits or stock dividends) for at least 5 consecutive trading days during the five-year period ending December 31, 2016. This second requirement was satisfied during the fourth quarter of 2013.

Table of Contents

The table below presents the status of the restricted stock units at December 31, 2014 and changes during the year ended December 31, 2014:

	Restricted Stock Units	Weighted- average grant- date fair value
Outstanding and unvested at January 1, 2014	675,638	\$11.81
Granted	156,624	17.65
Vested	(37,857)	) 10.91
Forfeited	(5,434)	) 13.87
Outstanding and unvested at December 31, 2014	788,971	\$13.00

Customers Bancorp has a policy that permits its directors to elect to receive shares of Voting Common Stock in lieu of their cash retainers. In January 2014, Customers Bancorp issued 28,095 shares of Voting Common Stock with a fair value of \$0.5 million to the directors as compensation for their services during 2013. During the year ended December 31, 2014, Customers Bancorp issued 28,235 shares of Voting Common Stock with a fair value of \$0.5 million to directors as compensation for their services during 2014. The fair values were determined based on the opening price of the common stock on the day the shares were issued.

NOTE 15 – INCOME TAXES

The components of income tax expense were as follows:

	For the Year Ended December 31,		
	2014	2013	2012
	(in thousands)		
Current	\$26,361	\$15,394	\$16,003
Deferred	(6,187)	) 2,210	(3,731)
Total	\$20,174	\$17,604	\$12,272

Effective tax rates differ from the federal statutory rate of 35%, which is applied to income before income tax expense, due to the following:

	For the Year Ended December 31,					
	2014		2013		2012	
	Amount	% of pretax income	Amount	% of pretax income	Amount	% of pretax income
	(dollars in thousands)					
Federal income tax at statutory rate	\$22,185	35.00	% \$17,604	35.00	% \$12,631	35.00
State income tax	1,355	2.14	353	0.70	184	0.51
Tax-exempt interest	(260)	) (0.41)	) (155)	) (0.31)	) (85)	) (0.24)
Interest disallowance	11	0.02	7	0.01	4	0.01
Bank-owned life insurance	(1,296)	) (2.04)	) (868)	) (1.73)	) (466)	) (1.29)
Other	(1,821)	) (2.88)	) 663	1.33	4	0.01
Effective income tax rate	\$20,174	31.83	% \$17,604	35.00	% \$12,272	34.00

Deferred income taxes reflect temporary differences in the recognition of revenue and expenses for tax reporting and financial statement purposes, principally because certain items, such as the allowance for loan losses and loan fees are recognized in different periods for financial reporting and tax return purposes. A valuation allowance has not been established for deferred tax assets. Realization of the deferred tax assets is dependent on generating sufficient taxable income. Although realization is not assured, management believes it is more likely than not that all of the deferred tax asset will be realized. Deferred tax assets are recorded in other assets.

Table of Contents

The Bancorp accounts for income taxes under the liability method of accounting for income taxes. The income tax accounting guidance results in two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues. The Bancorp determines deferred income taxes using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur.

A tax position is recognized if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more likely than not means a likelihood of more than 50 percent; the terms examined and upon examination also include resolution of the related appeals or litigation process, if any. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances, and information available at the reporting date and is subject to management's judgment.

	December 31, 2014	2013
	(in thousands)	
Deferred tax assets:		
Allowance for loan losses	\$11,555	\$8,399
Net unrealized losses on securities	—	4,371
OREO expenses	588	403
Non-accrual interest	541	1,236
Net operating losses	1,892	2,003
Deferred compensation	5,112	4,250
Fair value adjustments on acquisitions	—	2,063
Cash flow hedge	681	—
Incentive compensation	1,558	942
Other	1,047	645
Total deferred tax assets	22,974	24,312
Deferred tax liabilities:		
Tax basis discount on acquisitions	(1,898)	(7,998)
Net unrealized gains on securities	(615)	—
Deferred loan costs	(4,524)	(2,438)
Bank premises and equipment	(991)	(1,182)
Other	(1,189)	(819)
Total deferred tax liabilities	(9,217)	(12,437)
Net deferred tax asset	\$13,757	\$11,875

The Bancorp had approximately \$5.4 million of federal net operating loss carryovers at December 31, 2014, that expire in 2023 through 2031.

The Bancorp and its subsidiaries are subject to U.S. federal income tax as well as income tax of various states primarily in the mid-Atlantic region of the U.S. Years that remain open for potential review by the Internal Revenue Service are 2011 through 2013 and the state taxing authorities are 2010 through 2013.

The Bancorp's policy is to record interest and penalties in other expense. Interest and penalties were immaterial for the years ended December 31, 2014 and 2013.

Table of Contents**NOTE 16 – TRANSACTIONS WITH EXECUTIVE OFFICERS, DIRECTORS, AND PRINCIPAL SHAREHOLDERS**

The Bancorp has had, and may be expected to have in the future, banking transactions in the ordinary course of business with its executive officers, directors, principal shareholders, their immediate families and affiliated companies (commonly referred to as related parties), on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with others. The activity relating to loans to such persons was as follows:

	For the Years Ended December 31,		
	2014	2013	2012
	(in thousands)		
Balance – January 1	\$7,273	\$3,272	\$3,657
Additions	5	9,280	14
Repayments	(7,269)	(5,279)	(399)
Balance – December 31	\$9	\$7,273	\$3,272

Some current directors, nominees for director and executive officers of the Bancorp and entities or organizations in which they were executive officers or the equivalent or owners of more than 10% of the equity were customers of and had transactions with or involving the Bancorp in the ordinary course of business during the fiscal year ended December 31, 2014. None of these transactions involved amounts in excess of 5% of the Bancorp's gross revenues during 2014 nor was the Bancorp indebted to any of the foregoing persons or entities in an aggregate amount in excess of 5% of the Bancorp's total consolidated assets at December 31, 2014. Additional transactions with such persons and entities may be expected to take place in the ordinary course of business in the future.

For the year ended December 31, 2013 and 2012 the Bancorp has paid approximately \$0.2 million, and \$0.4 million, respectively to Clipper Magazine and its division, Spencer Advertising Marketing as well as Jaxxon Promotions, Inc. A director of the Bancorp was the Chief Executive Officer of Clipper Magazine until retiring in June 30, 2013. The director remains a 25% shareholder of Jaxxon Promotions, Inc., which the Bancorp paid \$46,900 for services for the year ended December 31, 2014.

For the year ended December 31, 2014, 2013, and 2012 the Bancorp has paid approximately \$11,300, \$3,800, and \$6,400, respectively to Jastrem Premium Landscapes. An immediate family member of an Executive Vice President of the Bank is the sole proprietor of Jastrem Premium Landscapes.

NOTE 17 – FINANCIAL INSTRUMENTS WITH OFF-BALANCE-SHEET RISK

The Bancorp is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and letters of credit. Those instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the consolidated balance sheets.

The Bancorp's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit is represented by the contractual amount of those instruments. The Bancorp uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

The following financial instruments were outstanding whose contract amounts represent credit risk:

	December 31,	
	2014	2013
	(in thousands)	
Commitments to fund loans	\$231,294	\$202,809
Unfunded commitments to fund mortgage warehouse loans	713,619	905,442
Unfunded commitments under lines of credit	430,995	177,457
Letters of credit	36,206	29,116
Other unused commitments	7,685	8,010

Table of Contents

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Mortgage warehouse loan commitments are agreements to purchase mortgage loans from mortgage bankers that agree to purchase the loans back in a short period of time. These commitments generally fluctuate monthly as existing loans are repurchased by the mortgage bankers and new loans are purchased by the Bancorp.

Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The Bancorp evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bancorp upon extension of credit, is based on management's credit evaluation. Collateral held varies but may include personal or commercial real estate, accounts receivable, inventory and equipment.

Outstanding letters of credit written are conditional commitments issued by the Bancorp to guarantee the performance of a customer to a third party. The majority of these standby letters of credit expire within the next year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending other loan commitments. The Bancorp requires collateral supporting these letters of credit as deemed necessary. Management believes that the proceeds obtained through a liquidation of such collateral would be sufficient to cover the maximum potential amount of future payments required under the corresponding guarantees. The current amount of the liabilities as of December 31, 2014 and 2013 for guarantees under standby letters of credit issued is not material.

NOTE 18 – REGULATORY MATTERS

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

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

Table of Contents

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

(dollars in thousands)	Actual		For Capital Adequacy Purposes			To Be Well Capitalized Under Prompt Corrective Action Provisions		
	Amount	Ratio	Amount	Ratio		Amount	Ratio	
December 31, 2014								
Total capital (to risk-weighted assets)								
Customers Bancorp, Inc.	\$578,644	11.09 %	\$417,473	8.0 %		N/A	N/A	
Customers Bank	\$621,894	11.98 %	\$415,141	8.0 %		\$518,926	10.0	%
Tier 1 capital (to risk-weighted assets)								
Customers Bancorp, Inc.	\$437,712	8.39 %	\$208,737	4.0 %		N/A	N/A	
Customers Bank	\$480,963	9.27 %	\$207,570	4.0 %		\$311,356	6.0	%
Tier 1 capital (to average assets)								
Customers Bancorp, Inc.	\$437,712	6.69 %	\$261,622	4.0 %		N/A	N/A	
Customers Bank	\$480,963	7.39 %	\$260,462	4.0 %		\$325,577	5.0	%
December 31, 2013								
Total capital (to risk-weighted assets)								
Customers Bancorp, Inc.	\$411,527	13.21 %	\$249,196	8.0 %		N/A	N/A	
Customers Bank	\$435,432	14.11 %	\$246,936	8.0 %		\$308,670	10.0	%
Tier 1 capital (to risk-weighted assets)								
Customers Bancorp, Inc.	\$387,529	12.44 %	\$124,598	4.0 %		N/A	N/A	
Customers Bank	\$411,434	13.33 %	\$123,468	4.0 %		\$185,202	6.0	%
Tier 1 capital (to average assets)								
Customers Bancorp, Inc.	\$387,529	10.11 %	\$153,310	4.0 %		N/A	N/A	
Customers Bank	\$411,434	10.81 %	\$152,191	4.0 %		\$190,239	5.0	%

NOTE 19 – DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS

The Bancorp uses fair value measurements to record fair value adjustments to certain assets and liabilities and to disclose the fair value of its financial instruments. FASB ASC 825, Financial Instruments, requires disclosure of the estimated fair value of an entity's assets and liabilities considered to be financial instruments. For the Bancorp, as for most financial institutions, the majority of its assets and liabilities are considered to be financial instruments.

However, many of these instruments lack an available trading market as characterized by a willing buyer and willing seller engaging in an exchange transaction. For fair value disclosure purposes, the Bancorp utilized certain fair value measurement criteria under the FASB ASC 820, Fair Value Measurements and Disclosures, as explained below.

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

The fair value guidance provides a consistent definition of fair value, focusing on an exit price in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions and establishes a fair value hierarchy to rank the quality and reliability of the information used to determine fair values. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be

appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment. The fair value is a reasonable point within the range that is most representative of fair value under current market conditions. The fair value hierarchy is defined as follows:

129

Table of Contents

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

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

Cash and cash equivalents:

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

Investment securities:

The fair value of investment securities available for sale are determined by obtaining quoted market prices on nationally recognized and foreign securities exchanges (Level 1) and matrix pricing (Level 2), which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted prices. These assets are included as Level 1 and 2, based upon the lowest level of input that is significant to the fair value measurements.

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

Loans held for sale - Residential mortgage loans:

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

Loans held for sale - Mortgage warehouse loans:

The fair value of mortgage warehouse loans is the amount of cash initially advanced to fund the mortgage, plus accrued interest and fees, as specified in the respective agreements. The loan is used by mortgage companies as short-term bridge financing between the funding of mortgage loans and the finalization of the sale of the loans to an investor. Changes in fair value are not expected to be recognized since at inception of the transaction the underlying loans have already been sold to an approved investor or they have been hedged by the mortgage company. Additionally, the interest rate is variable, and the transaction is short-term, with an average life of 20 days from purchase to sale. These assets are included as Level 2 fair values, based upon the lowest level of input that is significant to the fair value measurements.

Loans held for sale - Multi-family loans:

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

Loans receivable, net of allowance for loan losses:

The fair values of loans are estimated using discounted cash flow analyses, using market rates at the balance sheet date that reflect the credit and interest rate-risk inherent in the loans. Projected future cash flows are calculated based upon

contractual maturity or call dates, projected repayments and prepayments of principal. Generally, for variable rate loans that reprice

130

Table of Contents

frequently and with no significant change in credit risk, fair values are based on carrying values. These assets are included as Level 3 fair values, based upon the lowest level of input that is significant to the fair value measurements.

Impaired loans:

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

FDIC loss sharing receivable:

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

Other real estate owned:

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

Accrued interest receivable and payable:

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

Deposit liabilities:

The fair values disclosed for deposits (e.g., interest and noninterest checking, passbook savings and money market deposit accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). These liabilities are included as Level 1 fair values, based upon the lowest level of input that is significant to the fair value measurements.

Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered in the market on certificates to a schedule of aggregated expected monthly maturities on time deposits. These assets are included as Level 2 fair values, based upon the lowest level of input that is significant to the fair value measurements.

Federal funds purchased:

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

Borrowings:

Borrowings consist of long-term and short-term FHLB advances, senior unsecured notes, and subordinated debt. For the short-term borrowings, the carrying amount is considered a reasonable estimate of fair value and is included as Level 1. Fair values of long-term FHLB advances are estimated using discounted cash flow analysis, based on quoted prices for new FHLB advances with similar credit risk characteristics, terms and remaining maturity. These prices obtained from this active market represent a market value that is deemed to represent the transfer price if the liability were assumed by a third party. Fair values of privately placed subordinated and senior unsecured debt are estimated by a third-party financial advisor using discounted cash flow analysis, based on market rates currently offered on such

debt with similar credit-risk characteristics, terms and remaining maturity. These liabilities are included as Level 2 fair values, based upon the lowest level of input that is significant to the fair value measurements. The \$63.3 million senior unsecured notes issued during third quarter 2013 are traded on the New York Stock Exchange, and their price can be obtained daily. This fair value measurement is classified as Level 1.

Table of Contents

Derivatives (Assets and Liabilities):

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

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

Off-balance-sheet financial instruments:

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

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

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

	Fair Value Measurements at December 31, 2014				
	Carrying Amount	Estimated Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(amounts in thousands)					
Assets:					
Cash and cash equivalents	\$371,023	\$371,023	\$371,023	\$—	\$—
Investment securities, available for sale	416,685	416,685	24,270	392,415	—
Loans held for sale	1,435,459	1,436,460	—	1,335,668	100,792
Loans receivable, net of allowance for loan losses	4,281,241	4,285,537	—	—	4,285,537
FHLB, Federal Reserve Bank and other restricted stock	82,002	82,002	—	82,002	—
Accrued interest receivable	15,205	15,205	—	15,205	—
FDIC loss sharing receivable	2,320	2,320	—	—	2,320
Derivatives	7,552	7,552	—	7,509	43
Liabilities:					
Deposits	\$4,532,538	\$4,540,507	\$546,436	\$3,994,071	\$—
FHLB advances	1,618,000	1,619,858	1,298,000	321,858	—
Other borrowings	88,250	92,069	66,944	25,125	—

Edgar Filing: EQUUS TOTAL RETURN, INC. - Form 10-K

Subordinated debt	110,000	111,925	—	111,925	—
Derivatives	9,716	9,716	—	9,716	—
Accrued interest payable	2,599	2,599	—	2,599	—

132

Table of Contents

			Fair Value Measurements at		December 31,
					2013
	Carrying Amount	Estimated Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(amounts in thousands)					
Assets:					
Cash and cash equivalents	\$233,068	\$233,068	\$233,068	\$—	\$—
Investment securities, available for sale	497,573	497,573	20,714	476,859	—
Loans held for sale	747,593	747,593	—	747,593	—
Loans receivable, net of allowance for loan losses	2,441,080	2,444,900	—	—	2,444,900
FHLB and Federal Reserve Bank stock	42,424	42,424	—	42,424	—
Accrued interest receivable	8,362	8,362	—	8,362	—
FDIC loss sharing receivable	10,046	10,046	—	—	10,046
Derivatives	3,763	3,763	—	3,523	240
Liabilities:					
Deposits	\$2,959,922	\$2,919,935	\$478,103	\$2,441,832	\$—
Federal funds purchased	13,000	13,000	13,000	—	—
FHLB advances	706,500	708,025	596,500	111,525	—
Other borrowings	63,250	64,768	64,768	—	—
Subordinated debt	2,000	2,000	—	2,000	—
Derivatives	3,537	3,537	—	3,537	—
Accrued interest payable	1,675	1,675	—	1,675	—

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

December 31, 2014

Fair Value Measurements at the End of the Reporting Period Using

Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
--	---	---	-------

(amounts in thousands)

Measured at Fair Value on a Recurring Basis:

Assets

Available-for-sale securities:

Mortgage-backed securities	\$—	\$377,311	\$—	\$377,311
Corporate notes	—	15,104	—	15,104
Equity securities	24,270	—	—	24,270
Derivatives (1)	—	7,509	43	7,552
Loans held for sale – fair value option	—	1,335,668	—	1,335,668
Total assets - recurring fair value measurements	\$24,270	\$1,735,592	\$43	\$1,759,905

Edgar Filing: EQUUS TOTAL RETURN, INC. - Form 10-K

Liabilities				
Derivatives (2)	\$—	\$9,716	\$—	\$9,716
Measured at Fair Value on a Nonrecurring Basis:				
Assets				
Impaired loans, net of specific reserves of \$1,342	\$—	\$—	\$ 2,380	\$2,380
Other real estate owned	—	—	9,149	9,149
Total assets - nonrecurring fair value measurements	\$—	\$—	\$ 11,529	\$11,529

Table of Contents

December 31, 2013
Fair Value Measurements at the End of the Reporting Period
Using
Quoted Prices in Active Markets for Identical Assets (Level 1) Significant Other Observable Inputs (Level 2) Significant Unobservable Inputs (Level 3) Total

(amounts in thousands)

Measured at Fair Value on a Recurring Basis:

Assets

Available-for-sale securities:

Mortgage-backed securities	\$—	\$451,536	\$—	\$451,536
Corporate notes	—	25,323	—	25,323
Equity securities	20,714	—	—	20,714
Derivatives (1)	—	3,523	240	3,763
Loans held for sale – fair value option	—	747,593	—	747,593
Total assets - recurring fair value measurements	\$20,714	\$1,227,975	\$240	\$1,248,929

Liabilities

Derivatives (2)	\$—	\$3,537	\$—	\$3,537
-----------------	-----	---------	-----	---------

Measured at Fair Value on a Nonrecurring Basis:

Assets

Impaired loans, net of specific reserves of \$2,342	\$—	\$—	\$3,836	\$3,836
Other real estate owned	—	—	335	335
Total assets - nonrecurring fair value measurements	\$—	\$—	\$4,171	\$4,171

(1)Included in Other Assets

(2)Included in Other Liabilities

The changes in Level 3 assets and liabilities measured at fair value on a recurring basis at December 31, 2014 and 2013 are summarized as follows:

	Residential Mortgage Loan Commitments
(amounts in thousands)	
Balance at January 1, 2014	\$240
Issuances	235
Settlements	(432)
Balance at December 31, 2014	\$43

	Loans Held for Sale (1)	Residential Mortgage Loan Commitments	Total
(amounts in thousands)			
Balance at January 1, 2013	\$—	\$—	\$—
Transfer from Level 2 to Level 3(1)	3,173	—	3,173
Recoveries	(1,463)	) —	(1,463)
Sales	(1,013)	) —	(1,013)
Transfer from loans held for sale to other assets (1)	(697)	) —	(697)
Issuances	—	240	240
Balance at December 31, 2013	\$—	\$240	\$240

(1) For additional information, refer to “NOTE 21 –LOSS CONTINGENCY.”

134

Table of Contents

The Bancorp's policy is to recognize transfers between levels when events or circumstances warrant transfers.

The following table summarizes financial assets and financial liabilities measured at fair value as of December 31, 2014 and 2013 for which the Bancorp utilized Level 3 inputs to measure fair value:

Quantitative Information about Level 3 Fair Value Measurements				
December 31, 2014	Fair Value Estimate	Valuation Technique	Unobservable Input	Range (Weighted Average) (3)
(amounts in thousands)				
Impaired loans	\$2,380	Collateral appraisal (1)	Liquidation expenses (2)	(8)%
Other real estate owned	9,149	Collateral appraisal (1)	Liquidation expenses (2)	(8)%
Residential mortgage loan commitments	43	Adjusted market bid	Pull-through rate	80%
Quantitative Information about Level 3 Fair Value Measurements				
December 31, 2013	Fair Value Estimate	Valuation Technique	Unobservable Input	Range (Weighted Average) (3)
(amounts in thousands)				
Impaired loans	\$3,836	Collateral appraisal (1)	Liquidation expenses (2)	-3% to -8% (-5.5%)
Other real estate owned	335	Collateral appraisal (1)	Liquidation expenses (2)	-3% to -8% (-5.5%)
Residential mortgage loan commitments	240	Adjusted market bid	Pull-through rate	80%

(1) Obtained from approved independent appraisers. Appraisals are current and in compliance with credit policy. The Bancorp does not discount appraisals.

(2) Fair value is adjusted for costs to sell.

(3) Presented as a percentage of the value determined by appraisal for impaired loans and other real estate owned.

NOTE 20 — DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

Risk Management Objectives of Using Derivatives

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

Cash Flow Hedges of Interest Rate Risk

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

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

Table of Contents

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

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

At December 31, 2014, Customers Bancorp had one outstanding interest rate derivative with a notional amount of \$150.0 million that was designated as a cash flow hedge of interest rate risk. The hedge expires in April of 2019.

Derivatives Not Designated as Hedging Instruments

The Bank executes interest rate swaps with commercial banking customers to facilitate their respective risk management strategies (typically the loan customers will swap a floating rate loan to a fixed rate loan). The customer interest rate swaps are simultaneously offset by interest rate swaps that the Bank executes with a third party in order to minimize interest rate risk exposure resulting from such transactions. Since the interest rate swaps associated with this program do not meet the hedge accounting requirements, changes in the fair value of both the customer swaps and the offsetting third-party market swaps are recognized directly in earnings. At December 31, 2014, the Bancorp had 44 interest rate swaps with an aggregate notional amount of \$251.9 million related to this program. At December 31, 2013, the Bancorp had 28 interest rate swaps with an aggregate notional amount of \$150.3 million related to this program.

The Bank enters into residential mortgage loan commitments in connection with its mortgage banking activities to fund mortgage loans at specified rates and times in the future. These commitments are short-term in nature and generally expire in 30 to 60 days. The residential mortgage loan commitments that relate to the origination of mortgage loans that will be held for sale are considered derivative instruments under applicable accounting guidance and are reported at fair value, with changes in fair value recorded directly to earnings. At December 31, 2014 and December 31, 2013, the Bank had an outstanding notional balance of residential mortgage loan commitments of \$3.8 million and \$7.1 million, respectively.

During first quarter 2014, the Bank purchased credit derivatives to hedge the performance risk associated with one of its counterparties. These derivatives are not designated as hedging instruments and are reported at fair value, with changes in fair value reported directly in earnings. At December 31, 2014, the Bank had an outstanding notional balance of credit derivatives of \$13.4 million.

Fair Value of Derivative Instruments on the Balance Sheet

The following table presents the fair value of the Bancorp's derivative financial instruments as well as the classification on the balance sheet.

	December 31, 2014			
	Derivative Assets Balance Sheet		Derivative Liabilities Balance Sheet	
	Location	Fair Value	Location	Fair Value
(amounts in thousands)				
Derivatives designated as cash flow hedges:				
Interest rate swaps	Other assets	\$—	Other liabilities	\$1,945
Total		\$—		\$1,945
Derivatives not designated as hedging instruments:				
Interest rate swaps	Other assets	\$7,332	Other liabilities	\$7,771
Credit contracts	Other assets	177	Other liabilities	—
Residential mortgage loan commitments	Other assets	43	Other liabilities	—
Total		\$7,552		\$7,771

Table of Contents

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

Effect of Derivative Instruments on Comprehensive Income

The following table presents the effect of the Bancorp's derivative financial instruments on comprehensive income for the years ended December 31, 2014 and 2013. Interest rate swap income amounts include premiums received from Bank customers.

	December 31, 2014	
	Income Statement Location	Amount of income (loss) recognized in earnings
(amounts in thousands)		
Derivatives not designated as hedging instruments:		
Interest rate swaps	Other non-interest income	\$550
Credit Contracts	Other non-interest income	(91)
Residential mortgage loan commitments	Mortgage loan and banking income	(197)
Total		\$262

	December 31, 2013	
	Income Statement Location	Amount of income recognized in earnings
(amounts in thousands)		
Derivatives not designated as hedging instruments:		
Interest rate swaps	Other non-interest income	\$711
Residential mortgage loan commitments	Mortgage loan and banking income	240
Total		\$951

	December 31, 2014		
	Amount of Loss Recognized in OCI on Derivatives (Effective Portion) (1)	Location of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)
(amounts in thousands)			
Derivatives in cash flow hedging relationships:			
Interest rate swaps	\$(1,264	) Interest expense	\$—

(1) Net of taxes

Credit-risk-related Contingent Features

By entering into derivative contracts, the Bank is exposed to credit risk. The credit risk associated with derivatives executed with Bank customers is the same as that involved in extending the related loans and is subject to the same standard credit

Table of Contents

policies. To mitigate the credit-risk exposure to major derivative dealer counterparties, the Bancorp only enters into agreements with those that maintain credit ratings of high quality.

Agreements with major derivative dealer counterparties contain provisions whereby default on any of the Bancorp's indebtedness would be considered a default on its derivative obligations. The Bancorp also has entered into agreements that contain provisions under which the counterparty could require the Bancorp to settle its obligations if the Bancorp fails to maintain its status as a well/adequately-capitalized institution. As of December 31, 2014, the fair value of derivatives in a net liability position (which includes accrued interest but excludes any adjustment for nonperformance-risk) related to these agreements was \$9.9 million. In addition, the Bancorp has collateral posting thresholds with certain of these counterparties and at December 31, 2014, had posted \$10.0 million of cash as collateral. The Bancorp records posted cash as a reduction in the outstanding balance of cash and cash equivalents and an increase in the balance of other assets.

Disclosures about Offsetting Assets and Liabilities

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

Offsetting of Financial Assets and Derivative Assets at
December 31, 2014

(amounts in thousands) Description	Gross Amount of Recognized Assets	Gross Amounts Offset in the Consolidated Balance Sheet	Net Amounts of Assets Presented in the Consolidated Balance Sheet	Gross Amounts Not Offset in the Consolidated Balance Sheet		
				Financial Instruments	Cash Collateral Received	Net Amount
Interest rate swap derivatives with institutional counterparties	\$ 192	\$—	\$ 192	\$ 192	\$—	\$—

Offsetting of Financial Assets and Derivative Assets at
December 31, 2013

Gross Amount of Recognized Assets	Gross Amounts Offset in the Consolidated Balance Sheet	Net Amounts of Assets Presented in the Consolidated Balance Sheet	Gross Amounts Not Offset in the Consolidated Balance Sheet		
			Financial Instruments	Cash Collateral Received	Net Amount

Sheet

(amounts in thousands)

Description

Interest rate swap derivatives
with institutional
counterparties

\$392	\$—	\$392	\$392	\$—	\$—
-------	-----	-------	-------	-----	-----

Table of ContentsOffsetting of Financial Liabilities and Derivative Liabilities at
December 31, 2014

(amounts in thousands) Description	Gross Amounts Not Offset in the Consolidated Balance Sheet					
	Gross Amount of Recognized Liabilities	Gross Amounts Offset in the Consolidated Balance Sheet	Net Amounts of Liabilities Presented in the Consolidated Balance Sheet	Financial Instruments	Cash Collateral Pledged	Net Amount
Interest rate swap derivatives with institutional counterparties	\$9,703	\$—	\$9,703	\$192	\$9,511	\$—

Offsetting of Financial Liabilities and Derivative Liabilities at
December 31, 2013

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

NOTE 21 — LOSS CONTINGENCY

During the first quarter of 2013, a suspected fraud was discovered in the Bank's loans held-for-sale portfolio. Total loans involved in this fraud initially appeared to be \$5.2 million, and management believed the range of possible loss to have been between \$1.5 million and \$3.2 million. Accordingly, management provided a loss contingency of \$2.0 million at March 31, 2013. During the second quarter of 2013, the Bank determined that an aggregate of \$1.0 million of the loans were not involved in the fraud, and these loans were subsequently sold. In addition, the Bank recovered \$1.5 million in cash from the alleged perpetrator. Since it was resolved that the loans no longer met the definition of "a loan," and since the Bank is pursuing restitution through the involved parties, the Bank determined this to be a receivable. As a result, the remaining aggregate of \$2.7 million of loans and the related \$2.0 million reserve were transferred to other assets. As of December 31, 2014, the net amount of the receivable and reserve of \$0.6 million remains in other assets.

Table of Contents

NOTE 22 – CONDENSED FINANCIAL STATEMENTS OF PARENT COMPANY

Following are the condensed balance sheets of Customers Bancorp, Inc. as of December 31, 2014 and 2013 and the income statements and statements of cash flows for each of the three years ending December 31, 2014, 2013 and 2012:

Balance Sheets

	December 31,	
	2014	2013
(amounts in thousands)		
Assets		
Cash in subsidiary bank	\$16,465	\$13,254
Investment securities available for sale, at fair value	5	5
Investments in and receivables due from subsidiaries	509,465	432,064
Other assets	6,678	5,044
Total assets	\$532,613	\$450,367
Liabilities and Shareholders' equity		
Borrowings	88,250	63,250
Other liabilities	1,218	494
Total liabilities	89,468	63,744
Shareholders' equity	443,145	386,623
Total Liabilities and Shareholders' Equity	\$532,613	\$450,367

Income Statements

	Year Ended December 31,		
	2014	2013	2012
(amounts in thousands)			
Operating income:			
Other	\$90	\$758	\$—
Total operating income	90	758	—
Operating expense:			
Interest	5,251	1,923	—
Other	5,611	3,395	2,708
Total operating expense	10,862	5,318	2,708
Loss before taxes and undistributed income of subsidiaries	(10,772)	(4,560)	(2,708)
Income tax benefit	3,797	1,596	948
Loss before undistributed income of subsidiaries	(6,975)	(2,964)	(1,760)
Equity in undistributed income of subsidiaries	50,189	35,658	25,578
Net income	\$43,214	\$32,694	\$23,818

Table of Contents

Statements of Cash Flows

	Year Ended December 31,		
	2014	2013	2012
(amounts in thousands)			
Cash Flows from Operating Activities:			
Net income	\$43,214	\$32,694	\$23,818
Adjustments to reconcile net income to net cash used in operating activities:			
Equity in undistributed earnings of subsidiaries	(50,189	) (35,658	) (25,578
Increase in other assets	(1,354	) (1,465	) (12
Increase (decrease) in other liabilities	1,497	(281	) 372
Net Cash Used in Operating Activities	(6,832	) (4,710	) (1,400
Cash Flows from Investing Activities:			
Purchases of investment securities available for sale	—	—	(6
Payments for investments in and advances to subsidiaries	(15,032	) (177,068	) (53,500
Net Cash Used in Investing Activities	(15,032	) (177,068	) (53,506
Cash Flows from Financing Activities:			
Proceeds from issuance of common stock	77	97,507	94,586
Proceeds from issuance of long-term debt	25,000	60,336	—
Exercise and redemption of warrants	6	264	—
Payments on partial shares for stock dividend	(8	) —	—
Purchase of treasury stock	—	(7,754	) —
Net Cash Provided by Financing Activities	25,075	150,353	94,586
Net Increase (Decrease) in Cash and Cash Equivalents	3,211	(31,425	) 39,680
Cash and Cash Equivalents – Beginning	13,254	44,679	4,999
Cash and Cash Equivalents – Ending	\$16,465	\$13,254	\$44,679

NOTE 23 – SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)

	2014			
Quarter Ended	December 31	September 30	June 30	March 31
(amounts in thousands, except per share data)				
Interest income	\$57,161	\$51,298	\$45,092	\$36,876
Interest expense	12,175	11,084	8,162	7,082
Net interest income	44,986	40,214	36,930	29,794
Provision for loan losses	2,459	5,035	2,886	4,368
Non-interest income	5,804	5,102	6,911	7,308
Non-interest expenses	27,864	24,679	25,205	21,169
Income before income taxes	20,467	15,602	15,750	11,565
Provision for income taxes	7,289	3,940	5,517	3,429
Net income available to common shareholders	\$13,178	\$11,662	\$10,233	\$8,136
Earnings per common share:				
Basic (1)	\$0.49	\$0.44	\$0.38	\$0.31
Diluted (1)	0.47	0.42	0.37	0.29

Table of Contents

	2013				
Quarter Ended	December 31	September 30	June 30	March 31	
(amounts in thousands, except per share data)					
Interest income	\$34,717	\$33,745	\$31,673	\$28,021	
Interest expense	6,803	6,547	5,557	5,394	
Net interest income	27,914	27,198	26,116	22,627	
Provision for loan losses	(512	) 750	2,116	(118	)
Non-interest income	7,695	4,661	5,550	4,797	
Non-interest expenses	22,301	18,347	16,895	16,481	
Income before income taxes	13,820	12,762	12,655	11,061	
Provision for income taxes	4,810	4,494	4,429	3,871	
Net income available to common shareholders	\$9,010	\$8,268	\$8,226	\$7,190	
Earnings per common share:					
Basic (1)	\$0.33	\$0.30	\$0.35	\$0.35	
Diluted (1)	0.32	0.30	0.34	0.35	

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

Table of Contents

MANAGEMENT’S RESPONSIBILITY FOR FINANCIAL STATEMENTS AND REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Management of Customers Bancorp, Inc. (the “Customers Bancorp”) is responsible for the integrity and objectivity of all information presented in this report. The consolidated financial statements were prepared in conformity with United States generally accepted accounting principles. Management believes that the consolidated financial statements of Customers Bancorp, Inc. fairly reflect the form and substance of transactions and that the financial statements fairly represent Customers Bancorp’s financial position and results of operations. Management has included in Customers Bancorp’s financial statements amounts that are based on estimates and judgments which it believes are reasonable under the circumstances.

The independent registered public accounting firm of BDO USA, LLP audits Customers Bancorp’s consolidated financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States).

The Board of Directors of Customers Bancorp has an Audit Committee composed of three independent Directors. The Committee meets periodically with financial management, the internal auditors and the independent registered public accounting firm to review accounting, internal control, auditing, corporate governance and financial reporting matters. The Audit Committee is responsible for the engagement of the independent auditors. The independent auditors and internal auditors have access to the Audit Committee.

Management of Customers Bancorp, Inc. is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in Internal Control – Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework in Internal Control – Integrated Framework, management concluded that our internal control over financial reporting was effective as of December 31, 2014. The effectiveness of our internal control over financial reporting as of December 31, 2014 has been audited by BDO USA, LLP, an independent registered public accounting firm, as stated in their report which is included herein.

Table of Contents

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure
None.

Item 9A. Controls and Procedures

Evaluation of Disclosure Controls and Procedures. We have established disclosure controls and procedures to ensure that material information relating to us, including our consolidated subsidiaries, is made known to the officers who certify our financial reports and to other members of senior management and the Board of Directors.

We carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the design and operating effectiveness of our disclosure controls and procedures, as defined in Exchange Act Rule 13a-15. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of December 31, 2014, our disclosure controls and procedures are effective. Management's Responsibility for Financial Statements and Report on Internal Control over Financial Reporting are included in Part II, Item 8, "Financial Statements and Supplementary Data," and are incorporated by reference herein. Our independent registered public accounting firm, BDO USA, LLP, also attested to, and reported on, the effectiveness of internal control over financial reporting as of December 31, 2014. BDO USA, LLP's attestation report, which appears in Part II, Item 8, "Financial Statements and Supplementary Data," is incorporated herein by reference.

Changes in Internal Control over Financial Reporting

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

Item 9B. Other Information

None

Table of Contents

PART III

Item 10. Directors, Executive Officers and Corporate Governance

The information required by this Item will be included in the Proxy Statement for the 2015 annual meeting in the sections titled “Our Board of Directors and Management,” and “Board Governance,” and is incorporated herein by reference.

Item 11. Executive Compensation

The information required by this Item will be included in the Proxy Statement for the 2015 annual meeting in the sections titled “Director Compensation,” “Executive Officer Compensation,” and “Board Governance,” and is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters

The information required by this Item will be included in the Proxy Statement for the 2015 annual meeting in the sections titled “Security Ownership of Certain Beneficial Owners and Management” and “Equity Compensation Plan Information” and is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information required by this Item will be included in the Proxy Statement for the 2015 annual meeting in the sections titled “Certain Relationships and Related Transactions” and “Board Governance” and is incorporated herein by reference.

Item 14. Principal Accountant Fees and Services

The information required by this Item will be included in the Proxy Statement for the 2015 annual meeting in the section titled “Proposal 2 — Ratification of Appointment of Independent Registered Public Accounting Firm,” and is incorporated herein by reference.

Table of Contents

PART IV

Item 15 Exhibits and Financial Statement Schedules

(a) 1. Financial Statements

Consolidated financial statements are included under Item 8 of Part II of this Form 10-K.

(b) 2. Financial Statements Schedules

Financial statements schedules are omitted because the required information is either not applicable, not required or is shown in the respective financial statements or in the notes thereto.

(c) Exhibits

Exhibit

No. Description

- | | |
|-----|--|
| 2.1 | Plan of Merger and Reorganization, dated September 15, 2011, incorporated by reference to Exhibit 2.1 to the Customers Bancorp Form 8-K filed with the SEC on September 22, 2011 |
| 2.2 | Agreement and Plan of Merger, dated as of August 23, 2010, by and among Customers Bank, Customers Bancorp, Inc., Berkshire Bank and Berkshire Bancorp, Inc., incorporated by reference to Exhibit 2.2 to the Customers Bancorp Form S-1/A filed with the SEC on January 13, 2011 |
| 2.3 | Purchase and Assumption Agreement, dated as of July 9, 2010, by and among Customers Bank, the FDIC as Receiver of USA Bank, and the FDIC acting in its corporate capacity, incorporated by reference to Exhibit 2.3 to the Customers Bancorp Form S-1/A filed with the SEC on January 13, 2011 |
| 2.4 | Purchase and Assumption Agreement, dated as of September 17, 2010, by and among Customers Bank, the FDIC as Receiver of ISN Bank, and the FDIC acting in its corporate capacity, incorporated by reference to Exhibit 2.4 to the Customers Bancorp Form S-1/A filed with the SEC on January 13, 2011 |
| 2.5 | Amendment to Agreement and Plan of Merger, dated as of April 27, 2011, by and among Berkshire Bancorp, Inc., Berkshire Bank, Customers Bancorp, Inc., and Customers Bank, incorporated by reference to Exhibit 2.5 to the Customers Bancorp Form S-1/A filed with the SEC on June 13, 2011 |
| 2.6 | Amendment to Agreement and Plan of Merger, dated as of September 16, 2011, by and among Berkshire Bancorp, Inc., Berkshire Bank, Customers Bancorp, Inc., and Customers Bank, incorporated by reference to Exhibit 2.2 to the Customers Bancorp Form 8-K filed with the SEC on September 22, 2011 |
| 3.1 | Amended and Restated Articles of Incorporation of Customers Bancorp, Inc., incorporated by reference to Exhibit 3.1 to the Customers Bancorp Form 8-K filed with the SEC on April 30, 2012 |
| 3.2 | Amended and Restated Bylaws of Customers Bancorp, Inc., incorporated by reference to Exhibit 3.2 to the Customers Bancorp Form 8-K filed with the SEC on April 30, 2012 |
| 3.3 | Articles of Amendment to the Amended and Restated Articles of Incorporation of Customers Bancorp, Inc., incorporated by reference to Exhibit 3.1 to the Customers Bancorp Form 8-K filed with the SEC on July 2, 2012 |
| 4.1 | Specimen stock certificate of Customers Bancorp, Inc. Voting Common Stock and Class B Non-Voting Common Stock, incorporated by reference to Exhibit 4.1 to the Customers Bancorp Form S-1/A filed with the SEC on May 1, 2012 |

Edgar Filing: EQUUS TOTAL RETURN, INC. - Form 10-K

- 4.2 Form of Warrant issued to investors in New Century Bank's March and February 2010 private offerings, 2009 private offering, and in partial exchange for New Century Bank's shares of 10% Series A Non-Cumulative Perpetual Convertible Preferred Stock in June 2009, incorporated by reference to Exhibit 4.8 to the Customers Bancorp Form S-1 filed with the SEC on April 22, 2010
- 4.3 Warrants issued to Jay S. Sidhu, June 30, 2009, incorporated by reference to Exhibit 4.9 to the Customers Bancorp Form S-1 filed with the SEC on April 22, 2010
- 4.4 Indenture, dated as of July 30, 2013, by and between Customers Bancorp, Inc., as Issuer, and Wilmington Trust, National Association, as Trustee, incorporated by reference to Exhibit 4.1 to the Customers Bancorp 8-K filed with the SEC on July 31, 2013
- 4.5 First Supplemental Indenture, dated as of July 30, 2013, by and between Customers Bancorp, Inc., as Issuer, and Wilmington Trust, National Association, as Trustee, incorporated by reference to Exhibit 4.2 to the Customers Bancorp 8-K filed with the SEC on July 31, 2013
- 4.6 6.375% Global Note in aggregate principal amount of \$55,000,000, incorporated by reference to Exhibit 4.3 to the Customers Bancorp 8-K filed with the SEC on July 31, 2013

Table of Contents

Exhibit No.	Description
4.7	Amendment to First Supplemental Indenture, dated August 27, 2013, by and between Customers Bancorp, Inc. and Wilmington Trust Company, National Association, as trustee, incorporated by reference to Exhibit 4.1 to the Customers Bancorp 8-K filed with the SEC on August 29, 2013
4.8	6.375% Global Note in aggregate principal amount of \$8,250,000, incorporated by reference to Exhibit 4.2 to the Customers Bancorp 8-K filed with the SEC on August 29, 2013
4.9	Form of Note Subscription Agreement (including form of Subordinated Note Certificate and Senior Note Certificate) incorporated by reference to Exhibit 10.1 to the Customers Bancorp 8-K filed with the SEC on June 26, 2014
10.1+	New Century Bank Management Stock Purchase Plan, incorporated by reference to Exhibit 10.1 to the Customers Bancorp Form S-1 filed with the SEC on April 22, 2010
10.2+	Amended and Restated Customers Bancorp, Inc. 2010 Stock Option Plan, incorporated by reference to Exhibit 10.2 to the Customers Bancorp Form 10-K filed with the SEC on March 21, 2012
10.3+	Amended and Restated Employment Agreement, dated as of March 26, 2012, by and between Customers Bancorp, Inc. and Jay S. Sidhu, incorporated by reference to Exhibit 10.3 to the Customers Bancorp Form S-1 filed with the SEC on March 28, 2012
10.4+	Amended and Restated Employment Agreement, dated as of March 26, 2012, by and between Customers Bancorp, Inc. and Richard Ehst, incorporated by reference to Exhibit 10.4 to the Customers Bancorp Form S-1 filed with the SEC on March 28, 2012
10.5	Agreement, dated as of May 19, 2009, by and between New Century Bank and Jay Sidhu, incorporated by reference to Exhibit 10.6 to the Customers Bancorp Form S-1 filed with the SEC on April 22, 2010
10.6+	Amended and Restated Customers Bancorp, Inc. 2004 Incentive Equity and Deferred Compensation Plan, incorporated by reference to Exhibit 10.7 to the Customers Bancorp Form 10-K filed with the SEC on March 21, 2012
10.7	Lease Agreement, dated January 5, 2007, by and between New Century Bank and Gateway Partnership LLC, incorporated by reference to Exhibit 10.10 to the Customers Bancorp Form S-1 filed with the SEC on April 22, 2010
10.8	Amendment to Lease, dated May 4, 2007, by and between New Century Bank and Gateway Partnership LLC, incorporated by reference to Exhibit 10.11 to the Customers Bancorp Form S-1 filed with the SEC on April 22, 2010
10.9+	Form of Restricted Stock Unit Award Agreement for Employees relating to the 2012 Special Stock Reward Program, incorporated by reference to Exhibit 10.25 to the Customers Bancorp Form S-1/A filed with the SEC on May 1, 2012
10.10	Stock Purchase Agreement, dated as of September 30, 2011, by and between Customers Bancorp, Inc. and Robert Tambur, incorporated by reference to Exhibit 10.24 to the Customers Bancorp Form S-1/A filed with the SEC on April 25, 2012

- 10.11 Subscription Agreement, dated May 19, 2009, by and between New Century Bank and Jay S. Sidhu, incorporated by reference to Exhibit 10.13 to the Customers Bancorp Form S-1 filed with the SEC on April 22, 2010
- 10.12 Amendment to Subscription Agreement, dated June 29, 2009, by and between New Century Bank and Jay S. Sidhu, incorporated by reference to Exhibit 10.14 to the Customers Bancorp Form S-1 filed with the SEC on April 22, 2010
- 10.13 Amendment #2 to Subscription Agreement, dated as of June 30, 2009, by and between New Century Bank and Jay S. Sidhu, incorporated by reference to Exhibit 10.15 to the Customers Bancorp Form S-1 filed with the SEC on April 22, 2010
- 10.14+ Amended and Restated Customers Bancorp, Inc. Bonus Recognition and Retention Plan, incorporated by reference to Exhibit 10.15 to the Customers Bancorp Form 10-K filed with the SEC on March 21, 2012
- 10.15+ Supplemental Executive Retirement Plan of Jay S. Sidhu, incorporated by reference to Exhibit 10.15 to the Customers Bancorp Form S-1/A filed with the SEC on April 18, 2011
- 10.16 Form of Stock Purchase Agreement used in the July and August 2012 private placement of voting common stock, incorporated by reference to Exhibit 4.3 to the Customers Bancorp Form S-3 filed with the SEC on October 22, 2012

Table of Contents

Exhibit No.	Description
10.17	Stock Purchase Agreement, dated as of August 17, 2012, by and between Customers Bancorp, Inc. and S.J. Finance Investment Fund, L.P., incorporated by reference to Exhibit 4.4 to the Customers Bancorp Form S-3 filed with the SEC on October 22, 2012
10.18	Securities Purchase Agreement, dated as of September 14, 2012, by and among the Corporation and the purchasers party thereto, incorporated by reference to Exhibit 10.1 to the Customers Bancorp Form 8-K filed with the SEC on September 17, 2012
10.19	Registration Rights Agreement, dated as of September 14, 2012, by and among the Corporation and the purchasers party thereto, incorporated by reference to Exhibit 10.2 to the Customers Bancorp Form 8-K filed with the SEC on September 17, 2012
10.20+	Form of Restricted Stock Unit Award Agreement for Directors relating to the 2012 Special Stock Reward Program, incorporated by reference to Exhibit 10.26 to the Customers Bancorp Form S-1/A filed with the SEC on May 1, 2012
10.21+	Form of Stock Option Agreement, incorporated by reference to Exhibit 10.18 to the Customers Bancorp Form 10-K filed with the SEC on March 21, 2012
10.22+	Form of Restricted Stock Unit Agreement, incorporated by reference to Exhibit 10.17 to the Customers Bancorp Form 10-K filed with the SEC on March 21, 2012
10.23	TARP Letter Agreement, dated as of September 16, 2011, by and among Customers Bancorp, Berkshire Bancorp, Inc. and Treasury, incorporated by reference to Exhibit 10.1 to Customers Bancorp's Form 8-K filed with the SEC on September 22, 2011
10.24	ARRA Letter Agreement, dated as of September 17, 2011, by and among Customers Bancorp and Treasury, incorporated by reference to Exhibit 10.2 to Customer Bancorp's Form 8-K filed with the SEC on September 22, 2011
10.25	Letter Agreement dated as of December 28, 2011 by and among Customers Bancorp and Treasury, incorporated by reference to Exhibit 10.1 to Customers Bancorp's Form 8-K filed with the SEC on January 4, 2012
10.26+	Change of Control Agreement, dated as of January 30, 2013, by and between Customers Bancorp, Inc. and Glenn Hedde, incorporated by reference to Exhibit 10.29 to Customers Bancorp's Form 10-K filed with the SEC on March 18, 2013
10.27+	Change of Control Agreement, dated as of January 30, 2013, by and between Customers Bancorp, Inc. and Warren Taylor, incorporated by reference to Exhibit 10.30 to Customers Bancorp's Form 10-K filed with the SEC on March 18, 2013
10.28	Termination and Non-Renewal Agreement, dated as of April 4, 2013, by and among Customers Bancorp, Inc., Acacia Life Insurance Company, and Ameritas Life Insurance Corp., incorporated by reference to Exhibit 10.1 to the Customers Bancorp Form 8-K filed with the SEC on April 10, 2013
16.1	

Edgar Filing: EQUUS TOTAL RETURN, INC. - Form 10-K

Letter dated July 2, 2013 from ParenteBeard LCC to the Securities and Exchange Commission, incorporated by reference to Exhibit 16.1 to the Customers Bancorp Form 8-K filed with the SEC on July 3, 2013

- 21.1 List of Subsidiaries of Customers Bancorp, Inc.
 - 23.1 Consent of BDO USA, LLP, filed herewith
 - 23.2 Consent of Baker Tilly Virchow Krause, LLP, filed herewith
 - 31.1 Certification of the Chief Executive Officer Pursuant to Exchange Act Rule 13a-14(a) or Rule 15d-14(a)
 - 31.2 Certification of the Chief Financial Officer Pursuant to Exchange Act Rule 13a-14(a) or Rule 15d-14(a)
 - 32.1 Certification of the Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, ad Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
 - 32.2 Certification of the Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, ad Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 101 Interactive Data Files regarding (a) Balance Sheets as of December 31, 2014 and 2013, (b) Statements of Income for the years ended December 31, 2014, 2013 and 2012, (c) Statements of Comprehensive Income for the years ended December 31, 2014, 2013 and 2012, (d) Statements of Cash Flows for the years ended December 31, 2014, 2013 and 2012, (e) Statements of Changes in Shareholders' Equity for the years ended December 31, 2014, 2013 and 2012 and (f) Notes to Financial Statements for the years ended December 31, 2014, 2013 and 2012.

Table of Contents

Exhibit No.	Description
+	Management Contract or compensatory plan or arrangement

149

Table of Contents

SIGNATURES

Pursuant to the requirements of the Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Customers Bancorp, Inc.

February 27, 2015

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

Customers Bancorp, Inc.

February 27, 2015

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

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Signature:	Title(s):	Date:
/s/ Jay S. Sidhu Jay S. Sidhu	Chairman, Chief Executive Officer and Director (principal executive officer)	February 27, 2015
/s/ Robert E. Wahlman Robert E. Wahlman	Executive Vice President and Chief Financial Officer (principal financial officer)	February 27, 2015
/s/ Carla A. Leibold Carla A. Leibold	Senior Vice President - Chief Accounting Officer and Controller (principal accounting officer)	February 27, 2015
/s/ Daniel K. Rothermel Daniel K. Rothermel	Director	February 27, 2015
/s/ Bhanu Choudhrie Bhanu Choudhrie	Director	February 27, 2015
/s/ John R. Miller John R. Miller	Director	February 27, 2015
/s/ T. Lawrence Way T. Lawrence Way	Director	February 27, 2015
/s/ Steven J. Zuckerman Steven J. Zuckerman	Director	February 27, 2015