DYNAVAX TECHNOLOGIES CORP
Form DEF 14A
April 20, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a) of the

Securities Exchange Act of 1934

(Amendment No.)

Filed by the Registrant Filed by a Party other than the Registrant

Check the appropriate box:

Preliminary Proxy Statement

Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))

Definitive Proxy Statement

Definitive Additional Materials

Soliciting Material under §240.14a-12

DYNAVAX TECHNOLOGIES CORPORATION
(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

No fee required.

Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

1. Title of each class of securities to which transaction applies:

2. Aggregate number of securities to which transaction applies:

3. Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

4. Proposed maximum aggregate value of transaction:

5. Total fee paid:

Fee paid previously with preliminary materials.

Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

1. Amount Previously Paid:

2. Form, Schedule or Registration Statement No.:

3. Filing Party:

4. Date Filed:

DYNAVAX TECHNOLOGIES CORPORATION

2929 Seventh Street, Suite 100

Berkeley, California 94710

NOTICE OF 2018 ANNUAL MEETING OF STOCKHOLDERS

May 31, 2018

Dear Stockholder:

You are cordially invited to attend the 2018 Annual Meeting of Stockholders of Dynavax Technologies Corporation, a Delaware corporation, or the Company. The meeting will be held on May 31, 2018, at 9:00 a.m. Pacific Time, at the Company s executive offices at 2929 Seventh Street, Suite 100, Berkeley, California 94710 for the following purposes:

1. To elect our nominees for Class III directors to hold office until the 2021 Annual Meeting of Stockholders or until their respective successors are duly elected and qualified.

2. To approve the Dynavax Technologies Corporation 2018 Equity Incentive Plan.

3. To amend and restate the Dynavax Technologies Corporation 2014 Employee Stock Purchase Plan to, among other things, increase the aggregate number of shares of common stock authorized for issuance under the plan by 600,000.

4. To approve, on an advisory basis, the compensation of the Company s named executive officers, as disclosed in the Proxy Statement accompanying this Notice.

5. To ratify the selection of Ernst & Young LLP as the independent registered public accounting firm of the Company for its fiscal year ending December 31, 2018.

6. To conduct any other business properly brought before the meeting or any adjournment(s) thereof.

These items of business are more fully described in the Proxy Statement accompanying this Notice.

The record date for the 2018 Annual Meeting is April 9, 2018. Only stockholders of record at the close of business on that date may vote at the meeting or any adjournment thereof.

Important Notice Regarding the Availability of Proxy Materials for the Stockholders Meeting to Be Held at 9:00 a.m., Pacific Time, on May 31, 2018 at 2929 Seventh Street, Suite 100, Berkeley, California 94710.

The proxy statement and annual report to stockholders

are available at http://investors.dynavax.com/annuals-proxies.cfm.

The Board of Directors recommends that you vote FOR the proposals identified above.

By Order of the Board of Directors

/s/ Steven N. Gersten
Steven N. Gersten
Secretary

Berkeley, California

April 20, 2018

Your vote is very important, regardless of the number of shares you own. Whether or not you expect to attend the meeting, please complete, date, sign and return the enclosed proxy as promptly as possible in order to ensure your representation at the meeting. A return envelope (which is postage prepaid if mailed in the United States) is enclosed for your convenience. Even if you have voted by proxy, you may still vote in person if you attend the meeting. Please note, however, that if your shares are held of record by a broker, bank or other nominee and you wish to vote at the meeting, you must obtain a proxy issued in your name from that record holder.

DYNAVAX TECHNOLOGIES CORPORATION

2929 Seventh Street, Suite 100

Berkeley, California 94710

PROXY STATEMENT

FOR THE 2018 ANNUAL MEETING OF STOCKHOLDERS

May 31, 2018

QUESTIONS AND ANSWERS ABOUT THIS PROXY MATERIAL AND VOTING

Why am I receiving these materials?

We have sent you this proxy statement and the enclosed proxy card because the Board of Directors, or Board, of Dynavax Technologies Corporation, or the Company or Dynavax, or we or us, is soliciting your proxy to vote at the 2018 Annual Meeting of Stockholders, or Annual Meeting. You are invited to attend the Annual Meeting to vote on the proposals described in this proxy statement. However, you do not need to attend the Annual Meeting to vote your shares. Instead, you may simply complete, sign and return the enclosed proxy card.

We intend to mail this proxy statement and accompanying proxy card on or about April 26, 2018, to all stockholders of record entitled to vote at the Annual Meeting.

How do I attend the Annual Meeting?

The Annual Meeting will be held on May 31, 2018 at 9:00 a.m. Pacific Time, at our executive offices at 2929 Seventh Street, Suite 100, Berkeley, California 94710. Directions to the Annual Meeting may be found at http://www.dynavax.com/contact. Information on how to vote in person at the Annual Meeting is discussed below. For admission to the Annual Meeting, stockholders may be asked to present proof of identification and a statement from their bank, broker or other nominee reflecting their beneficial ownership of our common stock as of April 9, 2018, as well as a proxy from the record holder to the stockholder.

Who can vote at the Annual Meeting?

Only stockholders of record at the close of business on April 9, 2018, will be entitled to vote at the Annual Meeting. On this record date, there were 62,255,860 shares of common stock outstanding and entitled to vote.

Stockholder of Record: Shares Registered in Your Name

If on April 9, 2018, your shares were registered directly in your name with our transfer agent, then you are a stockholder of record. As a stockholder of record, you may vote in person at the Annual Meeting or vote by proxy. Whether or not you plan to attend the Annual Meeting, we urge you to fill out and return the enclosed proxy card to ensure your vote is counted.

Beneficial Owner: Shares Registered in the Name of a Broker or Bank

If on April 9, 2018, your shares were held, not in your name, but rather in an account at a brokerage firm, bank, dealer or other similar organization, then you are the beneficial owner of shares held in street name and these proxy materials are being forwarded to you by that organization. The organization holding your account is considered to be the stockholder of record for purposes of voting at the Annual Meeting. As a beneficial owner, you have the right to direct your broker or other agent regarding how to vote the shares in your account. You are also invited to attend the Annual Meeting. However, since you are not the stockholder of record, you may not vote your shares in person at the Annual Meeting unless you request and obtain a valid proxy from your broker or other agent.

What am I voting on?

We are asking you to vote on five proposals:

1. To elect our nominees for Class III directors to hold office until the 2021 Annual Meeting of Stockholders or until their respective successors are duly elected and qualified.

2. To approve the Dynavax Technologies Corporation 2018 Equity Incentive Plan (the 2018 EIP).

3. To amend and restate the Dynavax Technologies Corporation 2014 Employee Stock Purchase Plan (the 2014 ESPP) to, among other things, increase the aggregate number of shares of common stock authorized for issuance under the plan by 600,000.

4. To approve, on an advisory basis, the compensation of the Company s named executive officers, as disclosed in this proxy statement.

5. To ratify the selection of Ernst & Young LLP as the independent registered public accounting firm of the Company for its fiscal year ending December 31, 2018.

What if another matter is properly brought before the Annual Meeting?

The Board knows of no other matters that will be presented for consideration at the Annual Meeting. If any other matters are properly brought before the Annual Meeting, it is the intention of the persons named in the accompanying proxy to vote on those matters in accordance with her or his best judgment.

How do I vote?

You may either vote For all the nominees to the Board or you may Withhold your vote for any nominee you specify. For each of the other matters to be voted on, you may vote For or Against or abstain from voting. The procedures for voting are fairly simple:

Stockholder of Record: Shares Registered in Your Name

If you are a stockholder of record, you may vote in person at the Annual Meeting or vote by proxy using the enclosed proxy card. Whether or not you plan to attend the Annual Meeting, we urge you to vote by proxy to ensure your vote is counted. You may still attend the Annual Meeting and vote in person even if you have already voted by proxy.

To vote in person, come to the Annual Meeting and we will give you a ballot when you arrive. Directions to the Annual Meeting may be found at http://www.dynavax.com/contact.

To vote using the proxy card, simply complete, sign and date the enclosed proxy card and return it promptly in the envelope provided. If you return your signed proxy card to us before the Annual Meeting, we will vote your shares as you direct.

To vote using the telephone, simply follow the instructions on the enclosed proxy card. Voting by telephone has the same effect as voting by mail. You may vote by telephone until 11:59 p.m., Eastern Time, May 30, 2018.

To vote using the internet, simply follow the instructions on the enclosed proxy card. You may vote by using the internet until 11:59 p.m., Eastern Time, May 30, 2018.

Beneficial Owner: Shares Registered in the Name of Broker or Bank

If you are a beneficial owner of shares registered in the name of your broker, bank or other agent, you should have received a proxy card and voting instructions with these proxy materials from that organization rather than from Dynavax. Simply complete and mail the proxy card to ensure that your vote is counted. To vote in person at the Annual Meeting, you must obtain a valid proxy from your broker, bank or other agent. Follow the instructions from your broker, bank or other agent included with these proxy materials, or contact your broker, bank or other agent to request a proxy form.

We provide internet proxy voting to allow you to vote your shares online, with procedures designed to ensure the authenticity and correctness of your proxy vote instructions. However, please be aware that you must bear any costs associated with your internet access, such as usage charges from internet access providers and telephone companies.

How many votes do I have?

On each matter to be voted upon, you have one vote for each share of common stock you own as of April 9, 2018.

What happens if I do not vote?

Stockholder of Record: Shares Registered in Your Name

If you are a stockholder of record and do not vote by completing your proxy card, by telephone, through the internet or in person at the Annual Meeting, your shares will not be voted.

Beneficial Owner: Shares Registered in the Name of Broker or Bank

If you are a beneficial owner and do not instruct your broker, bank, or other agent how to vote your shares, the question of whether your broker or nominee will still be able to vote your shares depends on whether the applicable stock exchange deems the particular proposal to be a routine matter. Brokers and nominees can use their discretion to vote uninstructed shares with respect to matters that are considered to be routine, but not with respect to non-routine matters. Under the rules and interpretations of the NYSE, non-routine matters are matters that may substantially affect the rights or privileges of stockholders, such as mergers, stockholder proposals, elections of directors (even if not contested), executive compensation (including any advisory stockholder votes on executive compensation and on the frequency of stockholder votes on executive compensation), and certain corporate governance proposals, even if management-supported. Accordingly, your broker or nominee may not vote your shares on Proposals 1, 2, 3 or 4 without your instructions, but may vote your shares on Proposal 5.

What if I return a proxy card but do not make specific choices?

If you return a signed and dated proxy card without marking any voting selections, your shares will be voted:

1. Proposal 1: For election of our nominees for Class III directors.

2. Proposal 2: For approval of the 2018 EIP;

3. Proposal 3: For approval of the amendment and restatement of the 2014 ESPP to, among other things, increase the aggregate number of shares of common stock authorized for issuance under the plan by 600,000;

4. Proposal 4: For advisory approval of executive compensation; and

5. Proposal 5: For ratification of the selection of Ernst & Young LLP as the independent registered public accounting firm of the Company for its fiscal year ending December 31, 2018.

If any other matter is properly presented at the Annual Meeting, your proxyholder (one of the individuals named on your proxy card) will vote your shares using his or her best judgment.

Who is paying for this proxy solicitation?

We will pay for the entire cost of soliciting proxies. In addition to mailing these proxy materials, our directors and employees may also solicit proxies in person, by telephone, or by other means of communication. Directors and employees will not be paid any additional compensation for soliciting proxies. We may also reimburse brokerage firms, banks and other agents for the cost of forwarding proxy materials to beneficial owners.

What does it mean if I receive more than one proxy card?

If you receive more than one proxy card, your shares are registered in more than one name or are registered in different accounts. Please complete, sign and return each proxy card to ensure that all of your shares are voted.

Can I change my vote after submitting my proxy?

Yes. You can revoke your proxy at any time before the final vote at the Annual Meeting. If you are the record holder of your shares, you may revoke your proxy in any one of three ways:

- You may submit another properly completed proxy card with a later date.

- You may send a timely written notice that you are revoking your proxy to Dynavax Technologies Corporation, Attention: Corporate Secretary, 2929 Seventh Street, Suite 100, Berkeley, California 94710.

- You may attend the Annual Meeting and vote in person. Simply attending the Annual Meeting will not, by itself, revoke your proxy.

Your proxy card with the most recent date is the one that will be counted.

If your shares are held by your broker or bank as a nominee or agent, you should follow the instructions provided by your broker or bank.

When are stockholder proposals due for next year s Annual Meeting?

To be considered for inclusion in next year s proxy materials, your proposal must be submitted in writing by December 27, 2018 to Dynavax Technologies Corporation, Attention: Corporate Secretary, 2929 Seventh Street, Suite 100, Berkeley, California 94710. However, if our 2019 Annual Meeting of Stockholders is not held between May 1, 2019, and June 30, 2019, then the deadline will be a reasonable time before we begin to print and send our proxy materials. If you wish to submit a proposal (including a director nomination) that is not to be included in next year s proxy materials or nominate a director, you must do so no later than April 1, 2019, and no earlier than March 2, 2019. However, if our 2018 Annual Meeting of Stockholders is not held between May 1, 2018, and June 30, 2018, then you must submit your proposal (or director nomination) not less than 60 days nor more than 90 days prior to the time we send our proxy materials.

How many votes are needed to approve each proposal?

- Proposal 1, to elect our nominees for Class III directors, the three nominees receiving the most For votes from the holders of shares present (either in person or represented by proxy) and cast for the election of directors will be elected. Only votes For will affect the outcome of the vote; Withhold votes will have no effect on the outcome of the vote. However, if a nominee receives a greater number of Withhold votes than For votes, such nominee will submit his or her offer of resignation for consideration by our Nominating and Corporate Governance Committee in accordance with our Majority Vote Policy discussed in more detail on page 63 of this proxy statement.

- Proposal 2, to approve the 2018 EIP, must receive For votes from the holders of a majority of shares present (either in person or by proxy) and cast at the meeting (i.e., representing the majority voting power). If you return your proxy and select Abstain, it will have the same effect as an Against vote. Broker non-votes will have no effect.

Proposal 3, to approve the amendment and restatement of the 2014 ESPP to, among other things, increase the aggregate number of shares of common stock authorized for issuance under the plan by 600,000, must receive For votes from the holders of a majority of shares present (either in person or by proxy) and cast at the meeting (i.e., representing the majority voting power). If you return your proxy and select Abstain, it will have the same effect as an Against vote. Broker non-votes will have no effect.

Proposal 4, advisory approval of the compensation of the Company s named executive officers, will be considered to be approved if it receives For votes from the holders of a majority of shares present (either in person or by proxy) and cast at the meeting (i.e., representing the majority voting power). If you return your proxy and select Abstain from voting, it will have the same effect as an Against vote. Broker non-votes will have no effect.

Proposal 5, to ratify the selection of Ernst & Young LLP as the Company s independent registered public accounting firm for our fiscal year ending December 31, 2018, must receive For votes from the holders of a majority of shares present (either in person or by proxy) and cast at the meeting (i.e., representing the majority voting power). If you return your proxy and select Abstain from voting, it will have the same effect as an Against vote. As Proposal 5 is considered a routine matter, we do not expect to receive any broker non-votes.

What is the quorum requirement?

A quorum of stockholders is necessary to hold a valid Annual Meeting. A quorum will be present if stockholders holding at least a majority of the outstanding shares entitled to vote are present at the Annual Meeting in person or represented by proxy. On the record date, there were 62,255,860 shares outstanding and entitled to vote.

Your shares will be counted towards the quorum only if you submit a valid proxy (or one is submitted on your behalf by your broker, bank or other nominee) or if you vote in person at the Annual Meeting. Abstentions and broker non-votes will be counted towards the quorum requirement. If there is no quorum, the holders of a majority of shares present at the Annual Meeting in person or represented by proxy may adjourn the Annual Meeting to another date.

How can I find out the results of the voting at the Annual Meeting?

Preliminary voting results will be announced at the Annual Meeting. Final voting results will be published in a current report on Form 8-K within four business days following the voting. If we are unable to obtain final results in that time, we will announce the preliminary results and subsequently file a second current report on Form 8-K with the final results.

What proxy materials are available on the internet?

The 2018 proxy statement and 2017 Annual Report on Form 10-K are available at http://investors.dynavax.com/annuals-proxies.cfm.

Householding of Proxy Materials

The Securities and Exchange Commission, or SEC, has adopted rules that permit companies and intermediaries (e.g., brokers) to satisfy the delivery requirements for Annual Meeting materials with respect to two or more stockholders sharing the same address by delivering a single set of Annual Meeting materials addressed to those stockholders. This process, which is commonly referred to as householding, potentially means extra convenience for stockholders and cost savings for companies. A number of brokers with account holders who are Dynavax stockholders will be householding our proxy materials. A single set of Annual Meeting materials will be delivered to multiple stockholders sharing an address unless contrary instructions have been received from the affected stockholders. Once you have received notice from your broker that they will be householding communications to your address, householding will continue until you are notified otherwise or until you revoke your consent. If, at any time, you no longer wish to participate in householding and would prefer to receive a separate set of Annual Meeting materials, please notify your broker and we will promptly deliver to you a separate set of our Annual Meeting materials. Direct your written request to Dynavax Technologies Corporation, Attention: Corporate Secretary, 2929 Seventh Street, Suite 100, Berkeley, California 94710, (510) 848-5100. Stockholders who currently receive multiple copies of the Annual Meeting materials at their addresses and would like to request householding of their communications should contact their brokers.

PROPOSAL 1

ELECTION OF DIRECTORS

Our Board is divided into three classes, and each class has a three-year term. Vacancies on the Board may be filled only by persons elected by a majority of the remaining directors. A director elected by the Board to fill a vacancy in a class, including vacancies created by an increase in the number of directors, shall serve for the remainder of the full term of that class and until the director s successor is elected and qualified.

Our Board presently has nine members. However, one of our Class III directors, Dr. Plotkin, has advised the Board of his decision to retire effective as of the date of the Annual Meeting. The Board has no current plans to fill the vacancy upon the effective date of Dr. Plotkin s resignation. There are three directors in the class whose term of office expires in 2018: Arnold L. Oronsky, Ph.D., Francis R. Cano, Ph.D. and Peggy V. Phillips, each of whom is a nominee for director and currently a director of the Company. Drs. Oronsky and Cano and Ms. Phillips were previously elected by the stockholders in 2015. If each nominee is elected at the Annual Meeting, each of these nominees will serve until the 2021 Annual Meeting and until his or her successor is elected and has qualified, or, if sooner, until the director s death, resignation or removal. There were six directors in attendance at our 2017 Annual Meeting.

Directors are elected by a plurality of the votes of the holders of shares present in person or represented by proxy and entitled to vote on the election of directors. The three nominees receiving the highest number of affirmative votes will be elected. Shares represented by executed proxies will be voted, if authority to do so is not withheld, for the election of the nominees named below. Although the election of directors at the Annual Meeting is uncontested and directors are elected by a plurality of votes cast, and we therefore anticipate that each of the named nominees for director will be elected at the Annual Meeting, under our Corporate Governance Guidelines, any nominee for director is required to submit an offer of resignation for consideration by the Nominating and Corporate Governance Committee if such nominee for director (in an uncontested election) receives a greater number of Withhold votes than For votes. In such case, the Nominating and Corporate Governance Committee will then consider all of the relevant facts and circumstances and recommend to the Board the action to be taken with respect to such offer of resignation. For more information on this policy see the section entitled Corporate Governance. If any nominee becomes unavailable for election as a result of an unexpected occurrence, your shares will be voted for the election of a substitute nominee proposed by our Board. Each person nominated for election has agreed to serve if elected. Our Board has no reason to believe that any nominee will be unable to serve.

THE BOARD OF DIRECTORS RECOMMENDS

A VOTE IN FAVOR OF EACH NAMED NOMINEE.

Set forth below is certain biographical information as of April 9, 2018, for the nominees and each person whose term as a director will continue after the Annual Meeting.

Name	Age	Position
Arnold L. Oronsky, Ph.D.	77	Chairperson of the Board
Francis R. Cano, Ph.D.	73	Director
Dennis A. Carson, M.D.	71	Director
Laura Brege	60	Director
Eddie Gray	59	Chief Executive Officer (CEO) and Director
Daniel L. Kisner, M.D.	71	Director
Peggy V. Phillips	64	Director
Natale Ricciardi	69	Director

Class III Directors Nominees

Arnold L. Oronsky, Ph.D.

Dr. Oronsky has been a member of our Board since November 1996 and became Chairperson of the Board in February 2006. Dr. Oronsky has been a managing director with InterWest Partners, a venture capital firm, since 2009. Prior to joining InterWest Partners in 1994, Dr. Oronsky was Vice President of Discovery Research for the Lederle Laboratories division of American Cyanamid, a pharmaceutical company. From 1973 until 1976, Dr. Oronsky was head of the inflammation, allergy and immunology research program at Ciba-Geigy Pharmaceutical Company. Dr. Oronsky also serves as a senior lecturer in the Department of Medicine at The Johns Hopkins Medical School. Dr. Oronsky has won numerous grants and awards and has published over 125 scientific articles. Dr. Oronsky currently serves on the boards of directors of Tesaro, Inc., an oncology-focused biopharmaceutical company, and KalVista Pharmaceuticals, Inc., a biotechnology company. Dr. Oronsky also served on the board of directors of MacroGenics, Inc., a biopharmaceutical company, from 2000 to 2014, and Applied Genetic Technologies Corporation, a biotechnology company, from November 2003 until August 2017. The Board believes that Dr. Oronsky s significant experience in growing and developing life sciences companies, particularly in the immunology area, provides significant leadership and insights for the Board in defining the strategy of the Company and qualifies him to be nominated as a director. He received his Ph.D. from Columbia University, College of Physicians and Surgeons and his A.B. from New York University.

Francis R. Cano, Ph.D.

Dr. Cano was appointed to our Board in November 2009. Dr. Cano has been President and Founder of Cano Biotech Corp., a consulting firm focusing on the vaccine business, since 1996 and also serves on the board of Biomerica, Inc., a developer and manufacturer of diagnostic products. Previously, Dr. Cano served on the board of Arbor Vita Corporation, a biopharmaceutical company. From 1993 to 1996, Dr. Cano was President and Chief Operating Officer for Aviron, a biopharmaceutical company, which was later acquired by MedImmune in 2001. As a Co-Founder of Aviron, he completed two rounds of venture financing, a licensing agreement with SmithKline Biologicals and in-licensed Flu-Mist influenza vaccine from the National Institutes of Health. For 21 years, Dr. Cano worked with the Lederle Laboratories Division of American Cyanamid, including as its Vice President and General Manager of the Biologicals unit. The Board believes that Dr. Cano s experience as a founder of and advisor to established vaccine businesses provides significant insights for the strategy of the Company with respect to key technical and operational issues in vaccine development and qualifies him to be nominated as a director. He earned a Ph.D. in Microbiology from Pennsylvania State University, served as a Research Associate at Rutgers Institute of Microbiology, and holds a M.S. in Microbiology and a B.S. in Biology from St. John s University.

Peggy V. Phillips

Ms. Phillips has been a member of our Board since August 2006. Ms. Phillips served on the board of directors of several biopharmaceutical companies: PhaseRx, Inc. from 2016 to 2018, Tekmira Pharmaceuticals from 2014 to 2015, Portola Pharmaceuticals from 2006 to 2013, as well as the Naval Academy Foundation from 2003 to 2011. From 1996 until 2002, she served on the board of directors of Immunex Corporation, a biotechnology company, and, from 1999, she served as its Chief Operating Officer until the company was acquired by Amgen in 2002. During her career at Immunex, she held positions of increasing responsibility in research, development, manufacturing, sales and marketing. As Senior Vice President for Pharmaceutical Development and General Manager for Enbrel ® from 1994 until 1998, she was responsible for clinical development and regulatory affairs as well as the launch, sales and marketing of the product. Prior to joining Immunex, Ms. Phillips worked at Miles Laboratories. The Board believes that Ms. Phillips provides significant experience in development and commercialization of biotechnology products. Her background and experience with larger, complex organizations provides significant operational and strategic insights in assessing the strategy of the Company and qualifies her to be nominated as a director. Ms. Phillips holds a B.S. and a M.S. in microbiology from the University of Idaho.

Class I Directors Continuing in Office Until the 2019 Annual Meeting

Dennis A. Carson, M.D.

Dr. Carson has been a member of our Board since December 1997. Dr. Carson is a noted researcher in the fields of autoimmune and immunodeficiency diseases and is co-discoverer with Dr. Eyal Raz of the immunostimulatory sequences (ISS) that form the basis of our technology. He has played key roles in the founding of Vical, Inc., a gene therapy company, IDEC Pharmaceuticals, a biopharmaceutical company, and Triangle Pharmaceuticals, a pharmaceutical company. Dr. Carson is former director of the Rebecca and John Moores Cancer Center at the University of California, San Diego and has been a professor in the Department of Medicine at the University of California, San Diego since 1990. The Board believes that Dr. Carson s significant experience in research and development provides important insights for the strategy of the Company, particularly with regard to scientific opportunities for development by the Company, and qualifies Dr. Carson to serve as a director. He is a member of the National Academy of Sciences, the American Academy of Arts and Sciences, and the Institute of Medicine, as well as the American Association for Cancer Research, the American Society for Clinical Investigation, the American Society of Hematology and the Association of American Physicians. He received his M.D. from Columbia University and his B.A. from Haverford College. Dr. Carson completed his residency in internal medicine and a postdoctoral fellowship at the University of California, San Diego.

Eddie Gray CEO and Director

Mr. Gray joined Dynavax as Chief Executive Officer and was appointed to our Board in May 2013. Most recently, Mr. Gray served as the President of Pharmaceuticals Europe and a member of the corporate executive team at GlaxoSmithKline plc (GSK) from 2008 until 2013 and as Senior Vice President and General Manager of Pharmaceuticals UK from 2001 through 2007. Prior to the formation of GSK, Mr. Gray was with SmithKline Beecham from 1988 through 2000 serving in various positions of increasing responsibility, including Vice President and Director of Anti-Infectives Marketing in the U.S., Vice President and Director of the Vaccines Business Unit in the U.S., and Vice President and General Manager of Pharmaceuticals in Canada. Our Board believes that Mr. Gray s more than 30 years of pharmaceutical industry experience, including, most recently, as the President of Pharmaceuticals Europe at GSK, a leading pharmaceutical company, and other senior management roles at GSK and its predecessor, where he was responsible for the launch, commercialization and strategic development of vaccines and other products, enables him to provide commercial and strategic leadership to the Company and qualifies Mr. Gray to serve as a director. Mr. Gray received a Bachelor of Science degree in Chemistry and Management Studies from the University of London and an MBA from the Cranfield School of Management in the UK.

Laura Brege

Ms. Brege has been a member of our Board since February 2015. Since September 2015, she has served as managing director of Cervantes Life Science Partners, LLC, a consulting firm providing integrated business solutions to life sciences companies. She has over 20 years of executive management experience in the pharmaceutical, biotechnology and venture capital industries. From September 2012 to July 2015, Ms. Brege was President and Chief Executive Officer of Nodality Inc., a life sciences company focused on innovative personalized medicine. Prior to joining Nodality in 2012, Ms. Brege held several senior-level positions at Onyx Pharmaceuticals, Inc., a biopharmaceutical and biotherapeutics company, from 2006 until 2012, including positions as Executive Vice President and Chief Operating Officer. While at Onyx she led multiple functions, including commercialization, strategic planning, corporate development, and medical, scientific and government affairs. Prior to Onyx, Ms. Brege was a General Partner at Red Rock Capital Management, a venture capital firm specializing in early stage financing for technology companies. Previously Ms. Brege was Senior Vice President and Chief Financial Officer at COR Therapeutics, where she helped build the company from an early stage R&D company through commercial launch of a successful cardiovascular product. Earlier in her career, she served as Chief Financial Officer at Flextronics, Inc. and Treasurer of The Cooper Companies. She serves on the board of directors of the following public pharmaceutical companies: Acadia Pharmaceuticals, Inc., Aratana Therapeutics, Inc., Pacira Pharmaceuticals, Inc. and Portola Pharmaceuticals, Inc. During the past five years, Ms. Brege also served on the boards of directors of

Angiotech Pharmaceuticals, Inc., a biotechnology company, and Delcath Systems, Inc., a pharmaceutical company. Our Board believes that Ms. Brege s background in finance and management of biotechnology companies and her participation as a member of the audit committees of other public companies provides important strategic insights for the Board in setting strategy and reviewing the operations of the Company, as well as qualifies Ms. Brege to serve on the Company s Audit Committee. Ms. Brege attended all Board and Audit Committee meetings of the Company and all meetings of the boards and committees on which she sits at other companies during the past year. Ms. Brege earned her undergraduate degrees from Ohio University (Honors Tutorial College) and her MBA degree from the University of Chicago.

Class II Directors Continuing in Office Until the 2020 Annual Meeting

Daniel L. Kisner, M.D.

Dr. Kisner has been a member of our Board since July 2010. From 2003 to 2010, Dr. Kisner served as a partner at Aberdare Ventures and prior to that as President and CEO of Caliper Technologies, leading its evolution from a start-up focused on microfluidic lab-on-chip technology to a publicly traded, commercial organization. Prior to Caliper, he was the President and Chief Operating Officer of Isis Pharmaceuticals, Inc., a biomedical pharmaceutical company. Previously, Dr. Kisner was Division Vice President of Pharmaceutical Development for Abbott Laboratories and Vice President of Clinical Research and Development at SmithKline Beecham Pharmaceuticals. In addition, he held a tenured position in the Division of Oncology at the University of Texas, San Antonio School of Medicine and is certified by the American Board of Internal Medicine in Internal Medicine and Medical Oncology. Additionally, he is currently serving on the boards of Conatus Pharmaceuticals, Inc., a biotechnology company, Nativis Inc., a medical device company, and Zynerba Pharmaceuticals, a biotechnology company. Dr. Kisner previously served as Chairman of the board for Tekmira Pharmaceuticals, a biopharmaceutical company, until March 2015. Our Board believes that Dr. Kisner s background with larger, complex technology-based organizations as well as his significant experience with corporate transactions, including investing in venture-backed life science companies provides the Board with insights for setting strategy of the Company and qualifies him to serve as a director. He holds a B.A. from Rutgers University and an M.D. from Georgetown University.

Natale (Nat) Ricciardi

Mr. Ricciardi has been a member of our Board since June 2013. Mr. Ricciardi spent his entire 39-year career at Pfizer Inc., a biopharmaceutical company, retiring in 2011 as a member of the Pfizer Executive Leadership Team. While holding the positions of President, Pfizer Global Manufacturing, and Senior Vice President of Pfizer Inc. from 2004 until 2011, Mr. Ricciardi was directly responsible for all of Pfizer s internal and external supply organization, a global enterprise that grew to more than 100 manufacturing facilities supplying small and large molecule pharmaceuticals, vaccines, consumer, nutrition and animal health products. Mr. Ricciardi maintained responsibility for global manufacturing activities from 2004 through 2011. Previously, from 1999 to 2004, he had oversight for Pfizer s U.S. manufacturing operations and from 1995 to 1999 was Vice President of Manufacturing for Pfizer s Animal Health Group. Mr. Ricciardi is currently a member of the board of directors of Asterias Biotherapeutics, Inc., a biotechnology company, Rapid Micro Biosystems, Inc., a healthcare environmental technology company, and Prestige Brands Holdings, Inc., a healthcare and household product company. Mr. Ricciardi also serves as a member of the board of directors of the 21st Century Foundation of The City College of New York and as a member of the Advisory Board of HealthCare Royalty Partners. Our Board believes Mr. Ricciardi s 39-year career at Pfizer Inc., a leading pharmaceutical company, including as a member of the Pfizer Executive Leadership Team and direct responsibility for all of Pfizer s internal supply organization, including global manufacturing, provides the Board with insights for reviewing the operations of the Company and qualifies him to serve as a director. Mr. Ricciardi earned a degree in Chemical Engineering from The City College of New York and an MBA in Finance and International Business from Fordham University.

PROPOSAL 2

APPROVAL OF THE 2018 EQUITY INCENTIVE PLAN

The Board is requesting stockholder approval of the Dynavax Technologies Corporation 2018 Equity Incentive Plan (the 2018 EIP). The 2018 EIP is intended to be the successor to the Dynavax Technologies Corporation 2011 Equity Incentive Plan (the 2011 EIP).

Why We Are Asking Our Stockholders to Approve the 2018 EIP

Currently, we maintain the 2011 EIP to grant stock options and restricted stock unit awards to our employees and directors. In addition, we maintain the Dynavax Technologies Corporation 2017 Inducement Award Plan (the 2017 Inducement Plan) to grant stock options and restricted stock unit awards to our new hires.

We are seeking stockholder approval of the 2018 EIP to increase the number of shares available for the grant of stock options, restricted stock unit awards and other awards, which will enable us to have a competitive equity incentive program to compete with our peer group for key talent. If the 2018 EIP is approved by our stockholders, no additional awards will be granted under the 2011 EIP or the 2017 Inducement Plan. We also have awards outstanding under the Dynavax Technologies Corporation 2004 Stock Incentive Plan and the Dynavax Technologies Corporation 2010 Employment Inducement Award Plan, but no additional awards may be granted under such plans.

Approval of the 2018 EIP by our stockholders will allow us to grant stock options, restricted stock unit awards and other awards at levels determined appropriate by the Board or Compensation Committee. The 2018 EIP will also allow us to utilize a broad array of equity incentives in order to secure and retain the services of our employees and directors, and to provide long-term incentives that align the interests of our employees and directors with the interests of our stockholders.

Requested Shares

If this Proposal 2 is approved by our stockholders, then subject to adjustment for certain changes in our capitalization, the aggregate number of shares of our common stock that may be issued under the 2018 EIP will not exceed the sum of (i) 5,000,000 new shares, (ii) the number of unallocated shares remaining available for grant under the 2011 EIP as of the effective date of the 2018 EIP, and (iii) certain shares subject to outstanding stock awards granted under the 2011 EIP and the 2017 Inducement Plan (together, the Prior Plans) that may become available for issuance under the 2018 EIP as such shares become available from time to time (as further described below in Description of the 2018 Equity Incentive Plan Shares Available for Awards).

Stockholder Approval

If this Proposal 2 is approved by our stockholders, the 2018 EIP will become effective as of the date of the Annual Meeting and no additional awards will be granted under the 2011 EIP or the 2017 Inducement Plan. In the event that our stockholders do not approve this Proposal 2, the 2018 EIP will not become effective, and the 2011 EIP and the 2017 Inducement Plan will continue to be effective in accordance with their terms.

Why You Should Vote for the 2018 EIP

The 2018 EIP Combines Compensation and Governance Best Practices

The 2018 EIP includes provisions that are designed to protect our stockholders interests and to reflect corporate governance best practices including:

Stockholder approval is required for additional shares. The 2018 EIP does not contain an annual evergreen provision. The 2018 EIP authorizes a fixed number of shares, so that stockholder approval is required to issue any additional shares.

Repricing is not allowed. The 2018 EIP prohibits the repricing of stock options and stock appreciation rights without prior stockholder approval.

No discounted stock options or stock appreciation rights. All stock options and stock appreciation rights granted under the 2018 EIP must have an exercise price equal to or greater than the fair market value of our common stock on the date the stock option or stock appreciation right is granted.

Reasonable share counting provisions. In general, when awards granted under the 2018 EIP lapse or are canceled, the shares reserved for those awards will be returned to the share reserve and be available for future awards. However, any shares received from the exercise of stock options or withheld for taxes will not be returned to our share reserve.

Minimum vesting requirements. The 2018 EIP provides that no award may vest until at least 12 months following the date of grant of such award, except that up to 5% of the share reserve of the 2018 EIP may be subject to awards that do not meet such vesting requirements.

Limit on non-employee director compensation. The aggregate value of all cash and equity-based compensation granted or paid by us to any individual for service as a non-employee director of the Board with respect to any fiscal year of the Company will not exceed (i) a total of $200,000 with respect to any such cash compensation and (ii) $800,000 in total value with respect to any such equity-based compensation (including awards granted under the 2018 EIP and any other equity-based awards), calculating the value of any such awards based on the grant date fair value of such awards for financial reporting purposes.

Awards subject to forfeiture/clawback. Awards granted under the 2018 EIP will be subject to recoupment in accordance with any clawback policy that we are required to adopt pursuant to the listing standards of any national securities exchange or association on which our securities are listed or as is otherwise required by the Dodd-Frank Wall Street Reform and Consumer Protection Act or other applicable law. In addition, the Board may impose other clawback, recovery or recoupment provisions in an award agreement, including a reacquisition right in respect of previously acquired shares or other cash or property upon the occurrence of cause.

Restrictions on dividends. The 2018 EIP provides that (i) no dividends or dividend equivalents may be paid with respect to any shares of our common stock subject to an award before the date such shares have vested, (ii) any dividends or dividend equivalents that are credited with respect to any such shares will be subject to all of the terms and conditions applicable to such shares under the terms of the applicable award agreement (including any vesting conditions), and (iii) any dividends or dividend equivalents that are credited with respect to any such shares will be forfeited to us on the date such shares are forfeited to or repurchased by us due to a failure to vest.

Overhang

The following table provides certain information regarding our equity incentive program.

	As of March 15, 2018
Total number of shares of common stock subject to outstanding stock options	4,972,623
Weighted-average exercise price of outstanding stock options	$ 18.46
Weighted-average remaining term of outstanding stock options	6.18 years
Total number of shares of common stock subject to outstanding full value awards	2,194,591
Total number of shares of common stock available for grant under the 2011 EIP (1)	343,956

	As of April 9, 2018
Total number of shares of common stock outstanding	62,255,860
Per-share closing price of common stock as reported on NASDAQ Capital Market	$ 18.60

(1) Although there were 848,200 shares available for grant under the 2017 Inducement Plan as of March 15, 2018, no additional awards will be granted under the 2017 Inducement Plan if the 2018 EIP is approved by our stockholders. As of March 15, 2018, there were no shares of common stock available for grant under any of our equity incentive plans, other than the 2011 EIP and the 2017 Inducement Plan, as described in this table.

We Manage Our Equity Incentive Award Use Carefully and Dilution Is Reasonable

We continue to believe that equity incentive awards such as stock options and restricted stock unit awards are a vital part of our overall compensation program. Our compensation philosophy reflects broad-based eligibility for equity incentive awards, and we grant awards to substantially all of our employees. However, we recognize that equity incentive awards dilute existing stockholders, and, therefore, we must responsibly manage the growth of our equity compensation program. We are committed to effectively monitoring our equity compensation share reserve, including our burn rate, to ensure that we maximize stockholders value by granting the appropriate number of equity incentive awards necessary to attract, reward, and retain employees. In addition, the vesting of some of our equity awards granted to our named executive officers are contingent on meeting pre-defined performance criteria, thereby ensuring alignment with value creation.

The following table shows our responsible historical dilution and burn rate percentages.

As of December 31	2017	2016	2015
Full Dilution(1)	14.92%	16.90%	11.88%
Gross Burn Rate(2)	5.23%	5.90%	4.18%

(1) Full Dilution is calculated as (shares available for grant + shares subject to outstanding equity incentive awards)/(weighted average common stock outstanding + shares available for grant + shares subject to outstanding equity incentive awards).

(2) Gross Burn Rate is calculated as (shares subject to options granted + shares subject to other equity incentive awards granted)/weighted average common stock outstanding.

The Size of Our Share Reserve Request Is Reasonable

If this Proposal 2 is approved by our stockholders, we will have 5,000,000 new shares available for grant after our Annual Meeting, and absent any unforeseen circumstances, we anticipate returning to stockholders for additional shares in 2019.

Burn Rate

The following table provides detailed information regarding the activity related to our equity incentive plans for fiscal years 2017, 2016 and 2015.

	Fiscal Year 2017	Fiscal Year 2016	Fiscal Year 2015
Total number of shares of common stock subject to stock options granted	535,497	1,414,262	1,338,661
Total number of shares of common stock subject to full value awards granted	2,217,303	856,258	36,986
Weighted-average number of shares of common stock outstanding	52,613,215	38,505,856	32,881,333
Burn Rate	5.23%	5.90%	4.18%

Description of the 2018 Equity Incentive Plan

A summary of the principal features of the 2018 EIP follows below. The summary is qualified by the full text of the 2018 EIP that is attached as Appendix A to this proxy statement.

Purpose

The 2018 EIP is designed to secure and retain the services of our employees and directors, provide incentives for our employees and directors to exert maximum efforts for the success of the Company and its affiliates, and provide a means by which our employees and directors may be given an opportunity to benefit from increases in the value of our common stock.

Types of Awards

The 2018 EIP provides for the grant of incentive stock options, nonstatutory stock options, stock appreciation rights, restricted stock awards, restricted stock unit awards, performance stock awards, and other stock awards.

Shares Available for Awards

Subject to adjustment for certain changes in our capitalization, the aggregate number of shares of our common stock that may be issued under the 2018 EIP will not exceed the sum of (i) 5,000,000 new shares, (ii) the number of unallocated shares remaining available for grant under the 2011 EIP as of the effective date of the 2018 EIP, and (iii) the Prior Plans Returning Shares (as defined below), as such shares become available from time to time.

The term Prior Plans Returning Shares refers to the following shares of our common stock subject to any outstanding stock award granted under either of the Prior Plans: (i) any shares subject to such stock award that are not issued because such stock award expires or otherwise terminates without all of the shares covered by such stock award having been issued; (ii) any shares subject to such stock award that are not issued because such stock award is settled in cash; and (iii) any shares issued pursuant to such stock award that are forfeited back to or repurchased by us because of a failure to vest.

The following shares of our common stock (collectively, the 2018 EIP Returning Shares) will also become available again for issuance under the 2018 EIP: (i) any shares subject to a stock award granted under the 2018 EIP that are not issued because such stock award expires or otherwise terminates without all of the shares covered by such stock award having been issued; (ii) any shares subject to a stock award granted under the 2018 EIP that are not issued because such stock award is settled in cash; and (iii) any shares issued pursuant to a stock award granted under the 2018 EIP that are forfeited back to or repurchased by us because of a failure to vest.

The following shares of our common stock will not become available again for issuance under the 2018 EIP: (i) any shares that are reacquired or withheld (or not issued) by us to satisfy the exercise, strike or purchase price of a stock award granted under the 2018 EIP or any Prior Plan (including any shares subject to such award that are not delivered because such award is exercised through a reduction of shares subject to such award); (ii) any shares that are reacquired or withheld (or not issued) by us to satisfy a tax withholding obligation in connection with a stock award granted under the 2018 EIP or any Prior Plan; (iii) any shares repurchased by us on the open market with the proceeds of the exercise, strike or purchase price of a stock award granted under the 2018 EIP or any Prior Plan; and (iv) in the event that a stock appreciation right granted under the 2018 EIP or any Prior Plan is settled in shares, the gross number of shares subject to such award.

The number of shares of our common stock available for issuance under the 2018 EIP will be reduced by: (i) one share for each share issued pursuant to a stock option or stock appreciation right with an exercise price that is at least 100% of the fair market value of our common stock on the date of grant (an Appreciation Award) granted under the 2018 EIP; and (ii) 1.28 shares for each share issued pursuant to a stock award that is not an Appreciation Award (a Full Value Award) granted under the 2018 EIP.

The number of shares of our common stock available for issuance under the 2018 EIP will be increased by: (i) one share for each Prior Plans Returning Share or 2018 EIP Returning Share subject to an Appreciation Award; and (ii) 1.28 shares for each Prior Plans Returning Share or 2018 EIP Returning Share subject to a Full Value Award.

Eligibility

All of our (including our affiliates) employees and non-employee directors are eligible to participate in the 2018 EIP and may receive all types of awards other than incentive stock options. Incentive stock options may be granted under the 2018 EIP only to our (including our affiliates) employees.

As of April 9, 2018, we (including our affiliates) had approximately 213 employees and eight non-employee directors.

Non-Employee Director Compensation Limit

The aggregate value of all cash and equity-based compensation granted or paid by us to any individual for service as a non-employee director of the Board with respect to any fiscal year of the Company will not exceed (i) a total of $200,000 with respect to any such cash compensation and (ii) $800,000 in total value with respect to any such equity-based compensation (including awards granted under the 2018 EIP and any other equity-based awards), calculating the value of any such awards based on the grant date fair value of such awards for financial reporting purposes.

Administration

The 2018 EIP will be administered by our Board, which may in turn delegate authority to administer the 2018 EIP to a committee. Our Board has delegated concurrent authority to administer the 2018 EIP to our Compensation Committee, but may, at any time, revest in itself some or all of the power delegated to our Compensation Committee. Our Board and Compensation Committee are each considered to be a Plan Administrator for purposes of this Proposal 2.

Subject to the terms of the 2018 EIP, the Plan Administrator may determine the recipients, the types of awards to be granted, the number of shares of our common subject to or the cash value of awards, and the terms and conditions of awards granted under the 2018 EIP, including the period of their exercisability and vesting. The Plan Administrator also has the authority to provide for accelerated exercisability and vesting of awards. Subject to the limitations set forth below, the Plan Administrator also determines the fair market value applicable to a stock award and the exercise or strike price of stock options and stock appreciation rights granted under the 2018 EIP.

The Plan Administrator may also delegate to one or more officers the authority to designate employees who are not officers to be recipients of certain stock awards and the number of shares of our common stock subject to such stock awards. Under any such delegation, the Plan Administrator will specify the total number of shares of our common stock that may be subject to the stock awards granted by such officer. The officer may not grant a stock award to himself or herself.

Repricing; Cancellation and Re-Grant of Stock Awards

Under the 2018 EIP, the Plan Administrator does not have the authority to reprice any outstanding stock option or stock appreciation right by reducing the exercise or strike price of the stock option or stock appreciation right or to cancel any outstanding stock option or stock appreciation right that has an exercise or strike price greater than the then-current fair market value of our common stock in exchange for cash or other stock awards without obtaining the approval of our stockholders. Such approval must be obtained within 12 months prior to such an event.

Minimum Vesting Requirements

Under the 2018 EIP, no award may vest until at least 12 months following the date of grant of such award, except that up to 5% of the share reserve of the 2018 EIP may be subject to awards that do not meet such vesting requirements.

Dividends and Dividend Equivalents

The 2018 EIP provides that dividends or dividend equivalents may be paid or credited with respect to any shares of our common stock subject to an award, as determined by the Plan Administrator and contained in the applicable award agreement; *provided, however*, that (i) no dividends or dividend equivalents may be paid with respect to any such shares before the date such shares have vested, (ii) any dividends or dividend equivalents that are credited with respect to any such shares will be subject to all of the terms and conditions applicable to such shares under the terms of the applicable award agreement (including any vesting conditions), and (iii) any dividends or dividend equivalents that are credited with respect to any such shares will be forfeited to us on the date such shares are forfeited to or repurchased by us due to a failure to vest.

Stock Options

Stock options may be granted under the 2018 EIP pursuant to stock option agreements. The 2018 EIP permits the grant of stock options that are intended to qualify as incentive stock options, or ISOs, and nonstatutory stock options, or NSOs.

The exercise price of a stock option granted under the 2018 EIP may not be less than 100% of the fair market value of our common stock on the date of grant and, in some cases (see Limitations on Incentive Stock Options below), may not be less than 110% of such fair market value.

The term of stock options granted under the 2018 EIP may not exceed seven years and, in some cases (see Limitations on Incentive Stock Options below), may not exceed five years. Except as otherwise provided in a participant s stock option agreement or other written agreement with us or one of our affiliates, if a participant s service relationship with us or any of our affiliates (referred to in this Proposal 2 as continuous service) terminates (other than for cause and other than upon the participant s death or disability), the participant may exercise any vested stock options for up to three months following the participant s termination of continuous service. Except as otherwise provided in a participant s stock option agreement or other written agreement with us or one of our affiliates, if a participant s continuous service terminates due to the participant s disability or death (or the participant dies within a specified period, if any, following termination of continuous service), the participant, or his or her beneficiary, as applicable, may exercise any vested stock options for up to 12 months following the participant s termination due to the participant s disability or for up to 18 months following the participant s death. Except as explicitly provided otherwise in a participant s stock option agreement or other written agreement with us or one of our affiliates, if a participant s continuous service is terminated for cause (as defined in the 2018 EIP), all stock options held by the participant will terminate upon the participant s termination of continuous service and the participant will be prohibited from exercising any stock option from and after such termination date. Except as otherwise provided in a participant s stock option agreement or other written agreement with us or one of our affiliates, the term of a stock option may be extended if the exercise of the stock option following the participant s termination of continuous service (other than for cause and other than upon the participant s death or disability) would be prohibited by applicable securities laws or if the sale of any common stock received upon exercise of the stock option following the participant s termination of continuous service (other than for cause) would violate our insider trading policy. In no event, however, may a stock option be exercised after its original expiration date.

Acceptable forms of consideration for the purchase of our common stock pursuant to the exercise of a stock option under the 2018 EIP will be determined by the Plan Administrator and may include payment: (i) by cash, check, bank draft or money order payable to us; (ii) pursuant to a program developed under Regulation T as promulgated by the Federal Reserve Board; (iii) by delivery to us of shares of our common stock (either by actual delivery or attestation); (iv) by a net exercise arrangement (for NSOs only); or (v) in other legal consideration approved by the Plan Administrator.

Stock options granted under the 2018 EIP may vest and become exercisable in cumulative increments, as determined by the Plan Administrator at the rate specified in the stock option agreement (subject to the limitations described in Minimum Vesting Requirements above). Shares covered by different stock options granted under the 2018 EIP may be subject to different vesting schedules as the Plan Administrator may determine.

The Plan Administrator may impose limitations on the transferability of stock options granted under the 2018 EIP in its discretion. Generally, a participant may not transfer a stock option granted under the 2018 EIP other than by will or the laws of descent and distribution or, subject to approval by the Plan Administrator, pursuant to a domestic relations order or an official marital settlement agreement. However, the Plan Administrator may permit transfer of a stock option in a manner that is not prohibited by applicable tax and securities laws. In addition, subject to approval by the Plan Administrator, a participant may designate a beneficiary who may exercise the stock option following the participant s death. Notwithstanding the foregoing, no option may be transferred to any financial institution without prior stockholder approval.

Limitations on Incentive Stock Options

The aggregate fair market value, determined at the time of grant, of shares of our common stock with respect to ISOs that are exercisable for the first time by a participant during any calendar year under all of our stock plans may not exceed $100,000. The stock options or portions of stock options that exceed this limit or otherwise fail to qualify as ISOs are treated as NSOs. No ISO may be granted to any person who, at the time of grant, owns or is deemed to own stock possessing more than 10% of our total combined voting power or that of any affiliate unless the following conditions are satisfied:

- the exercise price of the ISO must be at least 110% of the fair market value of our common stock on the date of grant; and
- the term of the ISO must not exceed five years from the date of grant.

Subject to adjustment for certain changes in our capitalization, the aggregate maximum number of shares of our common stock that may be issued pursuant to the exercise of ISOs under the 2018 EIP is 10,000,000 shares.

Stock Appreciation Rights

Stock appreciation rights may be granted under the 2018 EIP pursuant to stock appreciation right agreements. Each stock appreciation right is denominated in common stock share equivalents. The strike price of each stock appreciation right will be determined by the Plan Administrator, but will in no event be less than 100% of the fair market value of our common stock on the date of grant. The Plan Administrator may also impose restrictions or conditions upon the vesting of stock appreciation rights that it deems appropriate. The appreciation distribution payable upon exercise of a stock appreciation right may be paid in shares of our common stock, in cash, in a combination of cash and stock, or in any other form of consideration determined by the Plan Administrator and set forth in the stock appreciation right agreement. Stock appreciation rights will be subject to the same conditions upon termination of continuous service and restrictions on transfer as stock options under the 2018 EIP.

Restricted Stock Awards

Restricted stock awards may be granted under the 2018 EIP pursuant to restricted stock award agreements. A restricted stock award may be granted in consideration for cash, check, bank draft or money order payable to us, the participant s services performed for us or any of our affiliates, or any other form of legal consideration acceptable to the Plan Administrator. Shares of our common stock acquired under a restricted stock award may be subject to forfeiture to or repurchase by us in accordance with a vesting schedule to be determined by the Plan Administrator (subject to the limitations described in Minimum Vesting Requirements above). Rights to acquire shares of our common stock under a restricted stock award may be transferred only upon such terms and conditions as are set forth in the restricted stock award agreement; *provided, however*, that no restricted stock award may be transferred to any financial institution without prior stockholder approval. Upon a participant s termination of continuous service for any reason, any shares subject to restricted stock awards held by the participant that have not vested as of such termination date may be forfeited to or repurchased by us.

Restricted Stock Unit Awards

Restricted stock unit awards may be granted under the 2018 EIP pursuant to restricted stock unit award agreements. Payment of any purchase price may be made in any form of legal consideration acceptable to the Plan Administrator. A restricted stock unit award may be settled by the delivery of shares of our common stock, in cash, in a combination of cash and stock, or in any other form of consideration determined by the Plan Administrator and set forth in the restricted stock unit award agreement. Restricted stock unit awards may be subject to vesting in accordance with a vesting schedule to be determined by the Plan Administrator (subject to the limitations described in Minimum Vesting Requirements above). Except as otherwise provided in a participant s restricted stock unit award agreement or other written agreement with us or one of our affiliates, restricted stock units that have not vested will be forfeited upon the participant s termination of continuous service for any reason.

Performance Stock Awards

A performance stock award is a stock award that is payable (including that may be granted, may vest, or may be exercised) contingent upon the attainment of pre-determined performance goals during a performance period. A performance stock award may require the completion of a specified period of continuous service. The length of any performance period, the performance goals to be achieved during the performance period, and the measure of whether and to what degree such performance goals have been attained will be determined by the Plan Administrator (subject to the limitations described in Minimum Vesting Requirements above). In addition, to the extent permitted by applicable law and the performance stock award agreement, the Plan Administrator may determine that cash may be used in payment of performance stock awards.

Performance goals under the 2018 EIP will be based on any one or more of the following performance criteria: (i) earnings (including earnings per share and net earnings); (ii) earnings before interest, taxes and depreciation; (iii) earnings before interest, taxes, depreciation and amortization (EBITDA); (iv) total stockholder return; (v) return on equity or average stockholder s equity; (vi) return on assets, investment, or capital employed; (vii) stock price or stock price performance; (viii) margin (including gross margin); (ix) net income (before or after taxes); (x) operating income; (xi) operating income after taxes; (xii) pre-tax profit; (xiii) operating cash flow; (xiv) sales or revenue targets; (xv) increases in revenue or product revenue; (xvi) expenses and cost reduction goals; (xvii) improvement in or attainment of working capital levels; (xviii) economic value added (or an equivalent metric); (xix) market share; (xx) cash flow; (xxi) cash flow per share; (xxii) share price performance; (xxiii) debt reduction; (xxiv) implementation or completion of projects or processes; (xxv) customer satisfaction; (xxvi) stockholders equity; (xxvii) capital expenditures; (xxviii) debt levels; (xxix) operating profit or net operating profit; (xxx) workforce diversity; (xxxi) growth of net income or operating income; (xxxii) billings; (xxxiii) submission to, or approval by, a regulatory body (including but not limited to the U.S. Food and Drug Administration) of an applicable filing for a product candidate or other product development milestones; (xxxiv) acquisitions, divestitures, joint ventures, strategic alliances, licenses or collaborations; (xxxv) spin-offs, split-ups, reorganizations, recapitalizations, restructurings, financings (debt or equity) or refinancings; (xxxvi) manufacturing or process development, clinical trial, regulatory, intellectual property, compliance or research objectives; and (xxxvii) any other measures of performance selected by the Plan Administrator.

Performance goals may be based on a company-wide basis, with respect to one or more business units, divisions, affiliates or business segments, and in either absolute terms or relative to the performance of one or more comparable companies or the performance of one or more relevant indices. The Plan Administrator is authorized to make appropriate adjustments in the method of calculating the attainment of performance goals for a performance period as follows: (i) to exclude restructuring and/or other nonrecurring charges; (ii) to exclude exchange rate effects, as applicable, for non-U.S. dollar denominated performance goals; (iii) to exclude the effects of changes to generally accepted accounting principles; (iv) to exclude the effects of any statutory adjustments to corporate tax rates; (v) to exclude the effects of items that are unusual in nature or occur infrequently as determined under generally accepted accounting principles; (vi) to exclude the dilutive effects of acquisitions or joint ventures; (vii) to assume that any business divested by the Company achieved performance objectives at targeted levels during the balance of a performance period following such divestiture; (viii) to exclude the effect of any change in the outstanding shares of our common stock by reason of any stock dividend or split, stock repurchase, reorganization, recapitalization, merger, consolidation, spin-off, combination or exchange of shares or other similar corporate change, or any distributions to common shareholders other than regular cash dividends; (ix) to exclude the effects of stock based compensation and/or the award of an annual cash incentive under our Annual Incentive Program; (x) to exclude the effect of any other unusual, non-recurring gain or loss or other extraordinary item; and (xi) to make other appropriate adjustments selected by the Plan Administrator.

In addition, the Plan Administrator retains the discretion to reduce or eliminate the compensation or economic benefit due upon the attainment of any performance goals and to define the manner of calculating the performance criteria it selects to use for a performance period.

Other Stock Awards

Other forms of stock awards valued in whole or in part by reference to, or otherwise based on, our common stock may be granted either alone or in addition to other stock awards under the 2018 EIP. Subject to the terms of the 2018 EIP (including the limitations described in Minimum Vesting Requirements above), the Plan Administrator will have sole and complete authority to determine the persons to whom and the time or times at which such other stock awards will be granted, the number of shares of our common stock to be granted and all other terms and conditions of such other stock awards.

Clawback Policy

Awards granted under the 2018 EIP will be subject to recoupment in accordance with any clawback policy that we are required to adopt pursuant to the listing standards of any national securities exchange or association on which our securities are listed or as is otherwise required by the Dodd-Frank Wall Street Reform and Consumer Protection Act or other applicable law. In addition, the Plan Administrator may impose other clawback, recovery or recoupment provisions in an award agreement, including a reacquisition right in respect of previously acquired shares or other cash or property upon the occurrence of cause.

Changes to Capital Structure

In the event of certain capitalization adjustments, the Plan Administrator will appropriately adjust: (i) the class(es) and maximum number of securities subject to the 2018 EIP; (ii) the class(es) and maximum number of securities that may be issued pursuant to the exercise of ISOs; and (iii) the class(es) and number of securities and price per share of stock subject to outstanding stock awards.

Corporate Transaction and Change in Control

The following provisions will apply to outstanding awards under the 2018 EIP and any Prior Plan in the event of a corporate transaction (as defined in the 2018 EIP and described below) or a change in control (as defined in the 2018 EIP and described below) unless otherwise provided in the instrument evidencing the award, in any other written agreement between us or one of our affiliates and the participant, or in our director compensation policy, or unless otherwise provided by the Plan Administrator at the time of grant of the award. For purposes of this Proposal 2, the term Transaction will mean such corporate transaction or change in control.

In the event of a Transaction, any surviving or acquiring corporation (or its parent company) may assume or continue any or all outstanding awards under the 2018 EIP and/or any Prior Plan, or may substitute similar stock awards for such outstanding awards (including, but not limited to, awards to acquire the same consideration paid to the stockholders of the Company pursuant to the Transaction), and any reacquisition or repurchase rights held by the Company in respect of shares issued pursuant to any outstanding awards under the 2018 EIP and/or any Prior Plan may be assigned by the Company to the surviving or acquiring corporation (or its parent company). The terms of any such assumption, continuation or substitution will be set by the Plan Administrator.

In the event of a Transaction in which the surviving or acquiring corporation (or its parent company) does not assume or continue outstanding awards under the 2018 EIP and/or any Prior Plan, or substitute similar stock awards for such outstanding awards, then with respect to any such awards that have not been assumed, continued or substituted and that are held by participants whose continuous service has not terminated prior to the effective time of the Transaction (the Current Participants), the vesting (and exercisability, if applicable) of such awards will be accelerated in full to a date prior to the effective time of the Transaction (contingent upon the closing or completion of the Transaction) as the Plan Administrator will determine (or, if the Plan Administrator does not determine such a date, to the date that is five days prior to the effective time of the Transaction), and such awards will terminate if not exercised (if applicable) prior to the effective time of the Transaction in accordance with the exercise procedures determined by the Plan Administrator, and any reacquisition or repurchase rights held by the Company with respect to such awards will lapse (contingent upon the closing or completion of the Transaction).

In the event of a Transaction in which the surviving or acquiring corporation (or its parent company) does not assume or continue outstanding awards under the 2018 EIP and/or any Prior Plan, or substitute similar stock awards for such outstanding awards, then with respect to any such awards that have not been assumed, continued or substituted and that are held by participants other than the Current Participants, such awards will terminate if not exercised (if applicable) prior to the effective time of the Transaction in accordance with the exercise procedures determined by the Plan Administrator; *provided, however*, that any reacquisition or repurchase rights held by the Company with respect to such awards will not terminate and may continue to be exercised notwithstanding the Transaction.

Notwithstanding the foregoing, in the event any outstanding award under the 2018 EIP and/or any Prior Plan held by a participant will terminate if not exercised prior to the effective time of a Transaction, the Plan Administrator may provide, in its sole discretion, that the participant may not exercise such award but instead will receive a payment, in such form as may be determined by the Plan Administrator, equal in value to the excess, if any, of (i) the value of the property the participant would have received upon the exercise of such award immediately prior to the effective time of the Transaction (including, at the discretion of the Plan Administrator, any unvested portion of such award), over (ii) any exercise price payable by the participant in connection with such exercise.

Outstanding awards under the 2018 EIP and any Prior Plan may be subject to additional acceleration of vesting and exercisability upon or after a change in control as may be provided in the participant s award agreement, in any other written agreement with us or one of our affiliates, or in our director compensation policy, but in the absence of such provision, no such acceleration will occur.

For purposes of the 2018 EIP, a corporate transaction generally will be deemed to occur in the event of the consummation of: (i) a sale or other disposition of all or substantially all of our consolidated assets; (ii) a sale or other disposition of at least 90% of our outstanding securities; (iii) a merger, consolidation or similar transaction following which we are not the surviving corporation; or (iv) a merger, consolidation or similar transaction following which we are the surviving corporation but the shares of our common stock outstanding immediately prior to the transaction are converted or exchanged into other property by virtue of the transaction.

For purposes of the 2018 EIP, a change in control generally will be deemed to occur in the event: (i) a person, entity or group acquires, directly or indirectly, our securities representing more than 50% of the combined voting power of our then outstanding securities, other than by virtue of a merger, consolidation, or similar transaction; (ii) there is consummated a merger, consolidation, or similar transaction and, immediately after the consummation of such transaction, our stockholders immediately prior thereto do not own, directly or indirectly, more than 50% of the combined outstanding voting power of the surviving entity or the parent of the surviving entity in substantially the same proportions as their ownership of our outstanding voting securities immediately prior to such transaction; (iii) there is consummated a sale or other disposition of all or substantially all of our consolidated assets, other than a sale or other disposition to an entity in which more than 50% of the entity s combined voting power is owned by our stockholders in substantially the same proportions as their ownership of our outstanding voting securities immediately prior to such sale or other disposition; or (iv) over a period of 12 months or less, a majority of our Board becomes comprised of individuals whose nomination, appointment, or election was not approved by a majority of the Board members or their approved successors.

Plan Amendments and Termination

The Board (or a committee of one or more directors delegated by the Board) will have the authority to amend or terminate the 2018 EIP at any time. However, except as otherwise provided in the 2018 EIP or an award agreement, no amendment or termination of the 2018 EIP may materially impair a participant s rights under his or her outstanding awards without the participant s consent.

We will obtain stockholder approval of any amendment to the 2018 EIP as required by applicable law and listing requirements. No incentive stock options may be granted under the 2018 EIP after the tenth anniversary of the date the 2018 EIP was adopted by the Board.

U.S. Federal Income Tax Consequences

The following is a summary of the principal United States federal income tax consequences to participants and us with respect to participation in the 2018 EIP. This summary is not intended to be exhaustive and does not discuss the income tax laws of any local, state or foreign jurisdiction in which a participant may reside. The information is based upon current federal income tax rules and therefore is subject to change when those rules change. Because the tax consequences to any participant may depend on his or her particular situation, each participant should consult the participant s tax adviser regarding the federal, state, local and other tax consequences of the grant or exercise of an award or the disposition of stock acquired the 2018 EIP. The 2018 EIP is not qualified under the provisions of Section 401(a) of the Internal Revenue Code of 1986, as amended (the Code), and is not subject to any of the provisions of the Employee Retirement Income Security Act of 1974. Our ability to realize the benefit of any tax deductions described below depends on our generation of taxable income as well as the requirement of reasonableness, the provisions of Section 162(m) of the Code and the satisfaction of our tax reporting obligations.

Nonstatutory Stock Options

Generally, there is no taxation upon the grant of an NSO if the stock option is granted with an exercise price equal to the fair market value of the underlying stock on the grant date. Upon exercise, a participant will recognize ordinary income equal to the excess, if any, of the fair market value of the underlying stock on the date of exercise of the stock option over the exercise price. If the participant is employed by us or one of our affiliates, that income will be subject to withholding taxes. The participant s tax basis in those shares will be equal to their fair market value on the date of exercise of the stock option, and the participant s capital gain holding period for those shares will begin on that date.

Subject to the requirement of reasonableness, the provisions of Section 162(m) of the Code and the satisfaction of our tax reporting obligation, we will generally be entitled to a tax deduction equal to the taxable ordinary income realized by the participant.

Incentive Stock Options

The 2018 EIP provides for the grant of stock options that are intended to qualify as incentive stock options, as defined in Section 422 of the Code. Under the Code, a participant generally is not subject to ordinary income tax upon the grant or exercise of an ISO. If the participant holds a share received upon exercise of an ISO for more than two years from the date the stock option was granted and more than one year from the date the stock option was exercised, which is referred to as the required holding period, the difference, if any, between the amount realized on a sale or other taxable disposition of that share and the participant s tax basis in that share will be long-term capital gain or loss.

If, however, a participant disposes of a share acquired upon exercise of an ISO before the end of the required holding period, which is referred to as a disqualifying disposition, the participant generally will recognize ordinary income in the year of the disqualifying disposition equal to the excess, if any, of the fair market value of the share on the date of exercise of the stock option over the exercise price. However, if the sales proceeds are less than the fair market value of the share on the date of exercise of the stock option, the amount of ordinary income recognized by the participant will not exceed the gain, if any, realized on the sale. If the amount realized on a disqualifying disposition exceeds the fair market value of the share on the date of exercise of the stock option, that excess will be short-term or long-term capital gain, depending on whether the holding period for the share exceeds one year.

For purposes of the alternative minimum tax, the amount by which the fair market value of a share of stock acquired upon exercise of an ISO exceeds the exercise price of the stock option generally will be an adjustment included in the participant s alternative minimum taxable income for the year in which the stock option is exercised. If, however, there is a disqualifying disposition of the share in the year in which the stock option is exercised, there will be no adjustment for alternative minimum tax purposes with respect to that share. In computing alternative minimum taxable income, the tax basis of a share acquired upon exercise of an ISO is increased by the amount of the adjustment taken into account with respect to that share for alternative minimum tax purposes in the year the stock option is exercised.

We are not allowed a tax deduction with respect to the grant or exercise of an ISO or the disposition of a share acquired upon exercise of an ISO after the required holding period. If there is a disqualifying disposition of a share, however, we will generally be entitled to a tax deduction equal to the taxable ordinary income realized by the participant, subject to the requirement of reasonableness and the provisions of Section 162(m) of the Code, and provided that either the employee includes that amount in income or we timely satisfy our reporting requirements with respect to that amount.

Restricted Stock Awards

Generally, the recipient of a restricted stock award will recognize ordinary income at the time the stock is received equal to the excess, if any, of the fair market value of the stock received over any amount paid by the recipient in exchange for the stock. If, however, the stock is not vested when it is received (for example, if the employee is required to work for a period of time in order to have the right to sell the stock), the recipient generally will not recognize income until the stock becomes vested, at which time the recipient will recognize ordinary income equal to the excess, if any, of the fair market value of the stock on the date it becomes vested over any amount paid by the recipient in exchange for the stock. A recipient may, however, file an election with the Internal Revenue Service, within 30 days following his or her receipt of the stock award, to recognize ordinary income, as of the date the recipient receives the award, equal to the excess, if any, of the fair market value of the stock on the date the award is granted over any amount paid by the recipient for the stock.

The recipient s basis for the determination of gain or loss upon the subsequent disposition of shares acquired from a restricted stock award will be the amount paid for such shares plus any ordinary income recognized either when the stock is received or when the stock becomes vested.

Subject to the requirement of reasonableness, the provisions of Section 162(m) of the Code and the satisfaction of our tax reporting obligation, we will generally be entitled to a tax deduction equal to the taxable ordinary income realized by the recipient of the restricted stock award.

Restricted Stock Unit Awards

Generally, the recipient of a restricted stock unit award structured to comply with the requirements of Section 409A of the Code or an exemption to Section 409A of the Code will recognize ordinary income at the time the stock is delivered equal to the excess, if any, of the fair market value of the stock received over any amount paid by the recipient in exchange for the stock. To comply with the requirements of Section 409A of the Code, the stock subject to a restricted stock unit award may generally only be delivered upon one of the following events: a fixed calendar date (or dates), separation from service, death, disability or a change in control. If delivery occurs on another date, unless the restricted stock unit award otherwise complies with or qualifies for an exemption to the requirements of Section 409A of the Code, in addition to the tax treatment described above, the recipient will owe an additional 20% federal tax and interest on any taxes owed.

The recipient s basis for the determination of gain or loss upon the subsequent disposition of shares acquired from a restricted stock unit award will be the amount paid for such shares plus any ordinary income recognized when the stock is delivered.

Subject to the requirement of reasonableness, the provisions of Section 162(m) of the Code and the satisfaction of our tax reporting obligation, we will generally be entitled to a tax deduction equal to the taxable ordinary income realized by the recipient of the restricted stock unit award.

Stock Appreciation Rights

Generally, if a stock appreciation right is granted with an exercise price equal to the fair market value of the underlying stock on the grant date, the recipient will recognize ordinary income equal to the fair market value of the stock or cash received upon such exercise. Subject to the requirement of reasonableness, the provisions of Section 162(m) of the Code, and the satisfaction of our tax reporting obligation, we will generally be entitled to a tax deduction equal to the taxable ordinary income realized by the recipient of the stock appreciation right.

Section 162(m) Limitations

Section 162(m) of the Code disallows a deduction to any publicly held corporation and its affiliates for certain compensation paid to covered employees in a taxable year to the extent that compensation paid to a covered employee exceeds $1 million. As a result, compensation (including compensation pursuant to awards granted under the 2018 EIP) paid to any of our covered employees under Section 162(m) of the Code in excess of $1 million per taxable year generally will not be deductible.

New Plan Benefits under 2018 EIP

Name and Position	Number of Shares
Eddie Gray[(1)] CEO and Director	
Michael S. Ostrach[(1)] Senior Vice President, Chief Financial Officer and Chief Business Officer	
Robert L. Coffman, Ph.D.[(1)] Senior Vice President and Chief Scientific Officer	
Robert Janssen, M.D.[(1)] Chief Medical Officer and Senior Vice President, Clinical Development, Medical and Regulatory Affairs	
David F. Novack[(1)] Senior Vice President, Operations and Quality	
All current executive officers as a group[(1)]	
All current directors who are not executive officers as a group[(2)]	105,000 per calendar year
All employees, including all current officers who are not executive officers, as a group[(1)]	

(1) Awards granted under the 2018 EIP to our executive officers and other employees are discretionary and are not subject to set benefits or amounts under the terms of the 2018 EIP, and our Board and our Compensation Committee have not granted any awards under the 2018 EIP subject to stockholder approval of this Proposal 2. Accordingly, the benefits or amounts that will be received by or allocated to our executive officers and other employees under the 2018 EIP, as well as the benefits or amounts which would have been received by or allocated to our executive officers and other employees for fiscal year 2017 if the 2018 EIP had been in effect, are not determinable.

(2) Awards granted under the 2018 EIP to our non-employee directors are discretionary and are not subject to set benefits or amounts under the terms of the 2018 EIP. However, pursuant to our current compensation program for non-employee directors, each of our current non-employee directors (except Dr. Plotkin, who has advised the Board of his decision to retire effective as of the date of the Annual Meeting) is eligible to receive an annual grant of a stock option to purchase 15,000 shares of our common stock. On and after the date of the Annual Meeting, any such stock options will be granted under the 2018 EIP if this Proposal 2 is approved by our stockholders. For additional information regarding our current compensation program for non-employee directors, please see Director Compensation below.

Vote Required

The affirmative vote of the holders of a majority of shares present (either in person or by proxy) and cast at the Annual Meeting (i.e., representing the majority voting power) will be required to approve this Proposal 2. Abstentions will be counted toward the tabulation of votes cast on proposals presented to the stockholders and will have the same effect as negative votes. Broker non-votes are counted towards a quorum but are not counted for any purpose in determining whether this Proposal 2 has been approved.

The Board Of Directors Recommends

A Vote In Favor Of Proposal 2.

PROPOSAL 3

APPROVAL OF AN AMENDMENT AND RESTATEMENT OF THE 2014 EMPLOYEE STOCK PURCHASE PLAN

The Board is requesting stockholder approval of an amendment and restatement of the Dynavax Technologies Corporation 2014 Employee Stock Purchase Plan (the 2014 ESPP). We refer to such amendment and restatement of the 2014 ESPP in this proxy statement as the Amended 2014 ESPP .

The Amended 2014 ESPP contains the following material change from the 2014 ESPP:

- Subject to adjustment for certain changes in our capitalization, the maximum number of shares of our common stock that may be issued under the Amended 2014 ESPP will be 850,000 shares, which is an increase of 600,000 shares over the maximum number of shares of our common stock that may be issued under the 2014 ESPP.

Approval of the Amended 2014 ESPP will allow us to continue to provide our employees with the opportunity to acquire an ownership interest in the Company through their participation in the Amended 2014 ESPP, thereby encouraging them to remain in our service and more closely aligning their interests with those of our stockholders.

If this Proposal 3 is approved by our stockholders, an additional 600,000 shares of our common stock will be available for issuance under the Amended 2014 ESPP. As of April 9, 2018, a total of 40,439 shares of our common stock remained available for issuance under the 2014 ESPP. We do not maintain any other employee stock purchase plans. As of April 9, 2018, a total of 62,255,860 shares of our common stock were outstanding.

Summary of the Amended 2014 ESPP

A summary of the principal features of the Amended 2014 ESPP follows below. The summary is qualified by the full text of the Amended 2014 ESPP that is attached as Appendix B to this proxy statement.

Purpose

The purpose of the Amended 2014 ESPP is to provide a means by which our employees may be given an opportunity to purchase shares of our common stock, to assist us in retaining the services of our employees, to secure and retain the services of new employees and to provide incentives for such persons to exert maximum efforts for our success. The rights to purchase common stock granted under the Amended 2014 ESPP are intended to qualify as options issued under an employee stock purchase plan as that term is defined in Section 423(b) of the Internal Revenue Code of 1986, as amended (the Code).

Administration

The Board has the power to administer the Amended 2014 ESPP and may also delegate administration of the Amended 2014 ESPP to a committee comprised of one or more members of the Board. The Board has delegated administration of the Amended 2014 ESPP to the Compensation Committee, but may, at any time, revest in itself some or all of the powers previously delegated to the Compensation Committee. Each of the Board and the Compensation Committee is considered to be a Plan Administrator for purposes of this Proposal 3. The Plan Administrator has the power to construe and interpret both the Amended 2014 ESPP and the rights granted under it. The Plan Administrator has the power, subject to the provisions of the Amended 2014 ESPP, to determine when and how rights to purchase our common stock will be granted, the provisions of each offering of such rights (which need not be identical), and whether employees of any of our parent or subsidiary companies will be eligible to participate in the Amended 2014 ESPP.

Stock Subject to Amended 2014 ESPP

Subject to adjustment for certain changes in our capitalization, the maximum number of shares of our common stock that may be issued under the Amended 2014 ESPP is 850,000 shares, which is equal to the sum of (i) 50,000 shares that were approved at our 2014 annual meeting of stockholders, (ii) an additional 200,000 shares that were approved at our 2016 annual meeting of stockholders, and (iii) an additional 600,000 shares that are subject to approval by our stockholders under this Proposal 3. If any rights granted under the Amended 2014 ESPP terminate without being exercised in full, the shares of common stock not purchased under such rights again become available for issuance under the Amended 2014 ESPP. The shares of common stock purchasable under the Amended 2014 ESPP will be shares of authorized but unissued or reacquired common stock, including shares repurchased by us on the open market.

Offerings

The Amended 2014 ESPP will be implemented by offerings of rights to purchase our common stock to all eligible employees. The Plan Administrator will determine the duration of each offering period, provided that in no event may an offering period exceed 27 months. The Plan Administrator may establish separate offerings which vary in terms (although not inconsistent with the provisions of the Amended 2014 ESPP or the requirements of applicable laws). Each offering period will have one or more purchase dates, as determined by the Plan Administrator prior to the commencement of the offering period. The Plan Administrator has the authority to alter the terms of an offering prior to the commencement of the offering period, including the duration of subsequent offering periods. When an eligible employee elects to join an offering period, he or she is granted a right to purchase shares of our common stock on each purchase date within the offering period. On the purchase date, all contributions collected from the participant are automatically applied to the purchase of our common stock, subject to certain limitations (which are described further below under Eligibility).

The Plan Administrator has the discretion to structure an offering so that if the fair market value of our common stock on the first trading day of a new purchase period within the offering period is less than or equal to the fair market value of our common stock on the first day of the offering period, then that offering will terminate immediately as of that first trading day, and the participants in such terminated offering will be automatically enrolled in a new offering beginning on the first trading day of such new purchase period.

Eligibility

Any individual who is employed by us (or by any of our parent or subsidiary companies if such company is designated by the Plan Administrator as eligible to participate in the Amended 2014 ESPP) may participate in offerings under the Amended 2014 ESPP, provided such individual has been employed by us (or our parent or subsidiary, if applicable) for such continuous period preceding the first day of the offering period as the Plan Administrator may require, but in no event may the required period of continuous employment be equal to or greater than two years. In addition, the Plan Administrator may provide that an employee will not be eligible to be granted purchase rights under the Amended 2014 ESPP unless such employee is customarily employed for more than 20 hours per week and more than five months per calendar year. The Plan Administrator may also provide in any offering that certain of our employees who are highly compensated as defined in the Code are not eligible to participate in the Amended 2014 ESPP.

No employee will be eligible to participate in the Amended 2014 ESPP if, immediately after the grant of purchase rights, the employee would own, directly or indirectly, stock possessing 5% or more of the total combined voting power or value of all classes of our stock or of any of our parent or subsidiary companies, including any stock which such employee may purchase under all outstanding purchase rights and options. In addition, no employee may purchase more than $25,000 worth of our common stock (determined based on the fair market value of the shares at the time such rights are granted) under all our employee stock purchase plans and any employee stock purchase plans of our parent or subsidiary companies for each calendar year during which such rights are outstanding.

As of April 9, 2018, we had approximately 213 employees.

Participation in the Amended 2014 ESPP

An eligible employee may enroll in the Amended 2014 ESPP by delivering to us, within the time specified in the offering, an enrollment form authorizing contributions as specified by the Plan Administrator, which may be up to 10% of such employee s earnings during the offering period. Each participant will be granted a separate purchase right for each offering in which he or she participates. Unless an employee s participation is discontinued, his or her purchase right will be exercised automatically at the end of each purchase period at the applicable purchase price.

Purchase Price

The purchase price per share at which shares of our common stock are acquired pursuant to purchase rights on each purchase date during an offering period will not be less than the lower of (i) 85% of the fair market value of a share of our common stock on the first day of the offering period or (ii) 85% of the fair market value of a share of our common stock on the applicable purchase date.

As of April 9, 2018, the closing price of our common stock as reported on the Nasdaq Capital Market was $18.60 per share.

Payment of Purchase Price; Payroll Deductions

The purchase of shares during an offering period generally will be funded by a participant s payroll deductions accumulated during the offering period. A participant may change his or her rate of contributions, if and as permitted in the offering. All contributions made for a participant are credited to his or her account under the Amended 2014 ESPP and deposited with our general funds.

Purchase Limits

In connection with each offering made under the Amended 2014 ESPP, the Plan Administrator may specify (i) a maximum number of shares of our common stock that may be purchased by any participant pursuant to such offering, (ii) a maximum number of shares of our common stock that may be purchased by any participant on any purchase date pursuant to such offering, (iii) a maximum aggregate number of shares of our common stock that may be purchased by all participants pursuant to such offering, and/or (iv) a maximum aggregate number of shares of our common stock that may be purchased by all participants on any purchase date pursuant to such offering. If the aggregate purchase of shares of our common stock issuable upon exercise of purchase rights granted under such offering would exceed any such maximum aggregate number, then, in the absence of any action by the Plan Administrator otherwise, a pro rata allocation of available shares of our common stock will be made in as nearly a uniform manner as will be practicable and equitable.

Withdrawal

Participants may withdraw from a given offering by delivering a withdrawal form to us and terminating their contributions. Such withdrawal may be elected at any time prior to the end of an offering, except as otherwise provided by the Plan Administrator. Upon such withdrawal, we will distribute to the employee his or her accumulated but unused contributions without interest, and such employee s right to participate in that offering will terminate. However, an employee s withdrawal from an offering does not affect such employee s eligibility to participate in subsequent offerings under the Amended 2014 ESPP.

Termination of Employment

Except as required by law, a participant s outstanding purchase rights under any offering under the Amended 2014 ESPP will terminate immediately upon either (i) termination of the participant s employment with us (or any of our parent or subsidiary companies if such company is designated by the Plan Administrator as eligible to participate in the Amended 2014 ESPP) or (ii) any other circumstance or event that causes the participant to no longer be eligible to participate in the offering. In such event, we will distribute to the participant his or her accumulated but unused contributions without interest.

Restrictions on Transfer

Rights granted under the Amended 2014 ESPP are not transferable except by will, the laws of descent and distribution, or, if permitted by us, by a beneficiary designation. During the lifetime of the participant, such rights may only be exercised by the participant.

Changes in Capitalization

In the event of certain changes in our capitalization, the Plan Administrator will appropriately and proportionately adjust: (i) the class(es) and maximum number of securities subject to the Amended 2014 ESPP; (ii) the class(es) and number of securities subject to, and the purchase price applicable to outstanding offerings and purchase rights; and (iii) the class(es) and number of securities that are the subject of the purchase limits under each ongoing offering.

Effect of Certain Corporate Transactions

In the event of a corporate transaction (as defined in the Amended 2014 ESPP and described below), each outstanding purchase right under the Amended 2014 ESPP will be assumed or continued or a similar right will be substituted for such purchase right by the surviving or acquiring corporation (or its parent or subsidiary), unless the Plan Administrator determines to shorten any offering periods then in progress by setting a new purchase date prior to the corporate transaction. If the Plan Administrator sets such a new purchase date, then the Plan Administrator will notify each participant in writing at least 10 business days prior to the new purchase date that the purchase date for the participant s outstanding purchase rights has been changed to such new purchase date and that either: (i) the participant s outstanding purchase rights will be exercised automatically on such new purchase date, unless the participant withdraws from the applicable offering prior to such new purchase date, and such purchase rights will terminate immediately after such exercise; or (ii) in lieu of such exercise, we will pay to the participant on such new purchase date an amount in cash, cash equivalents, or property as determined by the Plan Administrator that is equal to the difference in the fair market value of the shares of common stock subject to the participant s outstanding purchase rights on such new purchase date and the applicable exercise price due had such purchase rights been exercised automatically on such new purchase date, and such purchase rights will terminate immediately after such payment.

For purposes of the Amended 2014 ESPP, a corporate transaction generally will be deemed to occur in the event of the consummation of: (i) a merger or consolidation in which we are not the surviving entity, except for a transaction the principal purpose of which is to change the state in which we are incorporated; (ii) the sale, transfer or other disposition of all or substantially all of our assets (including the capital stock of our subsidiary corporations); (iii) our complete liquidation or dissolution; (iv) any reverse merger or series of related transactions culminating in a reverse merger (including, but not limited to, a tender offer followed by a reverse merger) in which we are the surviving entity but in which securities possessing more than 40% of the total combined voting power of our outstanding securities are transferred to a person or persons different from those who held such securities immediately prior to such merger or the initial transaction culminating in such merger but excluding any such transaction or series of related transactions that the Plan Administrator determines will not be a corporate transaction; or (v) acquisition in a single or series of related transactions by any person or related group of persons (other than us or by an employee benefit plan sponsored by us) of beneficial ownership of securities possessing more than 50% of the total combined voting power of our outstanding securities but excluding any such transaction or series of related transactions that the Plan Administrator determines will not be a corporate transaction.

Duration, Amendment and Termination

The Board (or a committee of one or more directors delegated by the Board) may amend, suspend or terminate the Amended 2014 ESPP at any time. However, except in regard to certain capitalization adjustments, any amendment must be approved by our stockholders if such approval is required by applicable law or listing requirements.

Any outstanding purchase rights granted before an amendment, suspension or termination of the Amended 2014 ESPP will not be materially impaired by any such amendment, suspension or termination, except (i) with the consent of the employee to whom such purchase rights were granted, (ii) as necessary to comply with any laws, listing requirements or governmental regulations (including Section 423 of the Code), or (iii) as necessary to obtain or maintain favorable tax, listing or regulatory treatment.

Federal Income Tax Information

The following is a summary of the principal United States federal income taxation consequences to participants and us with respect to participation in the Amended 2014 ESPP. This summary is not intended to be exhaustive and does not discuss the income tax laws of any local, state or foreign jurisdiction in which a participant may reside. The information is based upon current federal income tax rules and therefore is subject to change when those rules change. Because the tax consequences to any participant may depend on his or her particular situation, each participant should consult the participant s tax adviser regarding the federal, state, local, and other tax consequences of the grant or exercise of an option or the disposition of common stock acquired under the Amended 2014 ESPP. The Amended 2014 ESPP is not qualified under the provisions of Section 401(a) of the Code and is not subject to any of the provisions of the Employee Retirement Income Security Act of 1974, as amended.

Rights granted under the Amended 2014 ESPP are intended to qualify for favorable federal income tax treatment associated with rights granted under an employee stock purchase plan which qualifies under the provisions of Section 423 of the Code.

A participant will be taxed on amounts withheld for the purchase of shares of our common stock as if such amounts were actually received. Otherwise, no income will be taxable to a participant as a result of the granting or exercise of a purchase right until a sale or other disposition of the acquired shares. The taxation upon such sale or other disposition will depend upon the holding period of the acquired shares.

If the shares are sold or otherwise disposed of more than two years after the beginning of the offering period and more than one year after the shares are transferred to the participant, then the lesser of the following will be treated as ordinary income: (i) the excess of the fair market value of the shares at the time of such sale or other disposition over the purchase price; or (ii) the excess of the fair market value of the shares as of the beginning of the offering period over the purchase price (determined as of the beginning of the offering period). Any further gain or any loss will be taxed as a long-term capital gain or loss.

If the shares are sold or otherwise disposed of before the expiration of either of the holding periods described above, then the excess of the fair market value of the shares on the purchase date over the purchase price will be treated as ordinary income at the time of such sale or other disposition. The balance of any gain will be treated as capital gain. Even if the shares are later sold or otherwise disposed of for less than their fair market value on the purchase date, the same amount of ordinary income is attributed to the participant, and a capital loss is recognized equal to the difference between the sales price and the fair market value of the shares on such purchase date. Any capital gain or loss will be short-term or long-term, depending on how long the shares have been held.

There are no federal income tax consequences to us by reason of the grant or exercise of rights under the Amended 2014 ESPP. We are entitled to a deduction to the extent amounts are taxed as ordinary income to a participant for shares sold or otherwise disposed of before the expiration of the holding periods described above (subject to the requirement of reasonableness and the satisfaction of tax reporting obligations).

Plan Benefits under 2014 ESPP

The following table sets forth, for each of the individuals and various groups indicated, the total number of shares of our common stock that have been purchased under the 2014 ESPP as of April 9, 2018.

2014 ESPP

Name and Position	Number of Shares
Eddie Gray CEO and Director	
Michael S. Ostrach Senior Vice President, Chief Financial Officer and Chief Business Officer	
Robert L. Coffman, Ph.D. Senior Vice President and Chief Scientific Officer	
Robert Janssen, M.D. Chief Medical Officer and Senior Vice President, Clinical Development, Medical and Regulatory Affairs	
David F. Novack Senior Vice President, Operations and Quality	1,171
All current executive officers as a group	1,171
All current directors who are not executive officers as a group	
Each nominee for election as a director:	
Arnold L. Oronsky, Ph.D.	
Francis R. Cano, Ph.D.	
Peggy V. Phillips	
Each associate of any executive officers, current directors or director nominees	
Each other person who received or is to receive 5% of purchase rights	
All employees, including all current officers who are not executive officers, as a group	208,390

New Plan Benefits under Amended 2014 ESPP

Participation in the Amended 2014 ESPP is voluntary and each eligible employee will make his or her own decision regarding whether and to what extent to participate in the Amended 2014 ESPP. In addition, we have not approved any grants of purchase rights that are conditioned on stockholder approval of this Proposal 3. Accordingly, we cannot determine the benefits or amounts that will be received in the future by individual employees or groups of employees under the Amended 2014 ESPP. Our non-employee directors will not be eligible to participate in the Amended 2014 ESPP.

Vote Required

The affirmative vote of the holders of a majority of shares present (either in person or by proxy) and cast at the Annual Meeting (i.e., representing the majority voting power) will be required to approve this Proposal 3. Abstentions will be counted toward the tabulation of votes cast on proposals presented to the stockholders and will have the same effect as negative votes. Broker non-votes are counted towards a quorum but are not counted for any purpose in determining whether this Proposal 3 has been approved.

THE BOARD OF DIRECTORS RECOMMENDS

A VOTE IN FAVOR OF PROPOSAL 3.

PROPOSAL 4

ADVISORY VOTE ON EXECUTIVE COMPENSATION

In accordance with SEC rules, Dynavax stockholders are being asked to approve, on an advisory basis, the compensation of our named executive officers as disclosed in this proxy statement, which is commonly referred to as a say-on-pay vote. This vote is not intended to address any specific item of compensation, but rather the overall compensation of our named executive officers, which results from our compensation philosophy, policies and practices as discussed in this proxy statement. The compensation of our named executive officers subject to the say-on-pay vote is described in the Compensation Discussion and Analysis, the accompanying tables, and the related narrative disclosure contained in this proxy statement.

Our Compensation Committee is responsible for designing and administering our executive compensation programs. Our Compensation Committee firmly believes that Dynavax s executive compensation programs should reward our named executive officers for performance, and that when key performance objectives are not achieved, the compensation of our named executive officers should reflect as much. We believe that the compensation of our named executive officers, as disclosed in this proxy, reflects this philosophy. In addition, our Compensation Committee believes that the compensation programs for our named executive officers have been instrumental in helping Dynavax be able to attract, retain and motivate our executive team, thereby enabling our Company to be in a position to move forward with our business strategy.

Our Board of Directors is now asking our stockholders to indicate their support for the compensation of our named executive officers as described in this proxy statement by casting a non-binding advisory vote For the following resolution:

RESOLVED, that the compensation paid to Dynavax s named executive officers, as disclosed pursuant to Item 402 of Regulation S-K, including the Compensation Discussion and Analysis, compensation tables and narrative discussion, is hereby APPROVED.

Although this vote is advisory and the outcome is not binding on our Board of Directors, the views expressed by our stockholders, whether through this vote or otherwise, are important to us. As a result, the Board of Directors and the Compensation Committee will carefully review the results of this vote, and they will consider these results in making future decisions about our executive compensation programs and arrangements.

Unless our Board of Directors modifies its policy on the frequency of future advisory votes on the compensation of our named executive officers, the next advisory vote on the compensation of our named executive officers will be held at the 2019 annual meeting of stockholders.

Approval of this advisory proposal requires the affirmative vote of the holders of a majority of shares present (either in person or by proxy) and cast at the Annual Meeting (i.e., representing the majority voting power). Abstentions will be counted toward the tabulation of votes cast on proposals presented to the stockholders and will have the same effect as negative votes. Broker non-votes are counted towards a quorum but are not counted for any purpose in determining whether this Proposal 4 has been approved.

THE BOARD OF DIRECTORS RECOMMENDS

A VOTE IN FAVOR OF PROPOSAL 4.

PROPOSAL 5

RATIFICATION OF SELECTION OF

INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Audit Committee has selected Ernst & Young LLP, or Ernst & Young, as our independent registered public accounting firm for the fiscal year ending December 31, 2018. Ernst & Young has audited our financial statements since 2002. Representatives of Ernst & Young are expected to be present at the Annual Meeting. Ernst & Young will have an opportunity to make a statement if it so desires and will be available to respond to appropriate questions.

If the stockholders fail to ratify the selection of Ernst & Young, the Audit Committee will reconsider whether or not to retain that firm. Even if the selection is ratified, the Audit Committee in its discretion may direct the appointment of a different independent registered public accounting firm at any time during the year if it determines that such a change would be in the best interests of the Company and its stockholders.

The affirmative vote of the holders of a majority of the shares present (either in person or by proxy) and cast at the Annual Meeting (i.e., representing the majority voting power) will be required to ratify the selection of Ernst & Young. Abstentions will be counted toward the tabulation of votes cast on proposals presented to the stockholders and will have the same effect as negative votes. Broker non-votes are counted towards a quorum but are not counted for any purpose in determining whether this matter has been approved; however, Proposal 5 is considered a routine matter, and therefore no broker non-votes are expected to exist in connection with this Proposal 5.

THE BOARD OF DIRECTORS RECOMMENDS

A VOTE IN FAVOR OF PROPOSAL 5.

AUDIT FEES

In connection with the audit of our 2017 financial statements, we entered into an engagement agreement with Ernst & Young which sets forth the terms by which Ernst & Young will perform audit services for us.

The following table represents aggregate fees billed to the Company for the fiscal years ended December 31, 2017 and 2016 by Ernst & Young, our principal auditors. The Audit Committee pre-approved all service fees described below.

	Fiscal Year Ended	
	2017	**2016**
Audit Fees[(1)]	$ 1,203,801	$ 1,300,804
Audit Related Fees		
Tax Fees[(2)]	40,500	
All Other Fees[(3)]	1,995	1,995
Total Fees	$ 1,246,296	$ 1,302,799

(1) Audit fees include fees for the audit of our consolidated financial statements and interim reviews of our quarterly financial statements, including compliance with the provisions of Section 404 of the Sarbanes-Oxley Act as well as fees related to registration statements, consents and other services related to SEC matters. In each of 2016 and 2017, audit fees included fees related to a comfort letter in connection with an equity offering.

(2) Tax fees include Section 382 study.

(3) All other fees represent subscription fees for an online accounting research tool and related database.

Pre-approval Policies And Procedures

Our Audit Committee has adopted a policy and procedures for the pre-approval of audit and non-audit services rendered by our independent registered public accounting firm, Ernst & Young. Under the policy, the Audit Committee pre-approves specified services in the defined categories of audit services, audit-related services, tax services and all other services up to specified amounts. Pre-approval may be given as part of the Audit Committee s approval of the scope of the engagement of the independent registered public accounting firm or on an interim basis by the Audit Committee Chair, as needed and on a case-by-case basis before the independent registered public accounting firm is engaged to provide each service.

The Audit Committee has determined that services rendered by Ernst & Young are compatible with maintaining the principal auditors independence.

EXECUTIVE OFFICERS

The following table sets forth certain information with respect to our executive officers as of April 9, 2018:

Name	Age	Position
Eddie Gray[(1)]	59	Chief Executive Officer and Director
Michael S. Ostrach	66	Senior Vice President, Chief Financial Officer and Chief Business Officer
Robert L. Coffman, Ph.D.	71	Senior Vice President and Chief Scientific Officer
Robert Janssen, M.D.	64	Chief Medical Officer and Senior Vice President, Clinical Development, Medical and Regulatory Affairs
David F. Novack	56	Senior Vice President, Operations and Quality

(1) Please see Class I Directors Continuing In Office Until the 2019 Annual Meeting in this proxy statement for more information about Mr. Gray.

Michael S. Ostrach Senior Vice President, Chief Financial Officer and Chief Business Officer

Mr. Ostrach is our Senior Vice President, Chief Financial Officer and Chief Business Officer. Mr. Ostrach joined Dynavax in October 2006 as Vice President, Chief Business Officer and General Counsel, and became Principal Financial Officer in September 2013, Chief Financial Officer in March 2015 and Senior Vice President in February 2016. Mr. Ostrach held the position of Dynavax s General Counsel from October 2006 to September 2015. From 2005 to 2006, he was Chief Operating Officer, Chief Financial Officer and General Counsel at Threshold Pharmaceuticals. From 1997 to 2004, Mr. Ostrach was at Kosan Biosciences, most recently as President and Chief Operating Officer. Mr. Ostrach began his corporate career at Cetus Corporation, where he served in several capacities between 1981 and 1991, initially as General Counsel and finally as Senior Vice President of Corporate Affairs and General Counsel. Following the acquisition of Cetus by Chiron Corporation in 1991, Mr. Ostrach became President of Chiron Technologies. He holds a B.A. from Brown University and a J.D. from Stanford Law School.

Robert L. Coffman, Ph.D. Senior Vice President and Chief Scientific Officer

Dr. Coffman was appointed Senior Vice President and Chief Scientific Officer of Dynavax in February 2014, and prior to that he was Vice President and Chief Scientific Officer of Dynavax since December 2000. Prior to joining Dynavax in 2000, Dr. Coffman was a founding member of the DNAX Research Institute in Palo Alto, California. Dr. Coffman has authored over 200 scientific publications, is a member of the National Academy of Sciences and the American Academy of Microbiology, and has received a number of prestigious awards for his work. With colleague Dr. Tim Mosmann, he defined the two principal subtypes of helper T cells, termed Th1 and Th2 cells, and demonstrated the central relationship between their differences in cytokine expression and function. Dr. Coffman defined basic mechanisms of T-cell regulation in asthma and infectious and parasitic diseases, and demonstrated the central role of regulatory CD4+ T cells in preventing inflammatory bowel disease. At Dynavax, Dr. Coffman has pioneered the development of agonists and antagonists for Toll-Like Receptors (TLRs), key recognition receptors in innate immunity. Dr. Coffman received an A.B. in Microbiology from Indiana University and a Ph.D. in Immunology from the University of California, San Diego.

Robert Janssen, M.D. Chief Medical Officer and Senior Vice President, Clinical Development, Medical and Regulatory Affairs

Dr. Janssen was appointed Chief Medical Officer and Senior Vice President, Clinical Development, Medical and Regulatory Affairs in January 2018. Dr. Janssen was appointed Chief Medical Officer and Vice President, Clinical Development and Regulatory Affairs in July 2013. He served as Dynavax s Vice President, Medical Affairs since November 2012 and was previously Senior Director, Clinical Development at Dynavax from 2010 through 2012, during which time he was extensively involved with Phase 3 clinical development of HEPLISAV-B and its

U.S. and European licensing applications. Prior to joining Dynavax, Dr. Janssen was Vice President, Medical Affairs at Gilead from 2008 to 2010 where he was responsible for oversight of physician and health care provider education focused on HIV and hepatitis B therapies. Until 2008, Dr. Janssen spent 23 years at the U.S. Centers for Disease Control and Prevention (CDC), most recently as the Director of the Division of HIV/AIDS Prevention from 2000 to 2008. Under his leadership, the CDC first explored HIV treatment as a mode of HIV prevention and launched several of the earliest Phase 3 trials of pre-exposure prophylaxis for HIV. Dr. Janssen received a Bachelor of Arts degree with Honors in Humanities from Stanford University and his M.D. degree from the University of Southern California. He is a neurologist with training in virology received at the University of Pennsylvania. Dr. Janssen has been the beneficiary of numerous honors and awards during his career. He has published over 130 scientific articles in a variety of journals and has served as a reviewer for leading scientific journals.

David F. Novack Senior Vice President, Operations and Quality

Mr. Novack joined Dynavax in March 2013 as Senior Vice President, Operations and Quality. Mr. Novack was formerly with Novartis Vaccines & Diagnostics where he served since 2009 as the Global Head of Technical Operations and Supply Chain for Diagnostics and previously from 2007 to 2009 as the Global Head of Vaccine Manufacturing Strategy. Prior to Novartis, Mr. Novack was the Vice President, Business Development for Vaxin, Inc., a vaccine company, from 2004 to 2006. From 1993 until 2004, Mr. Novack worked at MedImmune, formerly Aviron, serving in several capacities including business development, manufacturing, contract operations and most recently as Senior Director, Supply Chain Operations. Previously, from 1989 to 1993, Mr. Novack was with American Cyanamid Company in various roles. Mr. Novack received a B.S. in Biology from State University of New York and an M.B.A. from Columbia University.

Compensation Discussion And Analysis

Overview

This Compensation Discussion and Analysis discusses our executive compensation philosophy and practices and provides an overview of the Compensation Committee s 2017 decisions for the following named executive officers (NEOs) whose compensation is set forth in the Summary Compensation Table and other related tables contained in this proxy statement:

- Eddie Gray, Chief Executive Officer and Director;
- Michael S. Ostrach, Senior Vice President, Chief Financial Officer and Chief Business Officer;
- Robert L. Coffman, Ph.D., Senior Vice President and Chief Scientific Officer;
- Robert Janssen, M.D., Chief Medical Officer and Senior Vice President, Clinical Development, Medical and Regulatory Affairs; and
- David F. Novack, Senior Vice President, Operations and Quality.

We present this Compensation Discussion and Analysis in the following sections:

Executive Summary

Business Overview, Corporate Developments in 2017 and Early 2018 and Relationship to Executive Compensation

We are now a fully-integrated biopharmaceutical company focused on leveraging the power of the body s innate and adaptive immune responses through toll-like receptor (TLR) stimulation. Our first commercial product, HEPLISAV-B® (Hepatitis B Vaccine (Recombinant), Adjuvanted), was approved by the United States Food and Drug Administration (FDA) in November 2017 for prevention of infection caused by all known subtypes of hepatitis B virus in adults age 18 years and older. We commenced commercial shipments of HEPLISAV-B in January 2018. Our development efforts are primarily focused on stimulating the innate immune response to treat cancer in combination with other immunomodulatory agents. Our lead investigational immuno-oncology products are SD-101, currently being evaluated in Phase 2 clinical studies, and DV281, in a Phase 1 safety study. Given the nature of our Company, we believe delivery of long term value to our stockholders is the best measure of our performance.

Heading into 2017, we had diversified our portfolio such that our focus for the year was balanced between obtaining FDA approval of HEPLISAV-B and advancing our oncology program. As a result of this diversification, we viewed our success in 2017 and beyond as being based on our progress regarding HEPLISAV-B and our oncology program. Thus, we designed our 2017 executive compensation program to reward achievement of the specific related objectives we believed would advance our business strategy and create long-term value for our stockholders. In particular, our 2017 annual incentive program was aligned with our corporate objectives by selecting corporate goals as follows:

- Commercialization goals for HEPLISAV-B were weighted at 35%,
- Objectives specific to advancing our oncology pipeline were weighted at 55%, and
- Business plan goals that supported advancing our business and portfolio strategies were weighted at 10%.

Our NEOs were focused on executing our business strategy of transforming the Company into a commercial organization by obtaining FDA approval of HEPLISAV-B and successfully launching it, advancing a robust pipeline of immuno-oncology clinical stage development programs and discovering other cutting edge TLR-based vaccines and immunotherapies. The positive developments in late 2016 regarding oncology coupled with the receipt of a Complete Response Letter (CRL) from the FDA regarding HEPLISAV-B led us to reshape our business strategy in early 2017 to place greater emphasis on advancing our immuno-oncology program, while maintaining sufficient resources to advance HEPLISAV-B toward FDA approval in 2017.

2017 was a year of many positives for our Company, including our achievement of FDA approval of HEPLISAV-B, successful delivery of the corporate goals related to advancing our oncology programs and the achievement of the business plan goals that supported advancing our business and portfolio strategies. Key events that took place for our Company in 2017 are reflected below:

- On January 5, 2017, we announced that we were reshaping our strategy and operations to prioritize our emerging clinical and preclinical immuno-oncology portfolio. We implemented significant organizational restructuring and cost reductions to align around our immuno-oncology business, while allowing us to advance HEPLISAV-B through the FDA review process and an approval decision. To achieve these savings, we suspended manufacturing for HEPLISAV-B and reduced our global workforce by 38%, which resulted in approximately a 40% reduction in cash burn.
- On February 28, 2017, we announced that the FDA had accepted for review our responses to the CRL issued in November 2016 for the Biologics License Application (BLA) for HEPLISAV-B and that the FDA had established August 10, 2017 as the Prescription Drug User Fee Act (PDUFA) action date.
- On March 6, 2017, we announced encouraging data in patients with metastatic melanoma in the dose escalation phase of an ongoing Phase 1b/2 study investigating SD-101, our intratumoral TLR9 agonist, in combination with Keytruda® (pembrolizumab), Merck s anti-PD-1 treatment. The data was presented at the International Congress on Targeted Anticancer Therapies. Results evaluating 17 patients for efficacy and 22 patients for safety were reported.

On March 20, 2017, we announced upcoming data presentations on the following three programs based on stimulation of the immune response using TLR9 agonists at the 2017 American Association for Cancer Research Annual Meeting: (i) pharmacodynamic changes confirm the mechanism of action mediating SD-101 efficacy, in combination with pembrolizumab, in a phase 1b/2 study in metastatic melanoma, (ii) development of an inhaled TLR9 agonist for the immunotherapy of lung cancer and (iii) intratumoral administration of a TLR9-adjuvanted nanoparticle cancer vaccine stimulates more effective immunity in both injected and un-injected tumor sites compared to subcutaneous administration.

On April 3, 2017, we announced that the FDA had informed the Company that the Vaccines and Related Biological Products Advisory Committee (VRBPAC) would review HEPLISAV-B at its meeting scheduled for July 28, 2017. The PDUFA date remained unchanged.

On June 2, 2017, we announced the presentation of updated findings in patients with metastatic melanoma in the dose escalation phase of the ongoing Phase 1b/2 study investigating SD-101 in combination with Keytruda® (pembrolizumab). The data was presented at the 2017 American Society of Clinical Oncology Annual Meeting.

On July 28, 2017, we announced that the VRBPAC voted 12 to 1 that the safety data for HEPLISAV-B supports licensure for immunization against hepatitis B infection in adults 18 years of age and older. Three members of the panel abstained.

On August 3, 2017, we announced that the FDA had requested more detailed information about our proposed post-marketing study for HEPLISAV-B based on feedback received from the VRBPAC. The response to the information request triggered a major amendment to the BLA. The PDUFA date was updated and expected to be no later than November 10, 2017.

On August 15, 2017, we announced completion of an underwritten public offering of 5,750,000 shares of our common stock for net proceeds of approximately $80.8 million.

On October 19, 2017, we announced initiation of dosing in a phase 1B dose escalation clinical trial of our investigational inhaled TLR9 agonist, DV281, in patients with non-small cell lung cancer.

On November 9, 2017, we announced that the FDA approved HEPLISAV-B for prevention of infection caused by all known subtypes of hepatitis B virus in adults age 18 years and older.

On January 8, 2018, we announced HEPLISAV-B is now available in the United States for the prevention of hepatitis B in adults.

From January 3, 2017 to January 8, 2018, our closing stock price rose from $4.05 to $17.80.

Based on the decisions in early 2017 to restructure the Company and to not pay NEOs their 2016 annual cash incentive bonuses as well as not increase their base salaries, it was imperative to stabilize the business by retaining key talent, including our NEOs. Our Compensation Committee determined it was necessary to grant retention equity awards to maintain employee and management continuity while refocusing our strategic activities to prioritize our emerging clinical and preclinical immuno-oncology portfolio while still allowing us to advance HEPLISAV-B through the FDA review process and an approval decision. The provision of retention grants was consistent with feedback we received from stockholders during our outreach efforts regarding the importance of retaining key talent to support the long term success of the Company. To that end, in February 2017, the Compensation Committee determined that it was appropriate to approve special retention grants for certain employees, including our NEOs. The retention grants vest over two years, to link vesting with individuals leadership through a critical and transitional two-year period for the Company. We view the retention grants to NEOs as an exceptional event to meet the needs of our transition and path forward as a business. We continue to carefully evaluate our compensation arrangements to move our Company forward and ensure that our pay program aligns our executives compensation with our stockholders interests and our Company performance.

Compensation Governance Highlights

What we do	What we do not do
Design executive compensation program to align pay with performance	No excessive change in control or severance payments (no cash severance multiplier greater than 2x base + target bonus)
Majority of pay is variable and not guaranteed (over 80% for our CEO in 2017)	No repricing of underwater stock options without stockholder approval
Prohibit hedging and discourage pledging by executive officers and directors (no pledging in 2017)	No tax gross-ups
Grant equity awards with performance-based vesting	No perquisites
Conduct an annual say-on-pay vote	No guaranteed bonuses
Seek input from, listen to and respond to stockholders	

Consideration of Our Prior Say-on-Pay Votes and Related Stockholder Engagement

We held our first stockholder advisory vote on executive compensation, commonly referred to as a say-on-pay vote, at our 2011 stockholder annual meeting. At that meeting, over 99% of the shares that were voted on this proposal were cast in favor of our say-on-pay proposal. At that time, our stockholders also voted in favor of holding a say-on-pay vote once every three years and subsequently, our Board adopted a policy consistent with that preference. Accordingly, we held our second say-on-pay vote at our 2014 stockholder annual meeting and at that meeting, over 64% of the shares that were voted on this proposal were cast in favor of our say-on-pay proposal. In the absence of a say-on-pay vote in 2015, we received feedback from our stockholders on our executive compensation program in connection with the reelection of our Compensation Committee members, who each received support from approximately 69% of the shares cast. In February 2016, as part of a number of corporate governance improvements made in response to feedback from our stockholders and the proxy advisory firms, our Board of Directors adopted a policy changing the frequency of our say-on-pay vote from once every three years to every year and therefore we held a say-on-pay vote at our 2016 stockholder annual meeting and at that meeting, over 70% of the shares that were voted on this proposal were cast in favor of our say-on-pay proposal. Most recently, we held a say-on-pay vote at our 2017 stockholder annual meeting and at that meeting, over 86% of the shares that were voted on this proposal were cast in favor of our say-on-pay proposal.

Because of its importance, we continue to solicit feedback from our stockholders regarding our executive compensation program as part of our stockholder outreach. We consider the stockholder feedback process as being a year round activity. Thus, we obtained feedback from our stockholders in the spring of 2017, and will do so again in 2018, having already received feedback from several stockholders in 2018. As part of our annual stockholder feedback program, we contacted 17 of our largest stockholders in early spring 2018, and we spoke with 100% of the stockholders that wanted to provide us with feedback at that time. During these discussions we solicited feedback from our stockholders on our corporate governance and executive compensation practices. None of our stockholders expressed any concerns about our corporate governance or executive compensation practices. The bulk of the stockholders, while appreciating the outreach, did not feel a need to talk at the time.

Executive Compensation Program

Philosophy and Objectives

We believe our NEOs compensation should align our executives success with that of our stockholders over the long-term through achievement of strategic corporate objectives that are fundamental to our business model and that will create long-term stockholder value. Our executive compensation programs are designed to be competitive with our peer group to enable us to attract, motivate, reward, and retain outstanding talent. Our compensation programs are based on the following key principles:

- A significant component of pay is linked with performance and the achievement of our strategic goals.
- Alignment of our executives interests with those of our stockholders through equity compensation.
- Overall compensation that is competitive in the industry in which we compete for executive talent.
- Recognition of individual contributions, teamwork and corporate performance.

Compensation-Setting Process

Role of the Compensation Committee and Management

The Compensation Committee oversees and administers our executive compensation programs. The Compensation Committee acts pursuant to a charter adopted by our Board, which can be found at our website, www.dynavax.com. The Compensation Committee generally determines the compensation to be paid to the executive officers, including our NEOs. Either the compensation committee or the independent members of our Board, upon recommendation from the Compensation Committee, approve certain compensation of our CEO, and references in this Compensation Discussion and Analysis to our Board approving our CEO s compensation refer to the independent members of our Board.

The Compensation Committee (and the Board of Directors, with respect to our CEO) approves our corporate goals and the individual goals of our NEOs after considering the Company s recommendations on these matters. The Compensation Committee annually reviews the base salaries, cash incentives and equity compensation of our NEOs and periodically reviews other elements of our compensation. Compensation decisions are based primarily on the following:

- *Peer and Industry Data* The Compensation Committee uses peer and industry data provided by its consultant, Arnosti Consulting Inc. (Arnosti), as a reference in setting base salaries and target cash compensation, determining appropriate levels and mix of equity compensation and determining the type and portion of compensation tied to performance goals.
- *Annual Performance Reviews* The Chair of the Compensation Committee conducts annual performance reviews of our CEO taking into consideration feedback obtained during the course of the year from the independent members of our Board and the CEO s direct reports. Our CEO conducts and presents the performance reviews of the other NEOs to the Compensation Committee after the end of each fiscal year. In reviewing and determining the compensation of each NEO, the Compensation Committee also considers individual factors, such as: potential for future contributions to Company growth, industry experience and retention concerns.
- *CEO Recommendations* The Compensation Committee seeks input from our CEO for setting the salary and target cash compensation levels for the other NEOs, and also for purposes of setting annual performance metrics and target amounts under the Annual Incentive Program.

Role of Compensation Consultant

Arnosti was engaged by the Compensation Committee in 2010 as its independent compensation consultant. Since then, the Compensation Committee has met regularly with Arnosti, both with and without management present, depending upon the topic being discussed.

In February 2017 and again in January 2018, the Compensation Committee reviewed whether the work of Arnosti as a compensation consultant raised any conflict of interest, taking into consideration the following factors:

- The provision of other services to the Company;
- The amount of fees paid to Arnosti by the Company;
- Arnosti s policies and procedures that are designed to prevent conflicts of interest;
- Any business or personal relationship of Arnosti or the individual compensation advisors employed by Arnosti with an executive officer of the Company; and
- Any Company stock owned by Arnosti or the individual compensation advisors employed by Arnosti.

Based on the Compensation Committee s review of this information, it determined the work of Arnosti and the individual compensation advisors employed by Arnosti as compensation consultant to the Compensation Committee, did not create any conflict of interest. The Compensation Committee has the sole authority to direct, terminate or continue Arnosti s services, although the Company pays the cost for Arnosti s services.

In 2017, Arnosti provided advice to the Compensation Committee on several different aspects of its responsibilities related to our compensation programs and practices. Specifically, during 2017, Arnosti assisted the Compensation Committee as follows:

- Provided analyses and recommendation for NEO and VP retention;
- Reviewed and analyzed compensation levels of our NEOs in comparison to those of our peer companies;
- Provided general information concerning executive compensation trends and developments;
- Provided recommendations to the Compensation Committee on refining our peer group;
- Provided an assessment of the annual meeting voting results;
- Provided the Board with a review of competitive data from the peer group on Board compensation; and
- Reviewed the Compensation Discussion and Analysis for inclusion in our proxy statement.

2017 Peer Group

Our Compensation Committee uses a peer group for a general understanding of market compensation practices and our positioning within the peer group. Our Compensation Committee believes that over-reliance on benchmarking could result in compensation that is unrelated to the value delivered by the NEOs because compensation benchmarking does not take the specific performance of the NEOs, or the performance of the Company, into account.

Our Compensation Committee does not have a specific target compensation level for the NEOs or otherwise use a formulaic approach to setting pay at a particular positioning within the market data; rather, the Compensation Committee reviews a range of market data reference points of the Company s peer group with respect to total target cash compensation (including both base salary and the annual target performance bonus) and equity compensation (valued based on an approximation of grant date fair value and also considered as shares as a percentage of total common shares outstanding) to support its compensation decisions.

For 2017 compensation decisions, our Compensation Committee approved a peer group of biotechnology companies at a similar stage of product development with which we compete for executive talent that were of similar size to the Company in terms of market capitalization, product portfolio, pipeline and number of employees. To align with our strategic plan, which included commercialization of HEPLISAV-B and expansion of our pipeline with early clinical development in cancer immunotherapy, our peer group included companies that were:

both oncology and non-oncology focused,

companies that had their own manufacturing operations, and

approximately 40% of the companies in our 2017 peer group were commercial (italicized in chart below) companies.

The change in our peer group from 2016 to 2017 included removing five companies for various reasons including market caps that were out of range or that the company had been acquired. As of June 2016, which was shortly before the 2017 peer group was approved, the companies in the 2017 peer group had market capitalizations between ranging from $206 million to $2.443 billion and the median market capitalization of our peer group was $755 million. At that time, our market capitalization was $557 million. The following lists our 2017 peer group.

Aduro Biotech, Inc.

Ariad Pharmaceuticals Inc.

Array Biopharma, Inc.

BioCryst Pharmaceuticals, Inc.

Celldex Therapeutics, Inc.

Clovis Oncology, Inc.

Depomed Inc.

Eagle Pharmaceuticals, Inc.

Emergent BioSolutions, Inc.

Epizyme, Inc.

Exelixis, Inc.

Heron Therapeutics, Inc.

ImmunoGen, Inc.

Kite Pharma, Inc.

MacroGenics, Inc.

Nektar Therapeutics

NewLink Genetics Corporation

Novavax, Inc.

Puma Biotechnology, Inc.

Repligen Corporation

Sarepta Therapeutics, Inc.

Supernus Pharmaceuticals, Inc.

ZioPharm Oncology, Inc.

Elements of Executive Compensation

Our executive team continues to manage a changing and increasingly complex business. We strive to recognize these efforts by compensating our NEOs for the demands and risks associated with our business through three primary elements that are designed to reward performance in a simple and straightforward manner base salaries, annual performance-based cash incentives and long-term equity awards. During our annual stockholder outreach, our key stockholders expressed support for the elements of our executive compensation program, including our continued use of stock options as one portion of long-term equity awards and continuing to grant a portion of long-term equity awards with performance-based vesting. As reflected in the chart below, we responded to the feedback from our stockholders by introducing performance-based vesting for a portion of our 2016 and 2017 long-term equity awards.

The table below summarizes the purpose and key characteristics of each of our compensation elements.

Element	Purpose	Key Characteristics
Base Salary	Provides a fixed level of compensation for performing the essential day-to-day elements of the job; gives executives a degree of certainty in light of having a majority of their compensation at risk.	Fixed compensation that is reviewed annually and adjusted if and when appropriate; reflects each NEO s performance, experience, skills, level of responsibility and the breadth, scope and complexity of the position as well as the competitive marketplace for executive talent specific to our industry.
Annual Incentive Program	Motivates executive officers to achieve corporate and individual business goals, which we believe increase stockholder value, while providing flexibility to respond to opportunities and changing market conditions.	Annual cash incentive based on corporate and individual performance compared to pre-established goals. Our CEO s incentive is based entirely on corporate goals.

Element	Purpose	Key Characteristics
		Corporate goals focus on overarching objectives for the Company, while individual objectives represent key performance expectations at the departmental or individual level.
		Corporate goals are aligned with our business strategy and weighted by relative importance so that achievement can be objectively measured.
Long-Term Equity Incentives (Stock Options)	Motivates executive officers to achieve our business objectives by tying incentives to the appreciation of our common stock over the long term.	Stock options with an exercise price equal to the fair market value on the date of grant vesting over three years; the ultimate value realized, if any, depends on the appreciation of our common stock price and if our stock price does not appreciate, there is no value realized. In determining the aggregate size of equity grants in any given year, the Compensation Committee generally considers the same factors described above under Base Salary as well as the criticality of the executive to the long-term achievement of corporate goals.
Long-Term Equity Incentives (RSUs)	Motivates executive officers to achieve our corporate objectives by tying compensation to the performance of our common stock over the long term and/or the achievement of business and clinical development goals over the long term; motivates our executive officers to remain with the Company by mitigating swings in incentive values during periods when market volatility weighs on our stock price.	Restricted stock unit awards may vest based on continued service over a specified period of time and/or achievement of performance goals; the ultimate value realized varies with our common stock price. In March 2017, 20% of our executive officers annual grants were performance-based restricted stock unit awards vesting upon the Compensation Committee s certification of achievement of the following equally weighted pre-established performance goals:
		Initiate and complete enrollment in melanoma dose expansion study;
		Initiate and complete 75% enrollment in squamous cell carcinoma of the head and neck (SCCHN) dose expansion study;
		Submit and receive approved DV281 IND and initiate enrollment in dose escalation; and
		Complete preclinical research support and selection of third agent for SD101 immunotherapy regimen.

Element	Purpose	Key Characteristics
Other Compensation	Our executive officers participate in the same benefits offered to all other employees, which promote employee health and welfare and assist in attracting and retaining our executive officers.	Indirect compensation element consisting of programs such as medical, vision, dental, life and accidental death, long-term care and disability insurance as well as a 401(k) plan with a Company matching contribution, and other plans and programs made available to all eligible employees.
Severance and Change in Control Benefits	Serves our retention objectives by helping our named executive officers maintain continued focus and dedication to their responsibilities to maximize stockholder value, including in the event of a transaction that could result in a change in control of our Company.	Provides protection in the event of a termination of employment under specified circumstances, including following a change in control of our Company as described below under Potential Payments Upon Change in Control or Involuntary Termination.

2017 Executive Compensation Decisions

Total Target Cash Compensation Base Salaries and Target Bonus Percentages

When determining 2017 base salary and target bonus percentage adjustments, the Compensation Committee considered each individual s performance and Company performance, each individual s industry experience and tenure, internal pay equity, and retention concerns. The Compensation Committee also reviewed a range of market data reference points (the 10th, 25th, 50th, 60th, 75th and 90th percentiles of peer group data) with respect to total target cash compensation (including both base salary and the annual target performance bonus).

The Compensation Committee (and the board of directors, with respect to our CEO) decided that for 2017 each NEO s base salary and target bonus percentage would remain the same as in 2016 as shown in the table below. In addition, the Compensation Committee (and the Board of Directors, with respect to our CEO) decided that no bonuses would be paid to the NEOs in 2017 because HEPLISAV-B was not approved in 2016, notwithstanding multiple other individual and corporate goal achievements. In determining NEO compensation, the Compensation Committee takes into account peer group data; each NEO s industry experience, expertise, and tenure with the Company; internal pay equity and the Company s annual salary budget.

Name	2017 Base Salary	% Increase from Prior Year	2017 Target Bonus
Eddie Gray	$ 600,000	0%	60%
Michael S. Ostrach	$ 425,000	0%	50%
Robert L. Coffman, Ph.D.	$ 466,796	0%	50%
Robert Janssen, M.D.	$ 400,000	0%	50%
David F. Novack	$ 386,250	0%	50%

In early 2018, the Compensation Committee (and the Board with respect to Mr. Gray) approved increases to the base salaries of each of our NEOs to bring such base salary figures to a level at or above the 50th percentile of our peer group and, with respect to Dr. Janssen, to reflect his promotion to Senior Vice President. The 2018 base salaries for our NEOs are: for Mr. Gray, $621,000 (3.5% increase); for Mr. Ostrach, $439,875 (3.5% increase); for Dr. Coffman, $483,134 (3.5% increase); for Dr. Janssen, $438,000 (9.5% increase) and for Mr. Novack, $401,700 (4.0% increase). There are no changes to our NEOs target annual cash incentive percentages for 2018.

Long-Term Equity Incentive Awards

In making annual long-term equity incentive awards to NEOs in early 2017, the Compensation Committee considered each NEO s total options outstanding as of December 31, 2016, his performance during 2016, the potential amount that could be realized at different hypothetical stock prices upon exercise of those awards and each NEO s percentage of ownership of the Company. The Compensation Committee also reviewed peer group data reference points (the 10th, 25th, 50th, 60th, 75th and 90th percentiles of the market data) with respect to an approximation of grant date fair value and shares as a percentage of total common shares outstanding. The Compensation Committee made final determinations based on its judgment in accordance with our pay-for-performance philosophy and the need to retain and motivate these highly experienced and essential members of our management team.

The Compensation Committee (and the board of directors, with respect to our CEO) determined to grant each NEO s total long-term incentive compensation with a blend of both time-based RSUs and performance-based RSUs.

In February 2017, 80% of the 2017 annual grant was granted in the form of time-based RSUs. Subject to each individual s continuous service, one-third of the time-based RSUs subject to each annual grant vested on February 22, 2018, one third will vest on February 22, 2019 and the remainder will vest on February 22, 2020.

In response to prior feedback from our stockholders, the remaining 20% of the 2017 annual grant were performance-based RSUs granted in March 2017 and vest solely upon the Compensation Committee s certification of achievement of the following equally weighted pre-established performance goals:

- Initiate and complete enrollment in melanoma dose expansion study;
- Initiate and complete 75% enrollment in SCCHN dose expansion study;
- Submit and receive approved DV281 IND and initiate enrollment in dose escalation; and
- Complete preclinical research support and selection of third agent for SD101 immunotherapy regimen.

In February 2018, the Compensation Committee (and the board of directors, with respect to our CEO) affirmed the achievement of these performance goals and the vesting of these RSUs.

Name	Shares Subject to February 2017 Time-Based RSU Awards	Shares Subject to March 2017 Performance-Based RSU Awards
Eddie Gray	111,000	27,750
Michael S. Ostrach	25,500	6,375
Robert L. Coffman, Ph.D.	25,500	6,375
Robert Janssen, M.D.	25,500	6,375
David F. Novack	25,500	6,375

In early 2017, our Compensation Committee (and the board of directors, with respect to our CEO) also approved two equity grants to certain key employees, including our NEOs, in an effort to maintain employee and management continuity while refocusing our strategic activities to prioritize our emerging clinical and preclinical immuno-oncology portfolio while still allowing us to advance HEPLISAV-B through the FDA review process and an approval decision. As noted above, stockholder feedback following receipt of the FDA CRL recognized the importance of retaining the management team and other key talent needed to continue advancing our oncology program and thereby drive long-term stockholder value. Specifically, our Compensation Committee considered the following contributions of our NEOs:

Mr. Gray is vital to the success of our shifted strategic focus given his proven leadership with the Company and his role in redeveloping our corporate strategy to prioritize our emerging clinical and preclinical immuno-oncology portfolio.

Mr. Ostrach s experience managing our finance, accounting, business development, intellectual property and investor relations functions is crucial to our business going forward. Our ability to execute on our business plan is contingent on the Company raising the money we need to pursue our strategic plan. Mr. Ostrach has a proven track record in accomplishing this.

Dr. Coffman s role in advancing SD-101, DV281 and the other elements of our preclinical immuno-oncology portfolio is critical to our ability to execute our new corporate strategy.

Dr. Janssen s experience with HEPLISAV-B, running our clinical trial program, overseeing the design and conduct of new studies for oncology and managing our regulatory team is critical to the success of our business.

Mr. Novack s role overseeing an international manufacturing, quality and supply chain organization for HEPLISAV-B and our immuno-oncology portfolio is critical to our ability to execute our corporate strategy.

We view the grants listed below as an exceptional event to meet the needs of our transition and path forward as a business. Half of the retention grants, or the Initial Retention Grants, were granted in February 2017. Subject to each individual s continuous service, 50% of the RSUs subject to these grants vested on February 22, 2018, and the remainder will vest on February 22, 2019. The other half of the retention grants, or the Contingent Retention Grants, were approved subject to stockholder approval of the amendment of the 2011 Equity Incentive Plan, or the 2011 Plan, at our 2017 stockholder annual meeting to increase the authorized shares available thereunder. The grants were made in June 2017. Although each individual could elect to receive stock options in the amount of 1.35 times the number of RSUs, each of the grants was delivered as an RSU. Subject to each individual s continuous service, 50% of the shares subject to each Contingent Retention Grant will vest on June 2, 2018, and the remainder will vest on June 2, 2019. The two-year vesting schedule for the retention grants was designed to correspond to a critical and transitional two-year period during which the Company would be refocusing our strategic activities to prioritize our emerging clinical and preclinical immuno-oncology portfolio while still allowing us to advance HEPLISAV-B through the FDA review process and an approval decision.

Name	Shares Subject to 2017 RSU Initial Retention Grant	Shares Subject to 2017 RSU Contingent Retention Grant
Eddie Gray	150,000	150,000
Michael S. Ostrach	99,609	99,609
Robert L. Coffman, Ph.D.	109,405	109,405
Robert Janssen, M.D.	93,750	93,750
David F. Novack	90,527	90,527

In February 2018, our Board (upon the recommendation of the Compensation Committee) approved annual long-term equity incentive awards to our NEOs in the form of (i) a stock option to purchase 350,000 shares of our common stock to our CEO and (ii) a stock option to purchase 100,000 shares of our common stock to each of our NEOs, other than our CEO. Before determining the recommended form and size of these grants, the Compensation Committee considered each NEO s total options outstanding as of December 31, 2017, his performance during 2017, the potential amount that could be realized at different hypothetical stock prices upon exercise of those awards and each NEO s percentage of ownership of the Company in making these recommendations. The Compensation Committee also reviewed peer group data reference points (the 10th, 25th, 50th, 60th, 75th and 90th percentiles of the market data) with respect to an approximation of grant date fair value and shares as a percentage of total common shares outstanding. In March 2018, Compensation Committee (and the board of directors, with respect to our CEO) approved amending these options to provide that 20% of the shares subject to each option would vest, if at all, upon the Compensation Committee s certification of certain performance goals. The remaining 80% of each option grant vests over three years, with one-third of the shares subject to each such portion vesting 12 months after the grant date, and the remainder vesting in equal monthly installments thereafter.

2017 Annual Incentive Program Structure, Goals and Payout Decision

Structure. Our CEO does not have individual goals separate from the Company s corporate objectives. For our other NEOs, their total cash incentive payout is typically based on a weighting of 50% corporate and 50% individual goals. Our CEO recommends individual goals for each NEO, which are aligned with our business strategy and linked with corporate goals, and our Compensation Committee approves these goals. The individual goals for the NEOs are in addition to the general responsibilities each officer has for managing his respective functional or operational area.

2017 Corporate Goals. In early 2017, the Compensation Committee established the corporate and individual goals described below. While we now are a fully-integrated biopharmaceutical company with a marketed product and robust development programs, at the time we were a clinical stage company, and so our corporate goals were directly aligned with the specific strategic objectives, including advancing the development programs that we continue to believe will create long-term value for stockholders. In January 2018, the Compensation Committee evaluated the accomplishments and performance of the Company against such corporate goals. We have omitted details about the 2017 goals or achievement of goals in the table below only where we believe disclosing such details would result in competitive harm. After its consideration of the Company s performance, as more specifically described in the following chart, the Compensation Committee rated our 2017 corporate achievement at 125% of our 2017 corporate goals.

Corporate Goal	Weighting	Corporate Achievement	Corporate Achievement Percentage
Oncology: Advance the Pipeline	55%	The Compensation Committee determined that we exceeded or achieved each goal in this category and that, overall, we exceeded our goals in this category because of several factors, including:	60.5%
Advance oncology programs that are in clinical studies			
Develop clinical and regulatory strategy and preclinical research support to advance early immuno-oncology programs towards clinical studies		The advancement of the on-going Phase 1b/2 study investigating SD-101 to the dose escalation phase. The early data in patients with metastatic melanoma was encouraging.	
Develop strategy for efficient, scalable chemical synthesis and advancement of one TLR 7/8 agonist compound		The initiation of dosing in a phase 1B dose escalation clinical trial of our investigational inhaled TLR9 agonist, DV281, in patients with non-small cell lung cancer.	
		The advancement of three TLR 7/8 agonist programs.	
HEPLISAV-B Advancement	35%	The Compensation Committee determined that, overall, we exceeded our goals in this category because of several factors, including:	52.5%
Complete CRL responses and re-submission of BLA to FDA		The achievement of a 12:1 VRBPAC vote supporting the safety of HEPLISAV-B.	
Respond to FDA information requests and prepare for VRBPAC, to facilitate review completion			

	The attainment of FDA approval of HEPLISAV-B and an approved label including diabetes data.
Obtain ACIP recommendation in October 2017 or February 2018 meeting depending on timing of approval	

Corporate Goal	Weighting	Corporate Achievement	Corporate Achievement Percentage
Establish distribution service agreements with at least one wholesaler and one specialty distributor Submit supplemental BLA for prefilled syringes and diabetes data within two months of approval In vitro potency assay submission Complete design and approval of dialysis trial and submit IND Develop scalable launch plan		The submission of supplemental BLAs for prefilled syringe and in vitro potency assay in Q4. Diabetes BLA supplement not required because data included in approved label. The completion of scalable launch plan. The dialysis trial design and approval and IND submission in 2017 were not achieved due to the extension of the FDA s approval decision to November 2017. Unanimous ACIP recommendation was obtained in February 2018.	
Sustain the DVAX Business Plan	10%	The Compensation Committee determined that we exceeded or achieved each goal in this category and that, overall, we exceeded our goals in this category because of several factors, including:	12%
At least one year of cash at year end 2017 Control net cash usage within budget Develop and advance Company s immuno-oncology presence and profile as measured by e.g., (i) oncology scientific meetings and presentations and (ii) establish scientific advisory board and develop key opinion leader relationships Develop business development strategy and, as necessary, secure appropriate partnership to further develop SD-101 in combination with other agents Enable pre-clinical evaluation and validation of double and/or triple combinations by securing access to agents consistent with scientific prioritization		Financing strategy and effective budget management that resulted in greater cash balance at year- end than we had planned ($196M). Our corporate communications, activities and scientific presentations and the positive news flow from our corporate achievements enabled us to develop and advance the profile of our immuno-oncology program. We also established consulting relationships with key opinion leaders for individual consulting and service on Scientific Advisory Board. Business development strategy for further development of SD-101 in combination with other agents developed and discussions being held regarding securing access to agents.	

Total	**100%**	**125%**

The terms used, but not defined above, have the following definitions:

ACIP is the Centers for Disease Control and Prevention s Advisory Committee on Immunization Practices.

BLA is an FDA Biologics License Application.

CRL is a Complete Response Letter issued by the FDA to communicate it has completed its review of a new drug application and it will not approve the application in its present form.

IND is an Investigational New Drug Application.

VRBPAC is the FDA s Vaccines and Related Biological Products Advisory Committee.

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2017 Individual Goals. As described above, our CEO does not have individual goals separate from the Company s corporate objectives. For our other NEOs, the total cash incentive payout for 2017 was based on a weighting of 50% corporate and 50% individual goals. Our CEO recommends individual goals for each NEO, which are aligned with our business strategy and linked with corporate goals, and our Compensation Committee approves these goals. The 2017 individual goals for the NEOs include those listed below. These specific goals were in addition to the general responsibilities each officer had for managing his respective functional operational area. In early 2018, based on the recommendation of our CEO, as well as the observations by Compensation Committee members of these officers and its own assessment of each NEO s effectiveness, the Compensation Committee determined the level of achievement of each NEO s individual performance goals as follows:

Name	Individual Goals	Individual Achievement	Individual Achievement Percentage
Michael S. Ostrach		Mr. Ostrach exceeded his individual goals by:	125%
	1. Meet key financial objectives, including securing adequate financing to support HELPLISAV-B launch and oncology clinical development program, and optimize processes for managing financial reporting	Managing our financing strategy, implementing new processes and securing equity financing which resulted in greater cash balance at year-end than planned;	
	2. Develop business and communications strategies that are implementable and target the right opportunities	Substantially contributing to our corporate business and communication strategies; and	
	3. Optimize internal IP function, develop patent prosecution roadmap and file strategic patents related to vaccine and oncology assets	Optimizing internal IP function, developing and implementing our patent strategy, and obtaining and filing key patents, including a second HEPLISAV-B use patent.	
Robert L. Coffman, Ph.D.	1. Initiate Phase I clinical trial for DV281 for lung cancer, including completion of IND and other prerequisites.	Dr. Coffman exceeded his individual goals by:	130%
	2. Advance preclinical and clinical vaccine and oncology programs	Guiding the lung cancer project (DV281) to successful initiation of clinical studies;	
	3. Develop and implement strategies that will continue to broaden our scientific platform	Playing critical role in gaining approval of HEPLISAV-B; and	
		Conducting in-depth portfolio review for potential new cancer trials leading to identification of up-to-date, next steps for SD-101 development.	

Name	Individual Goals	Individual Achievement	Individual Achievement Percentage
Robert Janssen, M.D.	1. Lead regulatory efforts to obtain FDA-approval of HEPLISAV-B and subsequent ACIP recommendation and post-marketing clinical program 2. Develop and implement clinical, regulatory and medical affairs strategies to advance immuno-oncology and vaccine programs in the clinic, including initiation of DV281 dose-escalation trial 3. Develop and advance Company s immuno-oncology presence and profile	Dr. Janssen exceeded his individual goals by: Leading and making invaluable contributions to obtaining FDA approval of HEPLISAV-B; Note: ACIP voted unanimously in favor of HEPLISAV-B recommendation on February 2018. Supervising and advancing of our oncology and vaccine pipelines, including initiation of DV281 dose-escalation trial in Q4 2017; and Substantially contributing to KOL meetings, discussions with potential partners and creating various draft manuscripts for submission.	135%
David Novack	1. Deliver on all CMC related activities related to the Company s BLA submission for commercialization of HEPLISAV-B 2. Develop and implement manufacturing strategies for commercialization of HEPLISAV-B and to advance our immuno-oncology programs in the clinic 3. Continue to implement quality assurance strategies required for a commercial organization	Mr. Novack exceeded his individual goals by: Implementing our Company s restructuring at our Dusseldorf manufacturing site and in Berkeley in order to maintain the viability of HEPLISAV-B; Contributing to the achievement of the resolution of all regulatory requests related to HEPLISAV-B regulatory approval; Successfully planning and delivering clinical supply for oncology programs; and Demonstrating leadership and commitment to operational excellence methodologies and the use of metrics to monitor quality and performance.	125%

After making these determinations regarding levels of corporate and individual performance achieved against the pre-established performance goals, the Compensation Committee (and the Board with respect to the CEO) reviewed and approved the cash incentive payouts noted below. As noted above, for the NEOs other than the CEO,

the cash incentive payouts are based 50% on achievement of corporate goals and 50% on achievement of individual goals. There were no changes to the NEOs target annual cash incentive percentages between 2016 and 2017.

	2017 Target Annual Cash Incentive		2017 Actual Annual Cash Incentive Paid				
			Achievement of Corporate Goals		Achievement of Individual Goals		
Name	% of Base Salary	$	% of Target Annual Cash Incentive	$*	% of Target Annual Cash Incentive	$*	Total*
Eddie Gray	60%	$ 360,000	125%	$ 450,000	N/A	N/A	$ 450,000
Michael S. Ostrach	50%	$ 212,500	62.5%	$ 132,813	62.5%	$ 132,813	$ 265,625
Robert L. Coffman, Ph.D.	50%	$ 233,398	62.5%	$ 145,874	65%	$ 151,709	$ 297,582
Robert Janssen, M.D.	50%	$ 200,000	62.5%	$ 125,000	67.5%	$ 135,000	$ 260,000
David F. Novack	50%	$ 193,125	62.5%	$ 120,703	62.5%	$ 120,703	$ 241,406

* Amounts are rounded to the nearest dollar

Other Executive Compensation Matters

Equity Compensation Policies

Our Compensation Committee approves equity awards for NEOs and authorizes the CEO to approve equity awards for all other employees based on approved pools for annual and new hire grants. NEO awards are approved either at a regularly-scheduled meeting of the Compensation Committee or by unanimous written consent. The effective date of the grant is generally the date of the meeting, or the date the last person executes the unanimous written consent.

The exercise price of stock options is not less than the closing price of our common stock on the NASDAQ Capital Market on the grant date of the stock option. We have no practice of timing grants of stock options or restricted stock awards to coordinate with the release of material non-public information, and we have not timed the release of material non-public information for purposes of affecting the value of the compensation awarded to our NEOs or any other employee.

We encourage our NEOs to hold a significant equity interest in our Company, but we have not set specific stock ownership guidelines.

We have a policy that prohibits our executive officers, directors and other members of management from engaging in short sales, transactions in put or call options, hedging transactions or other inherently speculative transactions with respect to our stock.

Tax Effects of Executive Compensation

Our Compensation Committee considers the impact of the deduction limitation imposed by section 162(m) of the Internal Revenue Code of 1986, as amended (the Tax Code), in establishing and implementing compensation policies and practices. Section 162(m) generally prohibits us from deducting any compensation over $1 million per taxable year paid to our covered employees unless, under tax laws in effect prior to January 1, 2018, such compensation qualifies as performance-based compensation within the meaning of section 162(m). The exception from section 162(m) s deduction limit for performance-based compensation has been repealed, effective for taxable years beginning after December 31, 2017, such that compensation paid to our covered employees in excess of $1 million per taxable year will not be deductible unless it qualifies for transition relief applicable to certain arrangements in place as of November 2, 2017. Because of certain ambiguities and uncertainties as to the application and interpretation of section 162(m) and the regulations issued thereunder, including the uncertain scope of the transition relief under the legislation repealing section 162(m) s performance-based compensation exception from the deduction limit, no assurance can be given that compensation intended to satisfy the requirements for the performance-based compensation exception under section 162(m) in fact will. The Compensation Committee reserves the right to modify compensation that was initially intended to satisfy the requirements for the performance-based compensation exception under section 162(m) if it determines that such modifications are consistent with the Company s business needs.

The Compensation Committee also considers the impact of section 409A of the Tax Code, and in general, our executive plans and programs are designed to comply with the requirements of that section so as to avoid possible adverse tax consequences that may result from non-compliance.

Accounting Considerations

The accounting impact of our compensation programs is one of many factors that the Compensation Committee considers in determining the structure and size of our executive compensation programs. In general, the Company accounts for equity compensation paid to our employees under the Financial Accounting Standards Board Accounting Standards Codification Topic 718, Compensation Stock Compensation, or ASC 718, which requires us to estimate and record an expense over the service period of the equity award, and our cash compensation is recorded as an expense at the time the obligation is accrued.

Compensation Recovery Policy

Amounts paid and awards granted under our 2011 Plan are subject to recoupment in accordance with the Dodd-Frank Wall Street Reform and Consumer Protection Act and any applicable regulations under the Act, any clawback policy the Company adopts or as is required by applicable law. In addition, as a public company subject to the provisions of Section 304 of the Sarbanes-Oxley Act of 2002, if we are required as a result of misconduct to restate our financial results due to our material noncompliance with any financial reporting requirements under the federal securities laws, our chief executive officer and chief financial officer may be legally required to reimburse us for any bonus or other incentive-based or equity-based compensation they receive. In addition, we will comply with the requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act once the SEC final regulations on the subject become effective.

Compensation Risk Analysis

During fiscal 2017, our Compensation Committee reviewed our compensation policies as generally applicable to our employees in order to determine whether any such programs were likely to present a material risk to the Company. As part of its assessment, the Compensation Committee considered, among other things, the allocation of compensation among base salary and short- and long-term compensation, our approach to establishing Company-wide and individual financial, operational and other performance targets, and the nature of our key performance metrics. As a result of this review and analysis, the Compensation Committee s determined that our policies and programs do not encourage excessive or inappropriate risk taking, and that the level of risk that they do encourage is not reasonably likely to have a material adverse effect on the Company.

Report of the Compensation Committee of the Board of Directors on Executive Compensation

In early 2018, the Compensation Committee discussed with management the Compensation Discussion and Analysis, contained in this proxy statement. Based on this review and discussion, the Compensation Committee has recommended to the Board that the Compensation Discussion and Analysis be included in this proxy statement and incorporated into our Annual Report on Form 10-K for the fiscal year ended December 31, 2017.

The material in this report is not soliciting material, is furnished to, but not deemed filed with, the SEC and is not deemed to be incorporated by reference in any filing of the Company under the Securities Act or the Exchange Act, *other than the Company s Annual Report on Form 10-K, where it shall be deemed to be furnished, whether made before or after the date hereof and irrespective of any general incorporation language in any such filing.*

Ms. Peggy V. Phillips, Chairperson

Dr. Francis R. Cano, Ph.D.

Dr. Daniel Kisner, M.D.

Summary Compensation Table

The following table shows for the fiscal years ended December 31, 2017, 2016 and 2015, compensation awarded to or paid to, or earned by, NEOs.

Name and Principal Position	Year	Salary	Stock Awards(1)	Option Awards(2)	Non-Equity Incentive Compensation(3)	All Other Compensation(4)	Total
Eddie Gray	2017	$ 600,000	$ 2,094,113	$	$ 450,000	$ 2,000	$ 3,146,113
CEO and Director	2016	$ 600,000	$	$ 2,345,840	$	$ 2,000	$ 2,947,840
	2015	$ 566,500	$	$ 3,004,616	$ 370,491	$ 2,000	$ 3,943,607
Michael S. Ostrach	2017	$ 425,000	$ 1,126,060	$	$ 265,625	$ 2,000	$ 1,818,685
Senior Vice President, Chief	2016	$ 425,000	$	$ 703,752	$	$ 2,000	$ 1,130,752
Financial Officer, Chief	2015	$ 390,000	$	$ 1,420,353	$ 228,150	$ 2,000	$ 2,040,503
Business Officer							
Robert L. Coffman, Ph.D.	2017						

(117
)
7

(206
)
(199
)
Total interest expense
1,315

(8,465
)
(7,150
)
366

(14,204
)
(13,838
)
Net interest income, fully taxable equivalent basis
$
47,559

$
(66,867
)
$
(19,308
)
$
32,645

$
(36,946
)
$
(4,301
)

Net interest income totaled $619.4 million in 2013 compared to $639.9 million in 2012. On a tax equivalent basis, net interest income totaled $645.9 million in 2013 and decreased $19.3 million from the previous year. This decrease was mainly the result of lower yields on loans and investment securities, partially offset by higher loan balances and lower rates paid on deposits. The net yield on earning assets (tax equivalent) was 3.11% in 2013 compared with 3.41% in the previous year.

During 2013, tax equivalent interest income on loans declined $6.4 million from 2012 due to a 50 basis point decrease in average rates earned, offset by a $932.3 million, or 9.9%, increase in average loan balances. The average tax equivalent rate earned on the loan portfolio was 4.32% in 2013 compared to 4.82% in 2012. The lower rates depressed interest income by $49.1 million; however, the higher average balances contributed interest income of $42.8 million, which together resulted in a $6.4 million net decrease in interest income. The largest decline occurred in business real estate loan interest, which decreased $6.1 million as a result of a decline in rates of 39 basis points, partly offset by a $57.8 million, or 2.6% increase in average balances. Interest on revolving home equity loans decreased $1.8 million due to a $21.8 million decline in average balances coupled with a 21 basis point decrease in average rates. Higher levels of interest were earned on business, personal real estate and consumer loans, which increased $834 thousand, $711 thousand, and $897 thousand, respectively. These increases were due to higher average balances, which increased 13.6% in business, 12.7% in personal real estate and 21.7% in consumer loans, partly offset by lower average rates earned. Average consumer loan balances increased $256.7 million, which was mainly the result of increases of $196.2 million in auto loans and $88.7 million in fixed rate home equity loans. These increases were partially offset by an $82.9 million decrease in marine and recreational vehicle (RV) loans as that portfolio continues to pay down. Interest earned on consumer credit card loans decreased by $809 thousand due to a 44 basis point decrease in the average rate earned, partly offset by the impact of a $21.8 million increase in average balances.

Tax equivalent interest income on investment securities decreased by $21.9 million in 2013 due to a 25 basis point decrease in average rates earned on these investments, while total average balances increased only slightly. The average rate earned on the total investment securities portfolio declined from 2.55% in 2012 to 2.30% in 2013. Interest income on mortgage-backed securities decreased $20.0 million in 2013 mainly due to a $665.0 million, or 17.3%, decline in average balances. Other declines occurred in interest on asset-backed securities (down $4.5 million) and U.S. government and federal agency obligations (down $3.5 million)due to rate declines, partly offset by higher average balances. The rate decline in U.S. government obligations was largely due to a decrease in interest of $3.2 million on inflation-protected securities. Interest income on state and municipal obligations and government-sponsored enterprise obligations increased $4.5 million and $3.0 million, respectively, due to higher average invested balances, partly offset by declines in rates earned. State and municipal average balances rose $240.9 million, or 17.5%, offset by a rate decline of 31 basis points. Government-sponsored enterprise obligations rose $193.3 million, or 63.0%, offset by a rate decline of 11 basis points. Interest on long-term resell agreements increased $1.9 million in 2013 compared to the prior year due to a $282.0 million increase in the average balances of these instruments, partly offset by a decrease in the average rate earned from 2.15% in the previous year to 1.80% in 2013. During 2013, interest expense on deposits decreased $7.0 million compared to 2012. This was the result of lower overall rates paid on total deposits, which declined 8 basis points in 2013 to .22%. Average rates paid on money market accounts declined 7 basis points, and rates paid on certificates of deposit declined 15 basis points. The resulting declines in interest expense were partly offset by the impact of higher average balances of money market accounts, which increased $579.1 million, or 7.1% over 2012. Interest expense on borrowings declined slightly, as the average rate paid fell 3 basis points. The average rate paid on total interest bearing liabilities decreased to .23% compared to .30% in 2012.

During 2012, tax equivalent interest income on loans declined $16.9 million compared to 2011 due to a 27 basis point decrease in average rates earned, partly offset by a $156.7 million increase in average balances. The average tax equivalent rate earned on the loan portfolio was 4.82% compared to 5.09% in the previous year. Interest earned on business loans decreased $2.6 million as a result of a decline in rates of 15 basis points and was partially offset by a 1.8% increase in average balances. Interest on construction loans decreased $3.7 million due to a $63.5 million decline in average balances coupled with a 23 basis point decrease in average rates. Business real estate average loan balances increased $76.2 million, or 3.6%, while average rates earned decreased by 32 basis points, which together resulted in a net $3.3 million decrease in interest income. Interest income on personal real estate loans and consumer loans declined $3.4 million and $3.7 million, respectively, due to lower rates partially offset by higher average loan balances. Average consumer loan balances increased $61.8 million, due to increases in auto loans and fixed rate home equity loans, but partly offset by declines in marine and RV loans. Consumer credit card loan interest increased $1.2 million due to a 41 basis point increase in the average rate earned, partly offset by a decline in the average balance outstanding of $16.0 million.

Tax equivalent interest income on investment securities decreased by $6.1 million in 2012 due to a 38 basis point decrease in average rates earned, partially offset by a $992.7 million, or 12.3%, increase in average balances outstanding. The average rate earned on the total investment securities portfolio declined from 2.93% in 2011 to 2.55% in 2012. Interest income on mortgage-backed securities decreased $6.9 million in 2012 due to a 43 basis point decrease in rates earned on these securities, offset by an increase of 8.3%, or $296.5 million, in average balances. Interest on asset-backed securities increased slightly due to an increase in average balances of $481.3 million partially offset by a decline in rates of 16 basis points. Interest on municipal securities increased $2.1 million due to higher average balances, which increased $202.1 million in 2012, partially offset by the impact of a 50 basis point decrease in average rates earned. Interest on U.S. government and federal agency securities decreased by $5.0 million in 2012, which was mostly due to a decrease in interest on inflation-protected securities. Interest on long-term resell agreements increased $5.7 million in 2012 over the prior year due to a $123.7 million increase in average balances, coupled with an increase of 40 basis points in the average rate earned.

During 2012, interest expense on deposits decreased $12.7 million compared to 2011. This was the result of lower rates on all deposit products coupled with a $402.2 million decline in average certificate of deposit balances, but partly offset by the effects of higher average balances of money market and interest checking accounts, which grew by $727.7 million. Average rates paid on deposit balances declined 13 basis points in 2012 to .30%. Interest expense on borrowings declined $1.1 million, mainly the result of average rates declining by 14 basis points to .33%, but partly offset by an increase of $151.0 million, or 14.6% in the average balances of federal funds purchased and securities sold under agreements to repurchase. The average rate paid on total interest bearing liabilities decreased to .30% compared to .43% in 2011.

Provision for Loan Losses

The provision for loan losses totaled $20.4 million in 2013, which represented a decrease of $6.9 million from the 2012 provision of $27.3 million. Net loan charge-offs for the year totaled $31.4 million compared with $39.3 million in 2012, or a decrease of $7.9 million. The decrease in net loan charge-offs from the previous year was mainly the result of lower construction and business real estate losses, which declined $4.4 million and $4.2 million, respectively, partly offset by higher business loan losses, which increased $1.6 million. The allowance for loan losses totaled $161.5 million at December 31, 2013, a decrease of $11.0 million compared to the prior year, and represented 1.47% of outstanding loans. The provision for loan losses is recorded to bring the allowance for loan losses to a level deemed adequate by management based on the factors mentioned in the following “Allowance for Loan Losses” section of this discussion.

Non-Interest Income

				% Change	
(Dollars in thousands)	2013	2012	2011	'13-'12	'12-'11
Bank card transaction fees	$166,627	$154,197	$157,077	8.1 %	(1.8)%
Trust fees	102,529	94,679	88,313	8.3	7.2
Deposit account charges and other fees	79,017	79,485	82,651	(.6)	(3.8)
Capital market fees	14,133	21,066	19,846	(32.9)	6.1
Consumer brokerage services	11,006	10,162	10,018	8.3	1.4
Loan fees and sales	5,865	6,037	7,580	(2.8)	(20.4)
Other	39,209	34,004	27,432	15.3	24.0
Total non-interest income	$418,386	$399,630	$392,917	4.7 %	1.7 %
Non-interest income as a % of total revenue*	40.3 %	38.4 %	37.8 %		
Total revenue per full-time equivalent employee	$219.5	$220.8	$219.0		

*Total revenue is calculated as net interest income plus non-interest income.

Non-interest income totaled $418.4 million, an increase of $18.8 million, or 4.7%, compared to $399.6 million in 2012. Bank card fees increased $12.4 million, or 8.1%, over last year, as a result of continued growth in corporate card fees of $9.9 million, or 13.9%. In addition, higher transaction volumes resulted in growth of 3.3% in merchant fees, while credit card fees also increased by 3.8%. Corporate card, merchant card and credit card fees for 2013 totaled

$80.6 million, $27.1 million and $23.4 million, respectively. Trust fee income increased $7.9 million, or 8.3%, resulting mainly from growth in personal and institutional trust fees. The market value of total customer trust assets (on which fees are charged) totaled $35.2 billion at year end 2013 and grew 16.4% over year end 2012. Deposit account fees decreased $468 thousand, or .6%, primarily due to a decline in overdraft and return item fees of $3.4 million. This decline was mainly the result of a new posting routine on debit card transactions which took effect in February 2013. Partly offsetting this effect was an increase in various other deposit fees and cash management fees of $3.0 million. Overdraft fees comprised 39.2% of total deposit account fees in 2013, down from 43.3% in 2012, while corporate cash management fees comprised 42.0% of total deposit account fees in 2013, compared to 40.3% in 2012. Capital market fees decreased $6.9 million, or 32.9%, compared to last year as customer demand for fixed income securities was weak this year. Consumer brokerage services revenue increased $844 thousand, or 8.3%, due to growth in advisory fees, while loan fees and sales revenue decreased $172 thousand, or 2.8%, due to a decline in loan commitment fees. Other non-interest income increased by $5.2 million, or 15.3%, as a result of a $3.0 million fair value loss recorded last year on an office building which was held for sale and net gains of $1.4 million recorded this year in sales of five retail branch facilities no longer in use. In addition, higher swap and foreign exchange fees were recorded in 2013.

During 2012, non-interest income increased $6.7 million, or 1.7%, over 2011 to $399.6 million. Bank card fees declined $2.9 million, or 1.8%, from 2011, due to a decline in debit card interchange fees of $19.3 million, or 35.7% (mainly the effect of new pricing regulations effective in the fourth quarter of 2011), which was partly offset by growth in corporate card fees of $13.0 million, or 22.4%. Corporate card and debit card fees for 2012 totaled $70.8 million and $34.6 million, respectively. Merchant fees grew by 8.9% due to higher transaction volumes and totaled $26.2 million for the year, while credit card fees grew 5.9% and totaled $22.6 million. Trust fee income increased $6.4 million, or 7.2%. The market value of total customer trust assets totaled $30.2 billion at year end 2012 and grew 10.7% over year end 2011. Deposit account fees decreased $3.2 million, or 3.8%, due to lower overdraft and return item fees of $6.5 million, while other deposit fees increased $3.4 million. Overdraft fees comprised 43.3% of total deposit account fees in 2012, down from 49.5% in 2011. Corporate cash management fees comprised 40.3% of total deposit account fees in 2012 and were flat compared to 2011. Capital market fees increased $1.2 million, or 6.1%. Consumer brokerage services revenue increased $144 thousand, or 1.4%, due to growth in advisory fees, mostly offset by lower life insurance revenue. Loan fees and sales revenue was down $1.5 million, or 20.4%, due to a decline in mortgage banking revenue (mainly because late in 2011 the Company adopted a policy of retaining all first mortgage loan originations). Other non-interest income increased by $6.6 million, or 24.0%, mainly due to higher tax credit sales income, leasing revenue and net gains related to banking properties in 2012.

Investment Securities Gains (Losses), Net

(In thousands)	2013	2012	2011
Available for sale:			
Common stock	$1,375	$—	$—
Municipal bonds	126	16	177
Agency mortgage-backed bonds	—	342	—
OTTI losses on non-agency mortgage-backed bonds	(1,284)	(1,490)	(2,537)
Non-marketable:			
Private equity investments	(4,642)	5,960	13,172
Total investment securities gains (losses), net	$(4,425)	$4,828	$10,812

Net gains and losses on investment securities during 2013, 2012 and 2011 are shown in the table above. Included in these amounts are gains and losses arising from sales of bonds from the Company's available for sale portfolio, including credit-related losses on debt securities identified as other-than-temporarily impaired. Also shown are gains and losses relating to non-marketable private equity investments, which are primarily held by the Parent's majority-owned private equity subsidiaries. These include fair value adjustments, in addition to gains and losses realized upon disposition. Portions of the fair value adjustments attributable to minority interests are reported as non-controlling interest in the consolidated statements of income, and resulted in income of $1.1 million in 2013 and expense of $1.3 million and $2.6 million in 2012 and 2011, respectively.

Net securities losses of $4.4 million were recorded in 2013, which included $4.6 million in losses resulting mainly from fair value adjustments on private equity investments, partly offset by a gain of $1.4 million relating to the donation of appreciated stock by the Company. Also included in net losses were credit-related impairment losses of $1.3 million on certain non-agency guaranteed mortgage-backed securities which have been identified as other-than-temporarily impaired. The cumulative credit-related impairment on these bonds totaled $12.8 million. These identified securities had a total fair value of $70.4 million at December 31, 2013, compared to $101.7 million at December 31, 2012.

Net securities gains of $4.8 million were recorded in 2012, compared to net gains of $10.8 million in 2011. In both years, these gains and losses were comprised mainly of fair value adjustments in the private equity investment portfolio, coupled with losses in the available for sale portfolio relating to other-than-temporary impairment (OTTI).

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Non-Interest Expense

(Dollars in thousands)	2013	2012	2011	% Change '13-'12	'12-'11
Salaries	$310,179	$302,675	$293,318	2.5 %	3.2 %
Employee benefits	56,688	58,224	52,007	(2.6)	12.0
Net occupancy	45,639	45,534	46,434	.2	(1.9)
Equipment	18,425	20,147	22,252	(8.5)	(9.5)
Supplies and communication	22,511	22,321	22,448	.9	(.6)
Data processing and software	78,245	73,798	68,103	6.0	8.4
Marketing	14,176	15,106	16,767	(6.2)	(9.9)
Deposit insurance	11,167	10,438	13,123	7.0	(20.5)
Debit overdraft litigation	—	—	18,300	NM	(100.0)
Other	72,603	70,226	64,497	3.4	8.9
Total non-interest expense	$629,633	$618,469	$617,249	1.8 %	.2 %
Efficiency ratio	60.5 %	59.3 %	59.1 %		
Salaries and benefits as a % of total non-interest expense	58.3 %	58.4 %	55.9 %		
Number of full-time equivalent employees	4,727	4,708	4,745		

Non-interest expense was $629.6 million in 2013, an increase of $11.2 million, or 1.8%, over the previous year. Salaries and benefits expense increased by $6.0 million, or 1.7%, mainly due to higher full-time salaries expense, partly offset by lower medical and incentives expense. Growth in salaries expense resulted partly from staffing costs associated with the Summit acquisition, coupled with staffing additions in commercial banking, wealth and commercial card. Full-time equivalent employees totaled 4,727 at December 31, 2013, an increase of .4%. Occupancy expense increased $105 thousand, or .2%, while supplies and communication expense increased $190 thousand, or .9%. Equipment expense decreased $1.7 million, or 8.5%, due to lower depreciation expense. Data processing and software expense increased $4.4 million, or 6.0%, mainly due to higher bank card processing expense and data processing termination fees relating to the Summit acquisition. Marketing expense declined $930 thousand, or 6.2%, while deposit insurance increased $729 thousand, or 7.0%. Other non-interest expense increased $2.4 million, or 3.4%, over the prior year, resulting mainly from an increase of $4.0 million in legal and professional fees, provisions of $2.8 million on letter of credit exposures, contribution expense of $1.5 million on appreciated stock, and higher travel and entertainment expense. These expense increases were partly offset by gains of $3.1 million on sales of foreclosed property in 2013, in addition to a 2012 charge of $5.2 million related to certain Visa-related interchange litigation that did not reoccur in 2013.

In 2012, non-interest expense was $618.5 million, an increase of $1.2 million, or .2%, over 2011. Salaries and benefits expense increased by $15.6 million, or 4.5%, largely due to higher salaries, incentive compensation, medical and retirement expense. Full-time equivalent employees totaled 4,708 at December 31, 2012, a decline of .8% from 2011. Occupancy expense declined $900 thousand, or 1.9%, primarily resulting from lower depreciation and outside services expense, partly offset by a decline in rent income. Equipment expense decreased $2.1 million, or 9.5%, also due to lower depreciation expense. Supplies and communication expense decreased slightly, while marketing expense was lower by $1.7 million, or 9.9%. Data processing and software expense increased $5.7 million, or 8.4%, mainly due to higher bank card processing expense. Deposit insurance expense declined $2.7 million, or 20.5%, as a result of new FDIC assessment rules which became effective in the second quarter of 2011. Other non-interest expense increased $5.7 million, or 8.9%, mainly due to the accrual in 2012 of $5.2 million as mentioned above. Also, during 2011, the Company's indemnification obligation related to certain Visa litigation was reduced by $4.4 million, and further adjustments were not reoccurring. Partly offsetting these increases to other non-interest expense in 2012 were reductions of $853 thousand in regulatory examination fees and $788 thousand in intangible asset amortization, in addition to an increase of $1.7 million in deferred loan origination costs. In addition, results for 2011 included a non-recurring charge of $18.3 million relating to the settlement of a class-wide debit card overdraft suit, discussed further in Note 20.

Income Taxes

Income tax expense was $122.2 million in 2013, compared to $127.2 million in 2012 and $121.4 million in 2011. The decrease in income tax expense in 2013 over 2012 was proportional to the decrease in pre-tax income. The effective tax rate, including the effect of non-controlling interest, was 31.9% in 2013 compared to 32.1% in 2012 and 2011. The Company's effective tax rates in the years noted above were lower than the federal statutory rate of 35% mainly due to tax-exempt interest on state and local municipal obligations.

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Financial Condition

Loan Portfolio Analysis

Classifications of consolidated loans by major category at December 31 for each of the past five years are shown in the table below. This portfolio consists of loans which were acquired or originated with the intent of holding to their maturity. Loans held for sale are separately discussed in a following section. A schedule of average balances invested in each loan category below appears on page 50.

	Balance at December 31				
(In thousands)	2013	2012	2011	2010	2009
Commercial:					
Business	$3,715,319	$3,134,801	$2,808,265	$2,957,043	$2,877,936
Real estate — construction and land	406,197	355,996	386,598	460,853	665,110
Real estate — business	2,313,550	2,214,975	2,180,100	2,065,837	2,104,030
Personal banking:					
Real estate — personal	1,787,626	1,584,859	1,428,777	1,440,386	1,537,687
Consumer	1,512,716	1,289,650	1,114,889	1,164,327	1,333,763
Revolving home equity	420,589	437,567	463,587	477,518	489,517
Student	—	—	—	—	331,698
Consumer credit card	796,228	804,245	788,701	831,035	799,503
Overdrafts	4,611	9,291	6,561	13,983	6,080
Total loans	$10,956,836	$9,831,384	$9,177,478	$9,410,982	$10,145,324

The contractual maturities of loan categories at December 31, 2013, and a breakdown of those loans between fixed rate and floating rate loans are as follows:

	Principal Payments Due			
(In thousands)	In One Year or Less	After One Year Through Five Years	After Five Years	Total
Business	$1,742,479	$1,389,715	$583,125	$3,715,319
Real estate — construction and land	237,992	156,726	11,479	406,197
Real estate — business	551,360	1,466,073	296,117	2,313,550
Real estate — personal	147,777	492,884	1,146,965	1,787,626
Total business and real estate loans	$2,679,608	$3,505,398	$2,037,686	8,222,692
Consumer (1)				1,512,716
Revolving home equity (2)				420,589
Consumer credit card (3)				796,228
Overdrafts				4,611
Total loans				$10,956,836
Loans with fixed rates	$647,771	$2,103,755	$1,032,580	$3,784,106
Loans with floating rates	2,031,837	1,401,643	1,005,106	4,438,586
Total business and real estate loans	$2,679,608	$3,505,398	$2,037,686	$8,222,692

(1) Consumer loans with floating rates totaled $177.4 million.

(2) Revolving home equity loans with floating rates totaled $420.4 million.

(3) Consumer credit card loans with floating rates totaled $654.1 million.

Total loans at December 31, 2013 were $11.0 billion, an increase of $1.1 billion, or 11.4%, over balances at December 31, 2012. This increase included loan balances of $207.4 million acquired in the Summit transaction on September 1, 2013. On an overall basis, the growth in loans during 2013 occurred in all loan categories except in revolving home equity loans and consumer credit card loans, which experienced small declines. Business loans increased $580.5

million, or 18.5%, reflecting growth in tax-advantaged lending, aircraft lending, leasing, and dealer floor plan loans. Business real estate loans increased $98.6 million, or 4.5%, largely due to loans acquired in the Summit transaction. Construction loans increased $50.2 million, or 14.1%, and resulted from increased activity in residential construction as housing began to recover in 2012 and 2013 and the demand for new construction reduced available housing supplies. Personal real estate loans increased $202.8 million, or 12.8%, as lending activity continued to strengthen in 2013. The growth in personal real estate loans was mainly due to the Company's current practice of retaining all

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new loan production, instead of selling the loans in the secondary market, during the recent housing recovery. Consumer loans were higher by $223.1 million, or 17.3%, primarily due to strong demand for consumer automobile and fixed rate home equity lending, while marine and recreational vehicle lending continued to run off during the year. Revolving home equity loans decreased $17.0 million, or 3.9%, as borrowers continue to prefer fixed rate home equity loans with pre-determined payments and amortization schedules. The balance of these fixed rate loans grew $74.8 million. Consumer credit card loans decreased by $8.0 million, or 1.0%, as competition for new card customers remained intense and consumer card borrowers remained conservative in their use of revolving card plans.

The Company currently generates approximately 32% of its loan portfolio in the St. Louis market, 29% in the Kansas City market, and 39% in other regional markets. The portfolio is diversified from a business and retail standpoint, with 59% in loans to businesses and 41% in loans to consumers. A balanced approach to loan portfolio management and an historical aversion toward credit concentrations, from an industry, geographic and product perspective, have contributed to low levels of problem loans and loan losses.

The Company participates in credits of large, publicly traded companies which are defined by regulation as shared national credits, or SNCs. Regulations define SNCs as loans exceeding $20 million that are shared by three or more financial institutions. The Company typically participates in these loans when business operations are maintained in the local communities or regional markets and opportunities to provide other banking services are present. At December 31, 2013, the balance of SNC loans totaled approximately $406.3 million, with an additional $1.2 billion in unfunded commitments, compared to $483.1 million in loans and $1.1 billion in commitments at December 31, 2012.

Commercial Loans

Business

Total business loans amounted to $3.7 billion at December 31, 2013 and include loans used mainly to fund customer accounts receivable, inventories, and capital expenditures. The business loan portfolio includes tax advantaged financings which carry tax free interest rates. These loans totaled $705.0 million at December 31, 2013, which was a 62.0% increase over December 31, 2012 balances, and comprised 6.4% of the Company's total loan portfolio. The portfolio also includes direct financing and sales type leases totaling $368.8 million, which are used by commercial customers to finance capital purchases ranging from computer equipment to office and transportation equipment. These leases increased $57.3 million, or 18.4%, over 2012 and comprised 3.4% of the Company’s total loan portfolio. Also included in this portfolio are corporate card loans, which totaled $189.5 million at December 31, 2013. These loans, which decreased by 9.5% in 2013, are made in conjunction with the Company’s corporate card business, and assist businesses in shifting from paper checks to a credit card payment system in order to automate payment processes. These loans are generally short-term, with outstanding balances averaging between 7 to 13 days in duration, which helps to limit risk in these loans.

Business loans, excluding corporate card loans, are made primarily to customers in the regional trade area of the Company, generally the central Midwest, encompassing the states of Missouri, Kansas, Illinois, and nearby Midwestern markets, including Iowa, Oklahoma, Colorado and Ohio. This portfolio is diversified from an industry standpoint and includes businesses engaged in manufacturing, wholesaling, retailing, agribusiness, insurance, financial services, public utilities, healthcare, and other service businesses. Emphasis is upon middle-market and community businesses with known local management and financial stability. Consistent with management’s strategy and emphasis upon relationship banking, most borrowing customers also maintain deposit accounts and utilize other banking services. Net loan recoveries in this category totaled $867 thousand in 2013, while net loan recoveries of $2.5 million were recorded in 2012. Non-accrual business loans were $11.6 million (.3% of business loans) at December 31, 2013 compared to $13.1 million at December 31, 2012.

Real Estate-Construction and Land

The portfolio of loans in this category amounted to $406.2 million at December 31, 2013 and comprised 3.7% of the Company’s total loan portfolio. These loans are predominantly made to businesses in the local markets of the Company’s banking subsidiary. Commercial construction and land development loans totaled $240.9 million, or 59.3% of total construction loans at December 31, 2013. Commercial construction loans are made during the construction phase for small and medium-sized office and medical buildings, manufacturing and warehouse facilities, apartment complexes, shopping centers, hotels and motels, and other commercial properties. Exposure to larger, speculative commercial properties remains low. Commercial land development loans relate to land owned or developed for use in conjunction with business properties. Residential construction and land development loans at December 31, 2013 totaled $165.3 million, or 40.7% of total construction loans. The largest percentage of residential construction and land development loans are for projects located in the Kansas City and St. Louis metropolitan areas. Recent market stabilization has resulted in 14.1% growth in total construction and land loans during 2013. While credit risk in this sector has been high over the last few years, loss trends continue to improve, with net loan recoveries of $4.7 million and $283 thousand recorded in 2013 and 2012, respectively. Construction and land loans on non-accrual status declined to $10.2 million at year end 2013 compared to $13.7 million at year end 2012.

Real Estate-Business

Total business real estate loans were $2.3 billion at December 31, 2013 and comprised 21.1% of the Company's total loan portfolio. This category includes mortgage loans for small and medium-sized office and medical buildings, manufacturing and warehouse facilities, shopping centers, hotels and motels, churches, and other commercial properties. Emphasis is placed on owner-occupied (46.4% of this portfolio) and income producing commercial real estate properties, which present lower risk levels. The borrowers and/or the properties are generally located in local and regional markets. Additional information about loans by category is presented on page 32. At December 31, 2013, non-accrual balances amounted to $19.8 million, or .9%, of the loans in this category, up from $17.3 million at year end 2012. The Company experienced net charge-offs of $952 thousand in 2013 compared to net charge-offs of $5.1 million in 2012.

Personal Banking Loans

Real Estate-Personal

At December 31, 2013, there were $1.8 billion in outstanding personal real estate loans, which comprised 16.3% of the Company's total loan portfolio. The mortgage loans in this category are mainly for owner-occupied residential properties. The Company originates both adjustable rate and fixed rate mortgage loans. The Company retains adjustable rate mortgage loans, and in 2012 and 2013 retained all fixed rate loans as directed by its Asset/Liability Management Committee, given the low concentrations of these loans. The Company originates its loans and does not purchase any from outside parties or brokers. Further, it has never maintained or promoted subprime or reduced document products. At December 31, 2013, 34% of the portfolio was comprised of adjustable rate loans while 66% was comprised of fixed rate loans. Levels of mortgage loan origination activity decreased slightly in 2013 compared to 2012, with originations of $410 million in 2013 compared with $414 million in 2012. Interest rates remained at historic lows through mid-year and this resulted in higher mortgage originations from refinancing, however, rates rose significantly mid-year, which reduced new origination volumes. The Company has experienced lower loan losses in this category than many others in the industry and believes this is partly because of its conservative underwriting culture, stable markets, and the fact that it does not offer subprime lending products or purchase loans from brokers. Net loan charge-offs for 2013 amounted to $1.2 million, compared to $1.4 million in the previous year. The non-accrual balances of loans in this category decreased to $5.1 million at December 31, 2013, compared to $6.9 million at year end 2012.

Consumer

Consumer loans consist of auto, marine, tractor/trailer, recreational vehicle (RV), fixed rate home equity, and other consumer installment loans. These loans totaled $1.5 billion at year end 2013. Approximately 59% of consumer loans outstanding were originated indirectly from auto and other dealers, while the remaining 41% were direct loans made to consumers. Approximately 50% of the consumer portfolio consists of automobile loans, 19% in fixed rate home equity loans, and 17% in marine and RV loans. As mentioned above, total consumer loans increased by $223.1 million in 2013, mainly the result of growth in auto lending of $180.4 million, or 32%. Growth of $74.8 million in fixed rate home equity loans was offset by the run-off of $74.7 million in marine and RV loans. Net charge-offs on consumer loans were $7.5 million in 2013 compared to $8.1 million in 2012. Net charge-offs decreased to .5% of average consumer loans in 2013 compared to .7% in 2012. Consumer loan net charge-offs included marine and RV loan net charge-offs of $3.9 million, which were 1.3% of average marine and RV loans in 2013, compared to 1.8% in 2012.

Revolving Home Equity

Revolving home equity loans, of which 99% are adjustable rate loans, totaled $420.6 million at year end 2013. An additional $682.9 million was available in unused lines of credit, which can be drawn at the discretion of the borrower. Home equity loans are secured mainly by second mortgages (and less frequently, first mortgages) on residential property of the borrower. The underwriting terms for the home equity line product permit borrowing availability, in the aggregate, generally up to 80% or 90% of the appraised value of the collateral property at the time of origination. Net charge-offs totaled $986 thousand, or .2% of average revolving home equity loans, compared to $1.8 million in 2012.

Consumer Credit Card

Total consumer credit card loans amounted to $796.2 million at December 31, 2013 and comprised 7.3% of the Company's total loan portfolio. The credit card portfolio is concentrated within regional markets served by the Company. The Company offers a variety of credit card products, including affinity cards, rewards cards, and standard and premium credit cards, and emphasizes its credit card relationship product, Special Connections. Approximately 61% of the households in Missouri that own a Commerce credit card product also maintain a deposit relationship with the subsidiary bank. At December 31, 2013, approximately 82% of the outstanding credit card loan balances had a floating interest rate, compared to 77% in the prior year. Net charge-offs amounted to $25.1 million in 2013, an increase of $646 thousand over $24.5 million in 2012. The ratio of credit card loan net charge-offs to total average credit card loans totaled 3.3% in both 2013 and 2012. These ratios remain below national loss averages in those years.

Allowance for Loan Losses

The Company has an established process to determine the amount of the allowance for loan losses which assesses the risks and losses inherent in its portfolio. This process provides an allowance consisting of a specific allowance component based on certain individually evaluated loans and a general component based on estimates of reserves needed for pools of loans.

Loans subject to individual evaluation generally consist of business, construction, business real estate and personal real estate loans on non-accrual status, and include troubled debt restructurings that are on non-accrual status. These non-accrual loans are evaluated individually for impairment based on factors such as payment history, borrower financial condition, collateral, current economic conditions and loss experience. For collateral dependent loans, appraisals of collateral (including exit costs) are normally obtained annually but discounted based on date last received and market conditions. From these evaluations of expected cash flows and collateral values, specific allowances are determined.

Loans which are not individually evaluated are segregated by loan type and sub-type and are collectively evaluated. These loans include commercial loans (business, construction and business real estate) which have been graded pass, special mention or substandard and all personal banking loans, except personal real estate loans on non-accrual status. Collectively-evaluated loans include certain troubled debt restructurings with similar risk characteristics. Allowances determined for personal banking loans, which are generally smaller balance homogeneous type loans, use consistent methodologies which consider historical and current loss trends, delinquencies and current economic conditions. Allowances for commercial type loans, which are generally larger and more complex in structure with more unpredictable loss characteristics, use methods which consider historical and current loss trends, current loan grades, delinquencies, industry concentrations, economic conditions throughout the Company's markets as monitored by Company credit officers, and general economic conditions.

The Company’s estimate of the allowance for loan losses and the corresponding provision for loan losses rests upon various judgments and assumptions made by management. Factors that influence these judgments include past loan loss experience, current loan portfolio composition and characteristics, trends in delinquencies, portfolio risk ratings, levels of non-performing assets, and prevailing regional and national economic conditions. The Company has internal credit administration and loan review staffs that continuously review loan quality and report the results of their reviews and examinations to the Company’s senior management and Board of Directors. Such reviews also assist management in establishing the level of the allowance. In using this process and the information available, management must consider various assumptions and exercise considerable judgment to determine the overall level of the allowance for loan losses. Because of these subjective factors, actual outcomes of inherent losses can differ from original estimates. The Company’s subsidiary bank continues to be subject to examination by several regulatory agencies, and examinations are conducted throughout the year, targeting various segments of the loan portfolio for review. Refer to Note 1 to the consolidated financial statements for additional discussion on the allowance and charge-off policies.

At December 31, 2013, the allowance for loan losses was $161.5 million compared to a balance at year end 2012 of $172.5 million. Total loans delinquent 90 days or more and still accruing were $14.0 million at December 31, 2013, a decrease of $1.4 million compared to year end 2012. Non-accrual loans at December 31, 2013 were $48.8 million, a decrease of $2.6 million from the prior year, and were mainly comprised of $19.8 million of business real estate loans, $10.2 million of construction loans and $11.6 million of business loans. As the result of improving credit trends noted in the Company's analysis of the allowance, the provision for loan losses was $11.0 million less than net charge-offs for the year, thereby reducing the allowance for loan losses to $161.5 million. The percentage of allowance to loans, excluding loans held for sale, decreased to 1.47% at December 31, 2013 compared to 1.75% at year end 2012 as a result of the decrease in the allowance balance, in addition to loan growth. The percentage of allowance to non-accrual loans was 331% at December 31, 2013, compared to 336% at December 31, 2012.

Net loan charge-offs totaled $31.4 million in 2013, representing a $7.9 million decrease compared to net charge-offs of $39.3 million in 2012. Net recoveries on construction and land loans were $4.7 million in 2013, compared to $283 thousand in 2012. Business loans also remained in a net recovery position in 2013, with net recoveries of $867 thousand in 2013 compared to $2.5 million in 2012. Net charge-offs on business real estate loans decreased $4.2 million to $952 thousand in 2013, compared to net charge-offs of $5.1 million in 2012. Net charge-offs on consumer credit cards increased $646 thousand to $25.1 million in 2013, compared to $24.5 million in 2012; however, net consumer credit card charge-offs remained consistent at 3.34% of average consumer credit card loans in 2013 compared to 3.35% in 2012, as a result of a stabilizing economy. Consumer credit card loan charge-offs as a percentage of total net charge-offs rose to 80.1% in 2013 compared to 62.3% in 2012, as lower overall net charge-offs in other loan categories offset the slight rise in consumer credit card charge-offs.

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The ratio of net charge-offs to total average loans outstanding in 2013 was .30% compared to .42% in 2012 and .70% in 2011. The provision for loan losses in 2013 was $20.4 million, compared to provisions of $27.3 million in 2012 and $51.5 million in 2011.

The Company considers the allowance for loan losses of $161.5 million adequate to cover losses inherent in the loan portfolio at December 31, 2013.

The schedules which follow summarize the relationship between loan balances and activity in the allowance for loan losses:

	Years Ended December 31				
(Dollars in thousands)	2013	2012	2011	2010	2009
Loans outstanding at end of year(A)	$10,956,836	$9,831,384	$9,177,478	$9,410,982	$10,145,324
Average loans outstanding(A)	$10,311,654	$9,379,316	$9,222,568	$9,698,670	$10,629,867
Allowance for loan losses:					
Balance at beginning of year	$172,532	$184,532	$197,538	$194,480	$172,619
Additions to allowance through charges to expense	20,353	27,287	51,515	100,000	160,697
Loans charged off:					
Business	1,869	2,809	6,749	8,550	15,762
Real estate — construction and land	621	1,244	7,893	15,199	34,812
Real estate — business	2,680	7,041	4,176	4,780	5,957
Real estate — personal	1,570	2,416	3,217	2,484	3,150
Consumer	11,029	12,288	16,052	24,587	35,979
Revolving home equity	1,200	2,044	1,802	2,014	1,197
Consumer credit card	33,206	33,098	39,242	54,287	54,060
Overdrafts	2,024	2,221	2,254	2,672	3,493
Total loans charged off	54,199	63,161	81,385	114,573	154,410
Recoveries of loans previously charged off:					
Business	2,736	5,306	1,761	3,964	2,925
Real estate — construction and land	5,313	1,527	943	193	720
Real estate — business	1,728	1,933	613	722	709
Real estate — personal	343	990	445	428	363
Consumer	3,489	4,161	3,896	4,108	3,772
Revolving home equity	214	240	135	39	7
Consumer credit card	8,085	8,623	7,625	6,556	4,785
Overdrafts	938	1,094	1,446	1,621	2,293
Total recoveries	22,846	23,874	16,864	17,631	15,574
Net loans charged off	31,353	39,287	64,521	96,942	138,836
Balance at end of year	$161,532	$172,532	$184,532	$197,538	$194,480
Ratio of allowance to loans at end of year	1.47%	1.75%	2.01%	2.10%	1.92%
Ratio of provision to average loans outstanding	.20%	.29%	.56%	1.03%	1.51%

(A) Net of unearned income, before deducting allowance for loan losses, excluding loans held for sale.

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	Years Ended December 31 2013	2012	2011	2010	2009
Ratio of net charge-offs (recoveries) to average loans outstanding, by loan category:					
Business	(.03)%	(.08)%	.17%	.16%	.41%
Real estate — construction and land	(1.24)	(.08)	1.66	2.69	4.61
Real estate — business	.04	.23	.17	.20	.24
Real estate — personal	.07	.09	.19	.14	.18
Consumer	.52	.69	1.09	1.64	2.20
Revolving home equity	.23	.40	.36	.41	.24
Consumer credit card	3.34	3.35	4.23	6.28	6.77
Overdrafts	18.04	18.40	11.62	14.42	12.27
Ratio of total net charge-offs to total average loans outstanding	.30%	.42%	.70%	1.00%	1.31%

The following schedule provides a breakdown of the allowance for loan losses by loan category and the percentage of each loan category to total loans outstanding at year end:

(Dollars in thousands)	2013		2012		2011		2010		2009	
	Loan Loss Allowance Allocation	% of Loans to Total Loans	Loan Loss Allowance Allocation	% of Loans to Total Loans	Loan Loss Allowance Allocation	% of Loans to Total Loans	Loan Loss Allowance Allocation	% of Loans to Total Loans	Loan Loss Allowance Allocation	% of Loans to Total Loans
Business	$43,146	33.9%	$47,729	31.9%	$49,217	30.5%	$47,534	31.4%	$40,455	28.4%
RE — construction and land	18,617	3.7	20,555	3.6	28,280	4.2	21,316	4.9	33,659	6.6
RE — business	32,426	21.1	37,441	22.5	45,000	23.8	51,096	22.0	31,515	20.7
RE — personal	4,490	16.3	3,937	16.1	3,701	15.6	4,016	15.3	5,435	15.2
Consumer	15,440	13.8	15,165	13.1	15,369	12.1	19,449	12.4	30,257	13.1
Revolving home equity	3,152	3.8	4,861	4.5	2,220	5.1	2,502	5.1	1,737	4.8
Student	—	—	—	—	—	—	—	—	229	3.3
Consumer credit card	43,360	7.3	41,926	8.2	39,703	8.6	50,532	8.8	49,923	7.9
Overdrafts	901	.1	918	.1	1,042	.1	1,093	.1	1,270	—
Total	$161,532	100.0%	$172,532	100.0%	$184,532	100.0%	$197,538	100.0%	$194,480	100.0%

Risk Elements of Loan Portfolio

Management reviews the loan portfolio continuously for evidence of problem loans. During the ordinary course of business, management becomes aware of borrowers that may not be able to meet the contractual requirements of loan agreements. Such loans are placed under close supervision with consideration given to placing the loan on non-accrual status, the need for an additional allowance for loan loss, and (if appropriate) partial or full loan charge-off. Loans are placed on non-accrual status when management does not expect to collect payments consistent with acceptable and agreed upon terms of repayment. After a loan is placed on non-accrual status, any interest previously accrued but not yet collected is reversed against current income. Interest is included in income only as received and only after all previous loan charge-offs have been recovered, so long as management is satisfied there is no impairment of collateral values. The loan is returned to accrual status only when the borrower has brought all past due principal and interest payments current, and, in the opinion of management, the borrower has demonstrated the ability to make future payments of principal and interest as scheduled. Loans that are 90 days past due as to principal and/or interest payments are generally placed on non-accrual, unless they are both well-secured and in the process of collection, or they are comprised of those personal banking loans that are exempt under regulatory rules from being classified as non-accrual. Consumer installment loans and related accrued interest are normally charged down to the fair value of related collateral (or are charged off in full if no collateral) once the loans are more than 120 days delinquent. Credit card loans and the related accrued interest are charged off when the receivable is more than 180 days past due.

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The following schedule shows non-performing assets and loans past due 90 days and still accruing interest.

	December 31				
(Dollars in thousands)	2013	2012	2011	2010	2009
Total non-accrual loans	$48,814	$51,410	$75,482	$85,275	$106,613
Real estate acquired in foreclosure	6,625	13,453	18,321	12,045	10,057
Total non-performing assets	$55,439	$64,863	$93,803	$97,320	$116,670
Non-performing assets as a percentage of total loans	.51 %	.66 %	1.02 %	1.03 %	1.15 %
Non-performing assets as a percentage of total assets	.24 %	.29 %	.45 %	.53 %	.64 %
Total past due 90 days and still accruing interest	$13,966	$15,347	$14,958	$20,466	$42,632

The table below shows the effect on interest income in 2013 of loans on non-accrual status at year end.

(In thousands)	
Gross amount of interest that would have been recorded at original rate	$3,496
Interest that was reflected in income	283
Interest income not recognized	$3,213

Non-accrual loans, which are also classified as impaired, totaled $48.8 million at year end 2013, a decrease of $2.6 million from the balance at year end 2012. At December 31, 2013, non-accrual loans were comprised primarily of business real estate loans (40.5%), business loans (23.7%), and construction and land real estate loans (20.8%). Foreclosed real estate decreased $6.8 million to a total of $6.6 million at year end 2013. The decline was mainly due to the sell-off of a large 1-4 family development. Total non-performing assets remain low compared to the overall banking industry in 2013, with the non-performing loans to total loans ratio at .45% at December 31, 2013. Loans past due 90 days and still accruing interest decreased $1.4 million at year end 2013 compared to 2012. Balances by class for non-accrual loans and loans past due 90 days and still accruing interest are shown in the "Delinquent and non-accrual loans" section of Note 3 to the consolidated financial statements.

In addition to the non-performing and past due loans mentioned above, the Company also has identified loans for which management has concerns about the ability of the borrowers to meet existing repayment terms. They are classified as substandard under the Company's internal rating system. The loans are generally secured by either real estate or other borrower assets, reducing the potential for loss should they become non-performing. Although these loans are generally identified as potential problem loans, they may never become non-performing. Such loans totaled $98.3 million at December 31, 2013 compared with $141.9 million at December 31, 2012, resulting in a decrease of $43.6 million, or 30.7%. The change in potential problem loans was largely due to decreases of $21.2 million in business loans, and $12.0 million in construction and land real estate loans.

	December 31	
(In thousands)	2013	2012
Potential problem loans:		
Business	$23,691	$44,881
Real estate – construction and land	21,812	33,762
Real estate – business	50,349	55,362
Real estate – personal	2,486	7,891
Total potential problem loans	$98,338	$141,896

At December 31, 2013, there were approximately $83.2 million loans outstanding whose terms had been modified or restructured under a troubled debt restructuring. These loans have been extended to borrowers who are experiencing financial difficulty and who have been granted a concession, as defined by accounting guidance, and are further discussed in the "Troubled debt restructurings" section in Note 3 to the consolidated financial statements. This balance includes certain commercial loans totaling $38.2 million which are classified as substandard and included in the table above because of this classification.

Loans with Special Risk Characteristics

Management relies primarily on an internal risk rating system, in addition to delinquency status, to assess risk in the loan portfolio, and these statistics are presented in Note 3 to the consolidated financial statements. However, certain types of loans are considered at high risk of loss due to their terms, location, or special conditions. Construction and land loans and business real estate loans are subject to higher risk as a result of the current weak economic climate and issues in the housing industry. Certain personal real estate products (residential first mortgages and home equity loans) have contractual features that could increase credit exposure in a market of declining real estate prices, when interest rates are steadily increasing, or when a geographic area experiences an economic downturn. For these personal real estate loans, higher risks could exist when 1) loan terms require a minimum monthly payment that covers only interest, or 2) loan-to-collateral value (LTV) ratios at origination are above 80%, with no private mortgage insurance. Information presented below for personal real estate and home equity loans is based on LTV ratios which were calculated with valuations at loan origination date. The Company does not attempt to obtain updated appraisals or valuations unless the loans become significantly delinquent or are in the process of being foreclosed upon. For credit monitoring purposes, the Company relies on delinquency monitoring along with obtaining refreshed FICO scores, and in the case of home equity loans, reviewing line utilization and credit bureau information annually. This has remained an effective means of evaluating credit trends and identifying problem loans, partly because the Company offers standard, conservative lending products.

Real Estate - Construction and Land Loans

The Company's portfolio of construction loans, as shown in the table below, amounted to 3.7% of total loans outstanding at December 31, 2013.

(Dollars in thousands)	December 31, 2013	% of Total		% of Total Loans		December 31, 2012	% of Total		% of Total Loans	
Residential land and land development	$79,273	19.5	%	.7	%	$61,794	17.4	%	.6	%
Residential construction	86,043	21.2		.8		68,590	19.2		.7	
Commercial land and land development	77,444	19.1		.7		83,491	23.5		.9	
Commercial construction	163,437	40.2		1.5		142,121	39.9		1.4	
Total real estate – construction and land loans	$406,197	100.0	%	3.7	%	$355,996	100.0	%	3.6	%

Real Estate – Business Loans

Total business real estate loans were $2.3 billion at December 31, 2013 and comprised 21.1% of the Company's total loan portfolio. These loans include properties such as manufacturing and warehouse buildings, small office and medical buildings, churches, hotels and motels, shopping centers, and other commercial properties. Approximately 46% of these loans were for owner-occupied real estate properties, which present lower risk profiles.

(Dollars in thousands)	December 31, 2013	% of Total		% of Total Loans		December 31, 2012	% of Total		% of Total Loans	
Owner-occupied	$1,074,074	46.4	%	9.8	%	$1,035,407	46.7	%	10.5	%
Retail	271,228	11.7		2.5		245,021	11.1		2.5	
Office	265,352	11.5		2.4		269,756	12.2		2.7	
Multi-family	178,524	7.7		1.6		184,208	8.3		1.9	
Hotels	151,483	6.5		1.4		155,392	7.0		1.6	
Farm	138,842	6.0		1.3		123,613	5.6		1.3	
Industrial	89,045	3.9		.8		110,645	5.0		1.1	
Other	145,002	6.3		1.3		90,933	4.1		.9	
Total real estate - business loans	$2,313,550	100.0	%	21.1	%	$2,214,975	100.0	%	22.5	%

Real Estate - Personal Loans

The Company's $1.8 billion personal real estate loan portfolio is composed of first mortgages on residential real estate. The majority of this portfolio is comprised of approximately $1.5 billion of loans made to the retail customer base and includes both adjustable rate and fixed rate mortgage loans. As shown in Note 3 to the consolidated financial statements, 5.0% of the retail-based portfolio has FICO scores of less than 660, and delinquency levels have been low. Loans of approximately $15.8 million in this portfolio were structured with interest only payments. Interest only loans are typically made to high net-worth borrowers and generally have low LTV ratios or have additional collateral pledged to secure the loan, and, therefore, they are not perceived to represent above normal credit risk. Loans originated with interest only payments were not made to "qualify" the borrower for a lower payment amount. A small portion of the total portfolio is composed of personal real estate loans made to commercial customers, which totaled $244.3 million at December 31, 2013.

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The following table presents information about the retail-based personal real estate loan portfolio for 2013 and 2012.

(Dollars in thousands)	2013 Principal Outstanding at December 31	% of Loan Portfolio	2012 Principal Outstanding at December 31	% of Loan Portfolio
Loans with interest only payments	$15,849	1.0 %	$12,730	.9 %
Loans with no insurance and LTV:				
Between 80% and 90%	80,431	5.2	76,023	5.6
Between 90% and 95%	27,158	1.8	26,871	2.0
Over 95%	38,518	2.5	33,290	2.4
Over 80% LTV with no insurance	146,107	9.5	136,184	10.0
Total loan portfolio from which above loans were identified	1,546,768		1,360,194	

Revolving Home Equity Loans

The Company also has revolving home equity loans that are generally collateralized by residential real estate. Most of these loans (93.8%) are written with terms requiring interest only monthly payments. These loans are offered in three main product lines: LTV up to 80%, 80% to 90%, and 90% to 100%. As shown in the tables below, the percentage of loans with LTV ratios greater than 80% has remained a small segment of this portfolio, and delinquencies have been low and stable. The weighted average FICO score for the total current portfolio balance is 740. At maturity, the accounts are re-underwritten and if they qualify under the Company's credit, collateral and capacity policies, the borrower is given the option to renew the line of credit, or to convert the outstanding balance to an amortizing loan. If criteria are not met, amortization is required, or the borrower may pay off the loan. Over the next four years, approximately 57% of the Company's current outstanding balances are expected to mature. Of these balances, 79% have a FICO score above 700. The Company does not expect a significant increase in losses as these loans mature, due to their high FICO scores, low LTVs, and low historical loss levels.

(Dollars in thousands)	Principal Outstanding at December 31, 2013	*	New Lines Originated During 2013	*	Unused Portion of Available Lines at December 31, 2013	*	Balances Over 30 Days Past Due	*
Loans with interest only payments	$394,714	93.8 %	$44,348	10.5 %	$656,679	156.1 %	$4,284	1.0 %
Loans with LTV:								
Between 80% and 90%	42,162	10.0	10,767	2.6	36,274	8.6	284	.1
Over 90%	12,212	2.9	1,941	.4	10,312	2.5	163	—
Over 80% LTV	54,374	12.9	12,708	3.0	46,586	11.1	447	.1
Total loan portfolio from which above loans were identified	420,589		157,197		686,105			

* Percentage of total principal outstanding of $420.6 million at December 31, 2013.

(Dollars in thousands)	Principal Outstanding at December 31, 2012	*	New Lines Originated During 2012	*	Unused Portion of Available Lines at December 31, 2012	*	Balances Over 30 Days Past Due	*
	$409,593	93.6 %	$60,673	13.9 %	$637,677	145.7 %	$4,011	.9 %

Loans with interest only payments								
Loans with LTV:								
Between 80% and 90%	45,698	10.4	9,747	2.2	36,568	8.4	462	.1
Over 90%	15,310	3.5	1,528	.4	11,320	2.5	358	.1
Over 80% LTV	61,008	13.9	11,275	2.6	47,888	10.9	820	.2
Total loan portfolio from which above loans were identified	437,567		135,657		649,963			

* Percentage of total principal outstanding of $437.6 million at December 31, 2012.

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Fixed Rate Home Equity Loans

In addition to the residential real estate mortgage loans and the revolving floating rate line product discussed above, the Company offers a third choice to those consumers desiring a fixed rate loan and a fixed maturity date. This fixed rate home equity loan, typically for home repair or remodeling, is an alternative for individuals who want to finance a specific project or purchase and decide to lock in a specific monthly payment over a defined period. Outstanding balances for these loans were $284.9 million and $210.1 million at December 31, 2013 and 2012, respectively. At times, these loans are written with interest only monthly payments and a balloon payoff at maturity; however, only 2% of this portfolio was comprised of interest only loans at both December 31, 2013 and 2012. The delinquency history on this product has been low, as balances over 30 days past due totaled only $3.5 million, or 1.2% of the portfolio, at year end 2013 and $2.0 million, or .9% of the portfolio, at year end 2012.

(Dollars in thousands)	2013 Principal Outstanding at December 31	*		New Loans Originated	*		2012 Principal Outstanding at December 31	*		New Loans Originated	*	
Loans with interest only payments	$5,246	1.8	%	$6,530	2.3	%	$4,128	2.0	%	$5,464	2.6	%
Loans with LTV:												
Between 80% and 90%	52,355	18.4		30,893	10.8		36,427	17.3		26,438	12.6	
Over 90%	20,589	7.2		11,652	4.1		17,561	8.4		6,628	3.1	
Over 80% LTV	72,944	25.6		42,545	14.9		53,988	25.7		33,066	15.7	
Total loan portfolio from which above loans were identified	284,867						210,064					

* Percentage of total principal outstanding of $284.9 million and $210.1 million at December 31, 2013 and 2012, respectively.

Management does not believe these loans collateralized by real estate (revolving home equity, personal real estate, and fixed rate home equity) represent any unusual concentrations of risk, as evidenced by net charge-offs in 2013 of $986 thousand, $1.2 million and $318 thousand, respectively. The amount of any increased potential loss on high LTV agreements relates mainly to amounts advanced that are in excess of the 80% collateral calculation, not the entire approved line. The Company currently offers no subprime first mortgage or home equity loans, which are characterized as new loans to customers with FICO scores below 660. The Company does not purchase brokered loans.

Other Consumer Loans

Within the consumer loan portfolio are several direct and indirect product lines comprised mainly of loans secured by automobiles, marine, and RVs. During 2013, $507.7 million of new automobile loans were originated, compared to $440.2 million during 2012. Marine and RV loan production has been significantly curtailed in recent years with few new originations. The loss ratios experienced for marine and RV loans have been higher than for other consumer loan products, at 1.3% and 1.8% in 2013 and 2012, respectively. Balances over 30 days past due are relatively unchanged at year end 2013 compared to 2012. The table below provides the total outstanding principal and other data for this group of direct and indirect lending products at December 31, 2013 and 2012.

(In thousands)	2013 Principal Outstanding at December 31	New Loans Originated	Balances Over 30 Days Past Due	2012 Principal Outstanding at December 31	New Loans Originated	Balances Over 30 Days Past Due

Automobiles	$749,970	$507,678	$7,220	$569,616	$440,206	$4,454
Marine	68,162	2,765	2,860	88,858	1,450	2,948
RV	184,969	11	4,317	238,991	—	4,443
Total	$1,003,101	$510,454	$14,397	$897,465	$441,656	$11,845

Additionally, the Company offers low introductory rates on selected consumer credit card products. Out of a portfolio at December 31, 2013 of $796.2 million in consumer credit card loans outstanding, approximately $167.8 million, or 21.1%, carried a low introductory rate. Within the next six months, $46.4 million of these loans are scheduled to convert to the ongoing higher contractual rate. To mitigate some of the risk involved with this credit card product, the Company performs credit checks and detailed analysis of the customer borrowing profile before approving the loan application. Management believes that the risks in the consumer loan portfolio are reasonable and the anticipated loss ratios are within acceptable parameters.

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Investment Securities Analysis

Investment securities are comprised of securities which are classified as available for sale, non-marketable, or trading. During 2013, total investment securities decreased $404.2 million, or 4.3%, to $9.0 billion (excluding unrealized gains/losses) compared to $9.4 billion at the previous year end. During 2013, securities of $2.2 billion were purchased in the available for sale and non-marketable portfolios, which included $1.0 billion in asset-backed securities. Total sales, maturities and pay downs in these portfolios were $2.6 billion during 2013. During 2014, maturities and pay downs of approximately $1.6 billion are expected to occur. The average tax equivalent yield earned on total investment securities was 2.30% in 2013 and 2.55% in 2012.

At December 31, 2013, the fair value of available for sale securities was $8.9 billion, including a net unrealized gain in fair value of $41.1 million, compared to a net unrealized gain of $263.7 million at December 31, 2012. The overall unrealized gain in fair value at December 31, 2013 included gains of $28.5 million in agency mortgage-backed securities, $10.4 million in non-agency mortgage-backed securities, and $33.9 million in equity securities held by the Parent. These gains were partially offset by unrealized losses of $25.0 million in government-sponsored enterprise obligations.

Available for sale investment securities at year end for the past two years are shown below:

	December 31	
(In thousands)	2013	2012
Amortized Cost		
U.S. government and federal agency obligations	$498,226	$399,971
Government-sponsored enterprise obligations	766,802	467,063
State and municipal obligations	1,624,195	1,585,926
Agency mortgage-backed securities	2,743,803	3,248,007
Non-agency mortgage-backed securities	236,595	224,223
Asset-backed securities	2,847,368	3,152,913
Other debt securities	147,581	174,727
Equity securities	9,970	5,695
Total available for sale investment securities	$8,874,540	$9,258,525
Fair Value		
U.S. government and federal agency obligations	$505,696	$438,759
Government-sponsored enterprise obligations	741,766	471,574
State and municipal obligations	1,619,171	1,615,707
Agency mortgage-backed securities	2,772,338	3,380,955
Non-agency mortgage-backed securities	246,983	237,011
Asset-backed securities	2,844,071	3,167,394
Other debt securities	141,757	177,752
Equity securities	43,898	33,096
Total available for sale investment securities	$8,915,680	$9,522,248

The available for sale portfolio consists of agency mortgage-backed securities, which are collateralized bonds issued by agencies, including FNMA, GNMA, FHLMC, FHLB, Federal Farm Credit Banks and FDIC. Non-agency mortgage-backed securities totaled $247.0 million, at fair value, at December 31, 2013, and included Alt-A type mortgage-backed securities of $79.7 million and prime/jumbo loan type securities of $84.4 million. Certain of the non-agency mortgage-backed securities are other-than-temporarily impaired, and the processes for determining impairment and the related losses are discussed in Note 4 to the consolidated financial statements.

At December 31, 2013, U.S. government obligations included $505.6 million in U.S. Treasury inflation-protected securities, and state and municipal obligations included $127.7 million in auction rate securities, at fair value. Other debt securities include corporate bonds, notes and commercial paper. Available for sale equity securities are mainly comprised of common stock held by the Parent which totaled $37.2 million at December 31, 2013.

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The types of debt securities in the available for sale security portfolio are presented in the table below. Additional detail by maturity category is provided in Note 4 to the consolidated financial statements.

	December 31, 2013		
	Percent of Total Debt Securities	Weighted Average Yield	Estimated Average Maturity*
Available for sale debt securities:			
U.S. government and federal agency obligations	5.7 %	1.05 %	5.3 years
Government-sponsored enterprise obligations	8.4	1.65	6.2
State and municipal obligations	18.2	2.42	6.2
Agency mortgage-backed securities	31.2	2.74	3.9
Non-agency mortgage-backed securities	2.8	4.51	4.4
Asset-backed securities	32.1	.88	2.4
Other debt securities	1.6	2.40	5.9

*Based on call provisions and estimated prepayment speeds.

Non-marketable securities, which totaled $107.3 million at December 31, 2013, included $32.2 million in Federal Reserve Bank stock and $14.3 million in Federal Home Loan Bank (Des Moines) stock held by the bank subsidiary in accordance with debt and regulatory requirements. These are restricted securities which, lacking a market, are carried at cost. Other non-marketable securities also include private equity securities which are carried at estimated fair value.

The Company engages in private equity activities primarily through several private equity subsidiaries. These subsidiaries hold investments in various business entities, which are carried at fair value and totaled $56.6 million at December 31, 2013. In addition to investments held by its private equity subsidiaries, the Parent directly holds investments in several private equity concerns, which totaled $3.3 million at year end 2013. Most of the private equity investments are not readily marketable. While the nature of these investments carries a higher degree of risk than the normal lending portfolio, this risk is mitigated by the overall size of the investments and oversight provided by management, and management believes the potential for long-term gains in these investments outweighs the potential risks. Most of the private equity investments are held by a subsidiary qualified as a Small Business Investment Company.

Non-marketable securities at year end for the past two years are shown below:

	December 31	
(In thousands)	2013	2012
Debt securities	$28,485	$32,068
Equity securities	78,839	86,582
Total non-marketable investment securities	$107,324	$118,650

In addition to its holdings in the investment securities portfolio, the Company holds long-term securities purchased under agreements to resell, which totaled $1.2 billion at December 31, 2013 and 2012. These investments mature in 2014 through 2016, and most have rates that fluctuate with published indices within a fixed range. The counterparties to these agreements are other financial institutions from whom the Company has accepted collateral of $1.2 billion in marketable investment securities at December 31, 2013. The average rate earned on these agreements during 2013 was 1.60%.

The Company also holds $300.0 million in offsetting repurchase and resell agreements at December 31, 2013, which are further discussed in Note 19 to the consolidated financial statements. These agreements involve the exchange of collateral under simultaneous repurchase and resell agreements with the same financial institution counterparty. These repurchase and resell agreements have been offset against each other in the balance sheet, as permitted under current accounting guidance. The agreements mature in 2014 through 2015 and earned an average of 78 basis points during 2013.

Deposits and Borrowings

Deposits are the primary funding source for the Bank and are acquired from a broad base of local markets, including both individual and corporate customers. Total deposits were $19.0 billion at December 31, 2013, compared to $18.3 billion last year, reflecting an increase of $698.7 million, or 3.8%. Most of this growth occurred in the fourth quarter of 2013. Included in the increase are balances of $232.3 million acquired in the Summit transaction. Excluding these balances, total deposits grew 2.6% year over year and reflect a stabilization of the higher growth activity in 2012 and 2011.

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Average deposits grew by $1.2 billion, or 7.3%, in 2013 compared to 2012 with most of this growth occurring in business demand deposits, which grew $402.4 million, or 9.9%, and in money market deposits, which increased $579.1 million, or 7.1%. Certificates of deposit with balances under $100,000 fell on average by $82.2 million, or 7.4%, while certificates of deposit over $100,000 increased by $198.6 million, or 16.8%.

The following table shows year end deposits by type as a percentage of total deposits.

	December 31	
	2013	2012
Non-interest bearing	35.4 %	34.3 %
Savings, interest checking and money market	53.1	53.5
Time open and C.D.'s of less than $100,000	5.2	5.9
Time open and C.D.'s of $100,000 and over	6.3	6.3
Total deposits	100.0 %	100.0 %

Core deposits, which include non-interest bearing, interest checking, savings, and money market deposits, supported 75% of average earning assets in 2013 and 74% in 2012. Average balances by major deposit category for the last six years appear on page 50. A maturity schedule of time deposits outstanding at December 31, 2013 is included in Note 7 on Deposits in the consolidated financial statements.

The Company's primary sources of overnight borrowings are federal funds purchased and securities sold under agreements to repurchase (repurchase agreements). Balances in these accounts can fluctuate significantly on a day-to-day basis and generally have one day maturities. These short-term balances totaled $996.6 million at December 31, 2013. The Company also holds $350.0 million in long-term structured repurchase agreements that will mature throughout 2014. Total balances of federal funds purchased and repurchase agreements outstanding at year end 2013 were $1.3 billion, a $263.0 million increase over the $1.1 billion balance outstanding at year end 2012. On an average basis, these borrowings increased $108.7 million, or 9.2%, during 2013, with increases of $97.8 million in federal funds purchased and $10.9 million in repurchase agreements. The average rate paid on total federal funds purchased and repurchase agreements was .06% during 2013 and .07% during 2012.

Most of the Company's long-term debt is comprised of fixed rate advances from the FHLB. These borrowings increased to $105.3 million at December 31, 2013, from $103.7 million outstanding at December 31, 2012. The average rate paid on FHLB advances was 3.56% and 3.60% during 2013 and 2012, respectively. Most of the remaining balance outstanding at December 31, 2013 is due in 2017.

Liquidity and Capital Resources

Liquidity Management

Liquidity is managed within the Company in order to satisfy cash flow requirements of deposit and borrowing customers while at the same time meeting its own cash flow needs. The Company has taken numerous steps to address liquidity risk and has developed a variety of liquidity sources which it believes will provide the necessary funds for future growth. The Company manages its liquidity position through a variety of sources including:

- A portfolio of liquid assets including marketable investment securities and overnight investments,
- A large customer deposit base and limited exposure to large, volatile certificates of deposit,
- Lower long-term borrowings that might place demands on Company cash flow,
- Relatively low loan to deposit ratio promoting strong liquidity,
- Excellent debt ratings from both Standard & Poor's and Moody's national rating services, and
- Available borrowing capacity from outside sources.

During 2013, the Company saw faster growth in average loans (up 9.9%) than in deposits (up 7.3%), and maturities of marketable securities were largely used to fund loan growth, rather than reinvested in the portfolio. As a result, the Company's average loans to deposits ratio, one measure of liquidity, increased to 57.1% in 2013 from 55.8% in 2012.

The Company’s most liquid assets include available for sale marketable investment securities, federal funds sold, balances at the Federal Reserve Bank, and securities purchased under agreements to resell (resell agreements). At December 31, 2013 and 2012, such assets were as follows:

(In thousands)	2013	2012
Available for sale investment securities	$8,915,680	$9,522,248
Federal funds sold	43,845	27,595
Long-term securities purchased under agreements to resell	1,150,000	1,200,000
Balances at the Federal Reserve Bank	707,249	179,164
Total	$10,816,774	$10,929,007

Federal funds sold are funds lent to the Company’s correspondent bank customers with overnight maturities, and totaled $43.8 million at December 31, 2013. At December 31, 2013, the Company had lent funds totaling $1.2 billion under long-term resell agreements to other large financial institutions. The agreements mature in 2014 through 2016. Under these agreements, the Company holds marketable securities, safekept by a third-party custodian, as collateral, which totaled $1.2 billion in fair value at December 31, 2013. Interest earning balances at the Federal Reserve Bank, which have overnight maturities and are used for general liquidity purposes, totaled $707.2 million at December 31, 2013. The Company’s available for sale investment portfolio includes scheduled maturities and expected pay downs of approximately $1.6 billion during 2014, and these funds offer substantial resources to meet either new loan demand or help offset reductions in the Company’s deposit funding base. The Company pledges portions of its investment securities portfolio to secure public fund deposits, repurchase agreements, trust funds, letters of credit issued by the FHLB, and borrowing capacity at the Federal Reserve Bank. At December 31, 2013 and 2012, total investment securities pledged for these purposes were as follows:

(In thousands)	2013	2012
Investment securities pledged for the purpose of securing:		
Federal Reserve Bank borrowings	$505,690	$604,121
FHLB borrowings and letters of credit	58,445	46,732
Repurchase agreements	2,814,597	2,105,867
Other deposits	1,646,562	1,550,114
Total pledged securities	5,025,294	4,306,834
Unpledged and available for pledging	2,339,549	3,428,781
Ineligible for pledging	1,550,837	1,786,633
Total available for sale securities, at fair value	$8,915,680	$9,522,248

Liquidity is also available from the Company’s large base of core customer deposits, defined as non-interest bearing, interest checking, savings, and money market deposit accounts. At December 31, 2013, such deposits totaled $16.9 billion and represented 88.5% of the Company’s total deposits. These core deposits are normally less volatile, often with customer relationships tied to other products offered by the Company promoting long lasting relationships and stable funding sources. Total core deposits increased $741.1 million in 2013, with growth of $609.2 million in corporate core deposits and $131.9 million in consumer core deposits. Much of this growth occurred in the fourth quarter of 2013, reflecting seasonal patterns. While the Company considers core consumer deposits less volatile, corporate deposits could decline if interest rates increase significantly or if corporate customers increase investing activities and reduce deposit balances. If these corporate deposits decline, the Company's funding needs can be met by liquidity supplied by the investment security portfolio, totaling $1.6 billion as noted above. In addition, as shown on page 39, the Company has borrowing capacity of $3.4 billion through advances from the FHLB and the Federal Reserve.

(In thousands)	2013	2012
Core deposit base:		
Non-interest bearing	$6,750,674	$6,299,903

Interest checking	1,113,110	976,144
Savings and money market	8,995,126	8,841,799
Total	$16,858,910	$16,117,846

Time open and certificates of deposit of $100,000 or greater totaled $1.2 billion at December 31, 2013. These deposits are normally considered more volatile and higher costing and comprised 6.3% of total deposits at December 31, 2013.

Other important components of liquidity are the level of borrowings from third party sources and the availability of future credit. The Company's outside borrowings are mainly comprised of federal funds purchased, repurchase agreements, and advances from the FHLB, as follows:

(In thousands)	2013	2012
Borrowings:		
Federal funds purchased	$24,795	$24,510
Repurchase agreements	1,321,763	1,059,040
FHLB advances	105,310	103,710
Total	$1,451,868	$1,187,260

Federal funds purchased, which totaled $24.8 million at December 31, 2013, are unsecured overnight borrowings obtained mainly from upstream correspondent banks with which the Company maintains approved lines of credit. Repurchase agreements are secured by a portion of the Company's investment portfolio and are comprised of both non-insured customer funds, totaling $971.8 million at December 31, 2013, and structured repurchase agreements of $350.0 million. Customer repurchase agreements are offered to customers wishing to earn interest in highly liquid balances and are used by the Company as a funding source considered to be stable, but short-term in nature. The structured repurchase agreements were borrowed from an upstream financial institution and are due in 2014. The Company also borrows on a secured basis through advances from the FHLB, which totaled $105.3 million at December 31, 2013. All of these advances have fixed interest rates, with the majority maturing in 2017. The overall long-term debt position of the Company is small relative to its overall liability position.

The Company pledges certain assets, including loans and investment securities, to both the Federal Reserve Bank and the FHLB as security to establish lines of credit and borrow from these entities. Based on the amount and type of collateral pledged, the FHLB establishes a collateral value from which the Company may draw advances against the collateral. Also, this collateral is used to enable the FHLB to issue letters of credit in favor of public fund depositors of the Company. The Federal Reserve Bank also establishes a collateral value of assets pledged and permits borrowings from the discount window. The following table reflects the collateral value of assets pledged, borrowings, and letters of credit outstanding, in addition to the estimated future funding capacity available to the Company at December 31, 2013.

	December 31, 2013		
(In thousands)	FHLB	Federal Reserve	Total
Total collateral value pledged	$2,382,076	$1,507,280	$3,889,356
Advances outstanding	(105,310)	—	(105,310)
Letters of credit issued	(353,010)	—	(353,010)
Available for future advances	$1,923,756	$1,507,280	$3,431,036

The Company's average loans to deposits ratio was 57.1% at December 31, 2013, which is considered in the banking industry to be a measure of strong liquidity. Also, the Company receives outside ratings from both Standard & Poor's and Moody's on both the consolidated company and its subsidiary bank, Commerce Bank. These ratings are as follows:

	Standard & Poor's	Moody's
Commerce Bancshares, Inc.		
Issuer rating	A-	

Commercial paper rating		P-1
Rating outlook	Stable	Stable
Commerce Bank		
Issuer rating	A	Aa3
Bank financial strength rating		B
Rating outlook	Stable	Stable

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The Company considers these ratings to be indications of a sound capital base and strong liquidity and believes that these ratings would help ensure the ready marketability of its commercial paper, should the need arise. No commercial paper has been outstanding during the past ten years. The Company has no subordinated or hybrid debt instruments which would affect future borrowing capacity. Because of its lack of significant long-term debt, the Company believes that, through its Capital Markets Group or in other public debt markets, it could generate additional liquidity from sources such as jumbo certificates of deposit, privately-placed corporate notes or other forms of debt. Future financing could also include the issuance of common or preferred stock.

The cash flows from the operating, investing and financing activities of the Company resulted in a net increase in cash and cash equivalents of $489.7 million in 2013, as reported in the consolidated statements of cash flows on page 58 of this report. Operating activities, consisting mainly of net income adjusted for certain non-cash items, provided cash flow of $360.9 million and has historically been a stable source of funds. Investing activities used total cash of $713.7 million in 2013 and consisted mainly of purchases and maturities of available for sale investment securities, changes in long-term securities purchased under agreements to resell, and changes in the level of the Company's loan portfolio. Growth in the loan portfolio used cash of $938.2 million. Net sales, pay downs and maturities in the investment securities portfolio provided cash of $147.3 million, net repayments of long-term resell agreements provided cash of $50.0 million, and cash of $47.6 million was acquired in the Summit Bancshares, Inc. transaction. Investing activities are somewhat unique to financial institutions in that, while large sums of cash flow are normally used to fund growth in investment securities, loans, or other bank assets, they are normally dependent on the financing activities described below.

Financing activities provided total cash of $842.4 million, primarily resulting from a $719.2 million increase in deposits and a net increase of $263.0 million in borrowings of federal funds purchased and repurchase agreements. This increase to cash was partly offset by purchases of treasury stock of $69.4 million and cash dividend payments of $82.1 million. Future short-term liquidity needs for daily operations are not expected to vary significantly, and the Company maintains adequate liquidity to meet these cash flows. The Company's sound equity base, along with its low debt level, common and preferred stock availability, and excellent debt ratings, provide several alternatives for future financing. Future acquisitions may utilize partial funding through one or more of these options.

Cash flows resulting from the Company's transactions in its common stock were as follows:

(In millions)	2013	2012	2011
Exercise of stock-based awards and sales to affiliate non-employee directors	$10.2	$15.6	$15.3
Purchases of treasury stock	(69.4)	(104.9)	(101.2)
Cash dividends paid	(82.1)	(211.6)	(79.1)
Cash used	$(141.3)	$(300.9)	$(165.0)

The Parent faces unique liquidity constraints due to legal limitations on its ability to borrow funds from its bank subsidiary. The Parent obtains funding to meet its obligations from two main sources: dividends received from bank and non-bank subsidiaries (within regulatory limitations) and management fees charged to subsidiaries as reimbursement for services provided by the Parent, as presented below:

(In millions)	2013	2012	2011
Dividends received from subsidiaries	$200.4	$235.0	$180.1
Management fees	20.7	23.7	19.3
Total	$221.1	$258.7	$199.4

These sources of funds are used mainly to pay cash dividends on outstanding common stock, pay general operating expenses, and purchase treasury stock. At December 31, 2013, the Parent's available for sale investment securities totaled $57.8 million at fair value, consisting of common stock and non-agency backed collateralized mortgage obligations. To support its various funding commitments, the Parent maintains a $20.0 million line of credit with its subsidiary bank. There were no borrowings outstanding under the line during 2013 or 2012.

Company senior management is responsible for measuring and monitoring the liquidity profile of the organization with oversight by the Company's Asset/Liability Committee. This is done through a series of controls, including a written Contingency Funding Policy and risk monitoring procedures, which include daily, weekly and monthly reporting. In addition, the Company prepares forecasts to project changes in the balance sheet affecting liquidity and to allow the Company to better plan for forecasted changes.

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Capital Management

The Company maintains strong regulatory capital ratios, including those of its banking subsidiary, in excess of the "well-capitalized" guidelines under federal banking regulations. The Company's capital ratios at the end of the last three years are as follows:

	2013	2012	2011	Well-Capitalized Regulatory Guidelines
Regulatory risk-based capital ratios:				
Tier I capital	14.06 %	13.60 %	14.71 %	6.00 %
Total capital	15.28	14.93	16.04	10.00
Leverage ratio	9.43	9.14	9.55	5.00
Tangible common equity to assets	9.00	9.25	9.91	
Dividend payout ratio	31.51	79.48	31.06	

The Company's regulatory risked-based capital amounts and risk-weighted assets at the end of the last three years are as follows:

(In thousands)	2013	2012	2011
Regulatory risk-based capital:			
Tier I capital	$2,061,761	$1,906,203	$1,928,690
Tier II capital	177,875	185,938	174,711
Total capital	2,239,636	2,092,141	2,103,401
Total risk-weighted assets	14,660,536	14,015,648	13,115,261

The Company maintains a stock buyback program and purchases stock in the market under authorizations by its Board of Directors. At a July 2013 meeting, the Board of Directors approved the purchase of additional shares, bringing the total shares authorized for future purchase to 4,000,000 shares. During 2013 the Company purchased 1,741,806 shares of stock at an average cost of $39.82 per share. At December 31, 2013, 3,492,265 shares remained available for purchase under the current Board authorization.

The Company's common stock dividend policy reflects its earnings outlook, desired payout ratios, the need to maintain adequate capital levels and alternative investment options. The Company paid a special cash dividend of $1.36 per share in the fourth quarter of 2012, and the regular per share cash dividends increased 2.7% in 2013 compared with 2012. The Company also paid its twentieth consecutive annual 5% stock dividend in December 2013. The Board of Directors approved a 5% increase in the first quarter 2014 cash dividend.

Commitments, Contractual Obligations, and Off-Balance Sheet Arrangements

In the normal course of business, various commitments and contingent liabilities arise which are not required to be recorded on the balance sheet. The most significant of these are loan commitments totaling $8.4 billion (including approximately $3.8 billion in unused approved credit card lines) and the contractual amount of standby letters of credit totaling $325.6 million at December 31, 2013. As many commitments expire unused or only partially used, these totals do not necessarily reflect future cash requirements. Management does not anticipate any material losses arising from commitments or contingent liabilities and believes there are no material commitments to extend credit that represent risks of an unusual nature.

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A table summarizing contractual cash obligations of the Company at December 31, 2013 and the expected timing of these payments follows:

	Payments Due by Period				
(In thousands)	In One Year or Less	After One Year Through Three Years	After Three Years Through Five Years	After Five Years	Total
Long-term debt obligations, including structured repurchase agreements*	$351,178	$4,132	$100,000	$—	$455,310
Operating lease obligations	5,850	8,984	6,172	16,300	37,306
Purchase obligations	59,232	106,843	98,929	12,272	277,276
Time open and C.D.'s *	1,740,247	362,024	84,400	1,767	2,188,438
Total	$2,156,507	$481,983	$289,501	$30,339	$2,958,330

* Includes principal payments only.

As of December 31, 2013, the Company had unrecognized tax benefits of $1.4 million. This liability for unrecognized tax benefits represents an estimate of tax positions that the Company has taken in its tax returns which may not be sustained upon examination by taxing authorities. Since the ultimate amount and timing of any future cash settlements cannot be predicted with reasonable certainty, this estimated liability has been excluded from the table above. Further information about these benefits is located in Note 9 to the consolidated financial statements.

The Company funds a defined benefit pension plan for a portion of its employees. Under the funding policy for the plan, contributions are made as necessary to provide for current service and for any unfunded accrued actuarial liabilities over a reasonable period. During 2012, the Company made a discretionary contribution of $1.5 million to its defined benefit pension plan in order to reduce pension guarantee premiums. No contributions were made to the plan in 2013, and the Company is not required nor does it expect to make a contribution in 2014.

The Company has investments in several low-income housing partnerships within the areas it serves. These partnerships supply funds for the construction and operation of apartment complexes that provide affordable housing to that segment of the population with lower family income. If these developments successfully attract a specified percentage of residents falling in that lower income range, federal (and sometimes state) income tax credits are made available to the partners. The tax credits are normally recognized over ten years, and they play an important part in the anticipated yield from these investments. In order to continue receiving the tax credits each year over the life of the partnership, the low-income residency targets must be maintained. Under the terms of the partnership agreements, the Company has a commitment to fund a specified amount that will be due in installments over the life of the agreements, which ranges from 10 to 15 years. At December 31, 2013, the funded investments totaled $13.9 million and are recorded as other assets in the Company's consolidated balance sheet. Additional unfunded commitments, which are recorded as liabilities, amounted to $11.8 million at December 31, 2013.

The Company regularly purchases various state tax credits arising from third-party property redevelopment. These credits are either resold to third parties or retained for use by the Company. During 2013, purchases and sales of tax credits amounted to $65.1 million and $59.6 million, respectively. At December 31, 2013, the Company had outstanding purchase commitments totaling $181.8 million.

Interest Rate Sensitivity

The Company's Asset/Liability Management Committee (ALCO) measures and manages the Company's interest rate risk on a monthly basis to identify trends and establish strategies to maintain stability in net interest income throughout various rate environments. Analytical modeling techniques provide management insight into the Company's exposure to changing rates. These techniques include net interest income simulations and market value analysis. Management has set guidelines specifying acceptable limits within which net interest income and market value may change under various rate change scenarios. These measurement tools indicate that the Company is currently within acceptable risk guidelines as set by management.

The Company's main interest rate measurement tool, income simulations, projects net interest income under various rate change scenarios in order to quantify the magnitude and timing of potential rate-related changes. Income simulations are able to capture option risks within the balance sheet where expected cash flows may be altered under various rate environments. Modeled rate movements include "shocks, ramps and twists". Shocks are intended to capture interest rate risk under extreme conditions by immediately shifting rates up and down, while ramps measure the impact of gradual changes and twists measure yield curve risk. The size of the balance sheet is assumed to remain constant so that results are not influenced by growth predictions. The following table shows the expected effect that gradual basis point shifts in the swap curve over a twelve month period would have on the Company's net interest income, given a static balance sheet.

(Dollars in millions)	December 31, 2013 $ Change in Net Interest Income	December 31, 2013 % Change in Net Interest Income	September 30, 2013 $ Change in Net Interest Income	September 30, 2013 % Change in Net Interest Income	December 31, 2012 $ Change in Net Interest Income	December 31, 2012 % Change in Net Interest Income
300 basis points rising	($5.0)	(.81)%	($6.7)	(1.12)%	($2.1)	(.36)%
200 basis points rising	1.0	.17	(.8)	(.13)	3.1	.51
100 basis points rising	3.4	.56	1.8	.30	4.9	.82

The Company also employs a sophisticated simulation technique known as a stochastic income simulation. This technique allows management to see a range of results from hundreds of income simulations. The stochastic simulation creates a vector of potential rate paths around the market's best guess (forward rates) concerning the future path of interest rates and allows rates to randomly follow paths throughout the vector. This allows for the modeling of non-biased rate forecasts around the market consensus. Results give management insight into a likely range of rate-related risk as well as worst and best-case rate scenarios.

The Company also uses market value analyses to help identify longer-term risks that may reside on the balance sheet. This is considered a secondary risk measurement tool by management. The Company measures the market value of equity as the net present value of all asset and liability cash flows discounted along the current swap curve plus appropriate market risk spreads. It is the change in the market value of equity under different rate environments, or effective duration that gives insight into the magnitude of risk to future earnings due to rate changes. Market value analyses also help management understand the price sensitivity of non-marketable bank products under different rate environments.

Under the above scenarios at December 31, 2013, a gradual increase in interest rates of 100 basis points is expected to increase net interest income from the base calculation by $3.4 million, or .56%, and a rise of 200 basis points is expected to increase net interest income by $1.0 million, or .17%. Under a 300 basis points rising rate scenario, net interest income would decrease by $5.0 million, or .81%. Due to the already low interest rate environment, the Company did not model falling rate scenarios. The change in net interest income from the base calculation at December 31, 2013 for the three scenarios shown was higher than projections made at September 30, 2013, largely due to a change in the mix of interest bearing liabilities. Short-term borrowings of federal funds purchased and repurchase agreements, in addition to short-term certificates of deposit, are generally more rate-sensitive, and these balances declined from the previous quarter. They were replaced by higher balances of demand and money market deposits, which are less rate-sensitive. This change resulted in a more asset-sensitive risk pattern and improving income projections. As shown in the above scenarios, as rates rise from 100 to 300 basis points, the effect on projected net interest income generally becomes more negative. This occurs because, in the higher rate scenarios, the non-contractual deposits are modeled to become more rate sensitive, resulting in margin compression. Also, these scenarios project deposit run-off which is replaced by higher costing short-term borrowings. Rising rates also tend to slow prepayments of both residential mortgage loans and mortgage-backed securities, which also negatively affects net interest income.

Through review and oversight by the ALCO, the Company attempts to engage in strategies that neutralize interest rate risk as much as possible. The Company's balance sheet remains well-diversified with moderate interest rate risk and is well-positioned for future growth. The use of derivative products is limited and the deposit base is strong and stable. The loan to deposit ratio is still at relatively low levels, which should present the Company with opportunities to fund future loan growth at reasonable costs. The Company believes that its approach to interest rate risk has appropriately considered its susceptibility to both rising and falling rates and has adopted strategies which minimize impacts of interest rate risk.

Derivative Financial Instruments

The Company maintains an overall interest rate risk management strategy that permits the use of derivative instruments to modify exposure to interest rate risk. The Company’s interest rate risk management strategy includes the ability to modify the re-pricing characteristics of certain assets and liabilities so that changes in interest rates do not adversely affect the net interest margin and cash flows. Interest rate swaps are used on a limited basis as part of this strategy. As of December 31, 2013, the Company had entered into two interest rate swaps with a notional amount of $12.2 million which are designated as fair value hedges of certain fixed rate loans. The Company also sells swap contracts to customers who wish to modify their interest rate sensitivity. The Company offsets the interest rate risk of these swaps by purchasing matching contracts with offsetting pay/receive rates from other financial institutions. The notional amount of these types of swaps at December 31, 2013 was $584.8 million.

Credit risk participation agreements arise when the Company contracts, as a guarantor or beneficiary, with other financial institutions to share credit risk associated with certain interest rate swaps. These agreements provide for reimbursement of losses resulting from a third party default on the underlying swap.

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The Company enters into foreign exchange derivative instruments as an accommodation to customers and offsets the related foreign exchange risk by entering into offsetting third-party forward contracts with approved, reputable counterparties. In addition, the Company takes proprietary positions in such contracts based on market expectations. This trading activity is managed within a policy of specific controls and limits. Most of the foreign exchange contracts outstanding at December 31, 2013 mature within six months.

In all of these contracts, the Company is exposed to credit risk in the event of nonperformance by counterparties, who may be bank customers or other financial institutions. The Company controls the credit risk of its financial contracts through credit approvals, limits and monitoring procedures. Because the Company generally enters into transactions only with high quality counterparties, there have been no losses associated with counterparty nonperformance on derivative financial instruments.

The following table summarizes the notional amounts and estimated fair values of the Company's derivative instruments at December 31, 2013 and 2012. Notional amount, along with the other terms of the derivative, is used to determine the amounts to be exchanged between the counterparties. Because the notional amount does not represent amounts exchanged by the parties, it is not a measure of loss exposure related to the use of derivatives nor of exposure to liquidity risk.

(In thousands)	2013 Notional Amount	Positive Fair Value	Negative Fair Value	2012 Notional Amount	Positive Fair Value	Negative Fair Value
Interest rate swaps	$596,933	$11,428	$(11,729)	$435,542	$16,334	$(17,060)
Interest rate caps	9,736	1	(1)	27,736	1	(1)
Credit risk participation agreements	52,456	4	(69)	43,243	9	(196)
Foreign exchange contracts	81,207	1,547	(1,530)	47,897	396	(461)
Total at December 31	$740,332	$12,980	$(13,329)	$554,418	$16,740	$(17,718)

Operating Segments

The Company segregates financial information for use in assessing its performance and allocating resources among three operating segments. The results are determined based on the Company's management accounting process, which assigns balance sheet and income statement items to each responsible segment. These segments are defined by customer base and product type. The management process measures the performance of the operating segments based on the management structure of the Company and is not necessarily comparable with similar information for any other financial institution. Each segment is managed by executives who, in conjunction with the Chief Executive Officer, make strategic business decisions regarding that segment. The three reportable operating segments are Consumer, Commercial and Wealth. Additional information is presented in Note 13 on Segments in the consolidated financial statements.

The Company uses a funds transfer pricing method to value funds used (e.g., loans, fixed assets, cash, etc.) and funds provided (deposits, borrowings, and equity) by the business segments and their components. This process assigns a specific value to each new source or use of funds with a maturity, based on current swap rates, thus determining an interest spread at the time of the transaction. Non-maturity assets and liabilities are valued using weighted average pools. The funds transfer pricing process attempts to remove interest rate risk from valuation, allowing management to compare profitability under various rate environments. The Company also assigns loan charge-offs and recoveries (labeled in the table below as "provision for loan losses") directly to each operating segment instead of allocating an estimated loan loss provision. The operating segments also include a number of allocations of income and expense from various support and overhead centers within the Company.

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The table below is a summary of segment pre-tax income results for the past three years.

(Dollars in thousands)	Consumer	Commercial	Wealth	Segment Totals	Other/Elimination	Consolidated Totals
Year ended December 31, 2013:						
Net interest income	$268,283	$288,722	$40,194	$597,199	$ 22,173	$619,372
Provision for loan losses	(34,277)	3,772	(688)	(31,193)	10,840	(20,353)
Non-interest income	113,377	186,446	116,765	416,588	1,798	418,386
Investment securities losses, net	—	—	—	—	(4,425)	(4,425)
Non-interest expense	(270,209)	(235,346)	(96,530)	(602,085)	(27,548)	(629,633)
Income before income taxes	$77,174	$243,594	$59,741	$380,509	$ 2,838	$383,347
Year ended December 31, 2012:						
Net interest income	$274,844	$290,968	$39,498	$605,310	$ 34,596	$639,906
Provision for loan losses	(35,496)	(2,824)	(695)	(39,015)	11,728	(27,287)
Non-interest income	114,307	179,824	108,472	402,603	(2,973)	399,630
Investment securities gains, net	—	—	—	—	4,828	4,828
Non-interest expense	(266,740)	(226,935)	(90,659)	(584,334)	(34,135)	(618,469)
Income before income taxes	$86,915	$241,033	$56,616	$384,564	$ 14,044	$398,608
2013 vs 2012						
Increase (decrease) in income before income taxes:						
Amount	$(9,741)	$2,561	$3,125	$(4,055)	$ (11,206)	$(15,261)
Percent	(11.2)%	1.1%	5.5%	(1.1)%	(79.8)%	(3.8)%
Year ended December 31, 2011:						
Net interest income	$283,555	$283,790	$38,862	$606,207	$ 39,863	$646,070
Provision for loan losses	(47,273)	(16,195)	(712)	(64,180)	12,665	(51,515)
Non-interest income	131,253	162,533	101,836	395,622	(2,705)	392,917
Investment securities gains, net	—	—	—	—	10,812	10,812
Non-interest expense	(269,435)	(221,273)	(89,108)	(579,816)	(37,433)	(617,249)
Income before income taxes	$98,100	$208,855	$50,878	$357,833	$ 23,202	$381,035
2012 vs 2011						
Increase (decrease) in income before income taxes:						
Amount	$(11,185)	$32,178	$5,738	$26,731	$ (9,158)	$17,573
Percent	(11.4)%	15.4%	11.3%	7.5%	(39.5)%	4.6%

Consumer

The Consumer segment includes consumer deposits, consumer finance, and consumer debit and credit cards. Pre-tax profitability for 2013 was $77.2 million, a decrease of $9.7 million, or 11.2%, from 2012. This decrease was mainly due to a decline of $6.6 million, or 2.4%, in net interest income, coupled with an increase of $3.5 million, or 1.3%, in non-interest expense. In addition, non-interest income decreased $930 thousand, while the provision for loan losses decreased $1.2 million, or 3.4%. Net interest income declined due to a $4.7 million decrease in loan interest income and a $7.3 million decrease in net allocated funding credits assigned to the Consumer segment's loan and deposit portfolios, partly offset by a decline of $5.3 million in deposit interest expense. Non-interest income decreased mainly due to declines in deposit account fees (mainly overdraft charges), mortgage banking revenue, and ATM fees, but the declines were partly offset by growth in bank card fees. Non-interest expense increased over the prior year due to higher corporate management fees, bank card related expense, building rent expense and credit card fraud losses, partly offset by lower incentive compensation expense and allocated building security expense. The provision for loan losses totaled $34.3 million, a $1.2 million decrease from 2012, which was mainly due to lower losses on marine and RV loans. Total average loans in this segment increased $170.8 million, or 7.1%, in 2013 compared to the prior year due to growth in auto loan originations, partly offset by repayments of marine and RV loans. Average deposits increased 5.7% over the prior year, resulting mainly from growth in interest checking and money market deposit accounts, partly offset by a decline in certificates of deposit under $100,000.

Pre-tax profitability for 2012 was $86.9 million, a decrease of $11.2 million, or 11.4%, from 2011. This decrease was mainly due to a decline of $8.7 million, or 3.1%, in net interest income, coupled with a decline of $16.9 million, or 12.9%, in non-interest income. These income reductions were partly offset by a decrease of $11.8 million in the provision for loan losses and a $2.7 million decrease in non-interest expense. Net interest income declined due to a $7.9 million decrease in loan interest income and a $9.8 million decrease in net allocated funding credits, partly offset by a decline of $9.0 million in deposit interest expense. Non-interest income decreased mainly due to declines in bank card fee income (primarily debit card fees) and deposit account fees (mainly overdraft charges). Non-interest expense declined from the same period in the previous year due to lower FDIC insurance expense and corporate management fees, partly offset by higher salaries expense. The provision for loan losses totaled $35.5 million, an $11.8 million decrease from 2011, which was due mainly to lower losses on consumer credit card loans and marine and RV loans. Total average loans decreased 3.0% in 2012 compared to the prior year due to declines in held for sale student loans and personal real estate loans. Consumer loans grew, however, due to auto loan growth, which was partly offset by declining marine and RV loans. Average deposits increased 4.2% over the prior period, due mainly to money market and interest checking account growth, partly offset by lower balances of certificates of deposit under $100,000.

Commercial

The Commercial segment provides corporate lending (including the Small Business Banking product line within the branch network), leasing, international services, and business, government deposit, and related commercial cash management services, as well as merchant and commercial bank card products. The segment includes the Capital Markets Group, which sells fixed-income securities to individuals, corporations, correspondent banks, public institutions, and municipalities, and also provides investment safekeeping and bond accounting services. Pre-tax income for 2013 increased $2.6 million, or 1.1%, compared to the prior year, mainly due to higher non-interest income and a decline in the provision for loan losses, partly offset by higher non-interest expense and a decline in net interest income. Net interest income decreased $2.2 million, due to a $5.7 million decline in loan interest income, partly offset by higher net allocated funding credits of $3.0 million. Non-interest income increased by $6.6 million, or 3.7%, over the previous year due to growth in bank card fees (mainly corporate card), partly offset by lower capital market fees. Growth was also seen in corporate cash management fees and tax credit sales fees. Non-interest expense increased $8.4 million, or 3.7%, over the previous year, mainly due to higher full-time salaries expense, a provision recorded on a letter of credit exposure, and higher bank card related expense. These expense increases were partly offset by higher gains on sales of foreclosed property, lower incentive compensation, and lower processing costs. The provision for loan losses declined $6.6 million from last year, as business real estate loan net charge-offs declined $4.2 million and construction and land loan net recoveries increased $4.4 million, while business loan recoveries decreased by $1.6 million. Average segment loans increased $476.0 million, or 8.4%, compared to 2012 as a result of growth in all commercial loan categories. Average deposits increased $542.7 million, or 8.7%, due to growth in non-interest bearing accounts and certificates of deposit over $100,000.

In 2012, pre-tax profitability for the Commercial segment increased $32.2 million, or 15.4%, compared to the prior year, mainly due to a lower provision for loan losses and growth in net interest income and non-interest income. Net interest income increased $7.2 million, or 2.5%, due to higher net allocated funding credits of $15.4 million (related to higher average deposit balances), partly offset by a $10.1 million decline in loan interest income. The provision for loan losses in the segment totaled $2.8 million in 2012, a decrease of $13.4 million from 2011. During 2012, net recoveries of $2.5 million were recorded on business loans, compared to net charge-offs of $4.7 million in 2011. This decline in net charge-offs was partly due to recoveries of $3.6 million on two non-performing loans in 2012. In addition, net charge-offs on construction loans decreased $7.2 million. Non-interest income increased by $17.3 million, or 10.6.%, over the previous year due to growth in bank card fees (mainly corporate card), capital market fees and tax credit sales revenue. Non-interest expense increased $5.7 million, or 2.6%, over 2011, mainly due to higher salaries expense and bank card related expenses, partly offset by lower corporate management fees. Average segment loans increased 1.0% compared to 2011 as a result of a growth in business real estate, lease and tax-free loans, partly offset by a decline in construction loans. Average deposits increased 11.5% due to growth in non-interest bearing accounts, money market deposit accounts and interest checking accounts, partly offset by a decline in certificates of deposit over $100,000.

Wealth

The Wealth segment provides traditional trust and estate planning, advisory and discretionary investment management services, brokerage services, and includes Private Banking accounts. At December 31, 2013, the Trust group managed investments with a market value of $20.4 billion and administered an additional $14.8 billion in non-managed assets. It also provides investment management services to The Commerce Funds, a series of mutual funds with $1.8 billion in total assets at December 31, 2013. Wealth segment pre-tax profitability for 2013 was $59.7 million, compared to $56.6 million in 2012, an increase of $3.1 million, or 5.5%. Net interest income increased $696 thousand, or 1.8%, mainly due to a $1.2 million decline in deposit interest expense and an increase of $529 thousand in loan interest income, which were partly offset by a $1.1 million decrease in net allocated funding credits. Non-interest income increased $8.3 million, or 7.6%, over the prior year due to higher personal and institutional trust fees and brokerage advisory fees. Non-interest expense increased $5.9 million, or 6.5%, mainly due to higher full-time salary costs, incentive compensation and processing costs. Average assets increased $112.4 million, or 15.1%, during 2013 mainly due to higher loan balances (mainly consumer and personal real estate loans) originated in this segment. Average deposits also increased $195.9 million, or 11.6%, due to growth in money market and interest checking deposit accounts.

In 2012, pre-tax income for the Wealth segment was $56.6 million compared to $50.9 million in 2011, an increase of $5.7 million, or 11.3%. Net interest income increased $636 thousand, or 1.6%, and was impacted by a $1.8 million decline in deposit interest expense, partly offset by a $1.0 million decrease in net allocated funding credits. Non-interest income increased $6.6 million, or 6.5%, over the prior year due to higher personal and institutional trust fees. Non-interest expense increased $1.6 million, or 1.7%, mainly due to higher salary and benefit costs, partly offset by lower fraud losses and legal and professional fees. Average assets increased $62.9 million, or 9.2%, during 2012 mainly due to higher loan balances, while average deposits increased $158.5 million, or 10.3%, on higher money market and interest checking accounts.

The segment activity, as shown above, includes both direct and allocated items. Amounts in the “Other/Elimination” column include activity not related to the segments, such as certain administrative functions, the investment securities portfolio, and the effect of certain expense allocations to the segments. Also included in this category is the difference between the Company’s provision for loan losses and net loan charge-offs, which are generally assigned directly to the segments. In 2013, the pre-tax income in this category was $2.8 million, compared to $14.0 million in 2012. This decrease occurred partly due to a $12.4 million decline in net interest income in this category, related to the earnings of the investment portfolio and interest expense on borrowings not allocated to a segment. In addition, unallocated securities gains declined $9.3 million, while unallocated non-interest expense was lower by $6.6 million.

Impact of Recently Issued Accounting Standards

Other Comprehensive Income In February 2013, the Financial Accounting Standards Board (FASB) issued ASU 2013-02, "Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income". The amendments require an entity to present, either in the income statement or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income, but only if the amount reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety, an entity is required to cross-reference to other disclosures that provide additional detail about those amounts. This ASU was effective for annual and interim periods beginning January 1, 2013. Adoption of the ASU did not have a significant effect on the Company's consolidated financial statements (see Note 12 to the consolidated financial statements).

Balance Sheet In December 2011, the FASB issued ASU 2011-11, "Disclosures about Offsetting Assets and Liabilities". The ASU is a joint requirement by the FASB and International Accounting Standards Board to enhance current disclosures and increase comparability of GAAP and International Financial Reporting Standards (IFRS) financial statements. Under the ASU, an entity is required to disclose both gross and net information about instruments and transactions eligible for offset in the balance sheet, as well as instruments and transactions subject to an agreement similar to a master netting agreement. ASU 2013-01, "Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities" was issued in January 2013, and amended ASU 2011-11 to specifically include only derivatives accounted for under Topic 815, repurchase and reverse repurchase agreements, and securities borrowing and lending transactions that are either offset or subject to an enforceable master netting arrangement. Both ASUs were effective for annual and interim periods beginning January 1, 2013, and their required disclosures are included in the accompanying Note 19 to the consolidated financial statements.

Investment Companies In June 2013, the FASB issued ASU 2013-08, "Amendments to the Scope, Measurement, and Disclosure Requirements" for investment companies. The amendments changed the assessment of whether an entity is an investment company by requiring an entity to possess certain fundamental characteristics, while allowing judgment in assessing other typical characteristics. The ASU was effective January 1, 2014, and the Company did not change the status of any subsidiary or the accounting applied to a subsidiary under the new guidelines.

Derivatives The FASB issued ASU 2013-10, "Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes", in July 2013. These amendments allow the Fed Funds Effective Swap Rate (OIS) to be used as a U.S. benchmark interest rate for hedge accounting purposes, in addition to the current benchmark rates of UST (the rate on direct Treasury obligations of the U.S. government) and LIBOR (the London Interbank Offered Rate on swaps). The amendments were effective on a prospective basis for new or redesignated hedging relationships on July 17, 2013. The adoption did not have a significant effect on the Company's consolidated financial statements.

Investments - Equity Method and Joint Ventures The FASB issued ASU 2014-01, "Accounting for Investments in Qualified Affordable Housing Projects", in January 2014. These amendments allow investors in low income housing tax credit entities to account for the investments using a proportional amortization method, provided that certain conditions are met, and recognize

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amortization of the investment as a component of income tax expense. In addition, disclosures are required that will enable users to understand the nature of the investments, and the effect of the measurement of the investments and the related tax credits on the investor's financial statements. This ASU is effective for interim and annual periods beginning January 1, 2015 and should be applied retrospectively to all periods presented. The adoption is not expected to have a significant effect on the Company's consolidated financial statements.

Troubled Debt Restructurings by Creditors The FASB issued ASU 2014-04, "Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure", in January 2014. These amendments require companies to disclose the amount of foreclosed residential real estate property held and the recorded investment in consumer mortgage loans secured by residential real estate properties for which formal foreclosure proceedings are in process according to local requirements of the applicable jurisdiction. The ASU also defines when a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan. The amendments are effective for interim and annual periods beginning January 1, 2015. The adoption is not expected to have a significant effect on the Company's consolidated financial statements.

Corporate Governance

The Company has adopted a number of corporate governance measures. These include corporate governance guidelines, a code of ethics that applies to its senior financial officers and the charters for its audit committee, its committee on compensation and human resources, and its committee on governance/directors. This information is available on the Company’s Web site www.commercebank.com under Investor Relations.

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SUMMARY OF QUARTERLY STATEMENTS OF INCOME

Year ended December 31, 2013	For the Quarter Ended			
(In thousands, except per share data)	12/31/2013	9/30/2013	6/30/2013	3/31/2013
Interest income	$162,141	$162,144	$167,255	$158,745
Interest expense	(7,276)	(7,438)	(7,797)	(8,402)
Net interest income	154,865	154,706	159,458	150,343
Non-interest income	109,522	106,311	102,676	99,877
Investment securities gains (losses), net	(1,342)	650	(1,568)	(2,165)
Salaries and employee benefits	(95,012)	(91,405)	(89,569)	(90,881)
Other expense	(66,306)	(64,907)	(67,397)	(64,156)
Provision for loan losses	(5,543)	(4,146)	(7,379)	(3,285)
Income before income taxes	96,184	101,209	96,221	89,733
Income taxes	(30,359)	(32,764)	(30,182)	(28,925)
Non-controlling interest	90	(221)	(234)	209
Net income attributable to Commerce Bancshares, Inc.	$65,915	$68,224	$65,805	$61,017
Net income per common share — basic*	$.69	$.71	$.69	$.64
Net income per common share — diluted*	$.69	$.71	$.69	$.63
Weighted average shares — basic*	94,843	94,504	94,273	94,722
Weighted average shares — diluted*	95,321	94,975	94,667	94,966

Year ended December 31, 2012	For the Quarter Ended			
(In thousands, except per share data)	12/31/2012	9/30/2012	6/30/2012	3/31/2012
Interest income	$170,185	$		