

February 26, 2016

Dear Shareholders:

May 1, 2015 marked the 125th anniversary of Exchange Bank's first day of business. Exchange Bank has a rich history of serving its customers with integrity and establishing relationships based on trust. It is our responsibility to preserve and build upon the solid values on which this bank was founded. The tone we set as stewards of the Bank is critical, and we must lead a culture of excellence with high integrity.

The year 2015 will be remembered as one in which we focused on organic growth of our balance sheet complemented with a significant level of reinvestment back into the company. We have worked on improving technology, credit risk management, and business processes while adding to our ranks of talented personnel. We hired top professionals with expertise in specific areas of focus. Our retail banking manager and product delivery channels manager were fortified by key hires.

We are very proud of the exceptional financial performance that Exchange Bank delivered for its shareholders in 2015. We sustained excellent growth and profitability in the face of continued challenges, including historically low interest rates and intense competition.

Given the backdrop of low interest rates, volatility and uncertainty, strong operating results for 2015 were realized. Net income after tax of \$21.0 million during the year ended 2015 was up \$3.3 million or 19% above the \$17.7 million earned in 2014. This translated into an impressive 12.6% return on average equity and a 1.09% return on average assets for the year ended December 31, 2015. This level of earnings significantly improved shareholder value through an increase in retained earnings as well as an increase in the level of dividend payouts. Total dividends paid to Exchange Bank common shareholders for 2015 of \$3.77 million represented an increase of 42% above total dividends of \$2.66 million paid during 2014. We must acknowledge that certain non-recurring events played a role in the substantial increase in earnings. For this reason, it is important that we discuss the earnings in context of two viewpoints, one of core sustainable earnings and one of non-recurring events that contributed to the growth in earnings.

From a core earnings standpoint, 2015 was another solid year of positive earnings growth. The core earnings of the Bank are driven primarily by continued growth in loans and investments which were funded by a 10% growth in deposits. This asset growth led to an increase in net interest income of approximately \$4.4 million for the year ended December 31, 2015, a 7% increase over the year ended December 31, 2014. Growth in low cost core deposits of \$171.0 million, or 10.0%, allowed the Bank to fund growth of \$57.0 million in its loan portfolio, \$30.0 million in excess reserves at the Fed, and \$82.0 million in its investment securities portfolio. Finally, the strength of deposit growth allowed the Bank to pay off \$12.0 million of subordinated debt helping to cut annual interest expense by approximately \$250 thousand. Net loan growth of \$57.0 million belies the true level of financing provided to the community in the

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form of consumer and business lending. Strong, new loan production for the year totaling in excess of \$300.0 million was impacted by significant loan payoffs from our existing customer base, reflecting the improvement in the financial condition of our borrowers and the local economy, and acquisitions of several large business customers from out-of-state companies.

From every possible metric, the liquidity position of the Bank remains extremely strong. The cash generated from operations, combined with the robust deposit growth, place the Bank in a position of strength to meet both the future credit needs of our clients as well as a continued reinvestment in the infrastructure of the organization. Additionally, even with the reduction of subordinated debt, our regulatory capital levels remain strong and above all current regulatory requirements, including those proposed in the phase-in of the BASEL III capital standards.

This year's profitability was influenced by a number of non-recurring events which impacted both revenue and expense. As a result of the significant improvement in the Bank's credit quality and the recovery of loans previously charged off, \$3.2 million in provision for loan losses was reversed during the year. The Bank's level of reserves to support loan losses remains strong in comparison to industry standards and is supported by the continued improvement in asset quality. Additionally, the Bank experienced positive adjustments to interest income of approximately \$1.3 million associated with non-recurring investment income and recovery of interest on loans that had been previously charged off. Offsetting this unexpected revenue, the Bank recognized a number of non-recurring expenses totaling approximately \$1.0 million, primarily relating to retirement benefits. The difference between non-recurring income and expense, after tax, provided a positive adjustment of approximately \$2.2 million to the Bank's net income for the year. Normalized core earnings for the Bank, after removing all non-recurring events, would have been approximately \$18.8 million, an increase of 6% over the \$17.7 million earned for the year ended 2014. We are pleased with the Bank's continued level of profitability, notwithstanding the impact the level of positive, non-recurring events had on our earnings. However, due to the recent economic headwinds and the continued pressure on our net interest margin, combined with the expected absence of these elements of non-recurring earnings, it will be difficult to replicate the level of earnings achieved in 2015.

The positive news is that a majority of the non-recurring elements of increased earnings related to an improved credit profile of the Bank. The credit quality of the Bank now stands well above its peer group in terms of lower levels of troubled loans and higher levels of reserves to cover potential loan losses. The Bank ended 2015 with a level of non-accrual loans as a percentage of total loans at .33%, a decline from .99% as of December 31, 2014. The Bank's level of allowance for loan loss stood at 2.96% of total loans outstanding at the end of 2015 compared to a similar ratio of less than 2% maintained by the Bank's peer group. The credit quality of the Bank's loan portfolio will continue to contribute in a positive way to the outlook for earnings in the foreseeable future.

The Bank's Trust and Investment Department continued to be a bright spot for the Bank in 2015. With approximately \$950.0 million in assets under management, our Trust and Investment Department is the sixth largest community bank trust department by asset size in the state of California. The department contributed a record \$6.1 million in gross revenue to the Bank for the year ended December 31, 2015, an increase of 4.2% over the prior year. The department has a depth of experience and knowledge of the trust and investment markets, with twelve of the

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twenty staff members credentialed investment and trust professionals. We are proud to work closely with the top estate planning attorneys in Sonoma County. The Bank has witnessed particularly strong growth in the management of full service 401(k) plans for our small business clients, where unlike most other investment firms, the Bank serves in the capacity of full Discretionary Trustee.

Overall, 2015 was a very positive year from a number of standpoints as well as a year of contrasts. Exchange Bank, while a community bank serving the financial needs of our communities in northern California, is not insulated from the impact of the global economy. When we talk about contrasts, none stand out more than those that we witnessed during 2015 from a global economic perspective. In the U.S. the Fed ended eight years of monetary stimulus by raising the target Fed Funds rate of .25% to a target of .25% - .50%, while the majority of global central banks remain in an aggressive easing mode as they attempt to stimulate economic growth. Growth in China has faltered, slowing to 6.9% last year, the slowest pace in a quarter century. While much of the rest of the global economy is facing weakening economic prospects, the U.S. continues to witness strength in employment, the housing market, and consumer confidence. Meanwhile, U.S. inflation remained weak, with the consumer-price index falling a seasonally adjusted 0.1% in December. And then there is oil, which recently began trading below \$30 for the first time in 12 years. Cheaper oil can be good news, signaling lower costs across the economy. But, it may indicate slower demand from the factories, truckers, and car buyers that use petroleum products around the world. Global stocks ended a volatile year on a negative note, driven lower by heightened concerns about growth and fading confidence in the willingness or ability of central banks to give it new life.

This level of global economic turbulence led to an ongoing flight of capital to the safety and value of the U.S. Treasury, continuing to keep Treasury yields at historically low levels and the Fed to remain cautious about raising short-term rates as well. As a result, we continued to operate in an environment of extremely low interest rates and a Fed Funds rate that, until year-end, was anchored around 0%. This certainly extended the challenges the Bank has faced for several years in its ability to expand the net interest margin, as reinvestment rates for loans and investments remained much lower than we expected throughout 2015.

Our priorities for 2016 reflect our mission - to help our customers succeed, to make a difference in the communities we serve, to provide a fair return to our shareholders, and to recognize and reward our employees. We will focus on delivering individual customer solutions to build deeper, stronger relationships.

During this milestone year, there were many opportunities to pause and reflect upon where we have come from, where we are today, and what the future may hold for us. To achieve improved profitability we are going to focus on two main priorities: 1) growth in wallet share of existing relationships, and 2) improvements in our operating efficiency. We are embarking on a number of interesting initiatives around these themes, with focus on improving our customer experience, implementation of an improved loan origination system, and major corporate-wide projects to improve our back office processes.

We must continue to maintain discipline in controlling operating expenses while at the same time attract and retain the talent necessary for the future growth and prosperity of the Bank.

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During 2015, the acquisition of a talented team from a local, reputable mortgage company, combined with our highly successful residential mortgage group, strengthens our position as a key player in the North Bay's residential mortgage industry.

In 2015, Exchange Bank continued to invest in its infrastructure and deploy new and emerging technologies, thereby positioning itself for the future. A major tenant underlying each selected technology was a requirement for simple and intuitive use. Our goal will be to continue making it easy and enjoyable for our customers to do business with us.

We deliver our services via many channels and the Bank is committed to ensuring each channel provides a superior customer experience. Electronic and branch delivery channels must both be excellent – one without the other does not serve our customers well. Investments in mobile technologies, therefore, continued in 2015 with the pilot of business mobile banking, giving our commercial customers yet another convenient channel in which to transact their business. In 2016, the pilot will be expanded to a larger group of customers. Consumer online banking users will see new products and enhancements in 2016 as well. Emerging payment methods will be offered to our customers beginning with Apple Pay and likely to include others. New mobile technologies and products will be piloted. One such product, “Mobi Money”, will allow our customers to toggle their debit cards on and off quickly via a simple smartphone application. In the coming year, our investment in technology will be in support of our strategic business priorities, including a new automated lending platform, and a new teller and new accounts platform.

Naturally, the Bank continues to invest in technologies designed to ensure the confidentiality, integrity, and availability of its data and systems. Protecting the privacy of our customers' data is of critical importance and remains a primary requirement for all technologies and services offered. The integrity of the Bank's data is of equal importance as it serves as the foundation for driving strategic business decisions. Finally, data and systems must be readily available for our customers and our employees. The Bank, in 2015, continued to invest in technologies in support of all three objectives – confidentiality, integrity, and availability. Duplicate architectures were deployed to improve availability and new security technologies were implemented to protect customer data. Investments in cybersecurity and redundant computing architectures will continue in 2016, ensuring that the critical solutions we provide our customers and employees are not only secure, but also available at the needed time and via the preferred delivery channels. We will continue to invest heavily in technology as these are investments that will enable us to serve our clients more efficiently while providing the products and services that will help them achieve their financial objectives.

The Bank continued to strategically invest and grow our retail business in ways that make it easy for our customers to do business with us. The Bank recognizes the importance and increasing use of its online channels, but has not forgotten the value of its branch network and the connections it provides to our customers and our communities. Our branches, therefore, received considerable investment in 2015 with the deployment of image enabled ATM machines and interactive digital signage. Instant issue debit cards and near real-time enrollment in online banking were piloted in late 2015 and will continue deployment in early 2016. Each of these investments foster a more seamless and convenient interaction between our customers and their financial services. To further prevent fraud on our customer accounts, we launched EMV chip

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enabled debit cards to increase the security on debit card transactions. These efforts have improved our customer experience and make it easier for our customers to do business with us.

We invested in our branch network, continuing the journey started with our Windsor Branch of the Future, incorporating the open feel and layout of the new branch design. Our customers responded well to the merchandising and embraced the use of technology, demonstrated in higher adoption rates of our electronic and digital delivery channels. Moving forward, the Bank will continue to integrate key branch based technologies to the rest of our network. As we rethink the retail branch, we will continue to solve and implement changes for the future.

We are positioning ourselves to build on our strong retail branch client base and meet the emerging needs of our customers. We will capitalize on our opportunity to expand our digital presence and deepen relationships with new and existing customers. We are confident in our ability to add value to our customers by continuing to transform our branch experience and making it easier to bank with us.

In 2015, Exchange Bank continued to play a key role as a financial partner in the communities we serve by providing individuals and businesses with the financial resources they need to reach their goals, and fuel the growth and prosperity for their future success.

We continue to operate as one of the most compassionate and community-centric banks in Sonoma County. The extraordinary efforts of our employees were not limited to the financial results of the Bank. We value our employees' commitment, not only as volunteers, but as leaders in our community. Time and again they banded together to help the community through work in non-profit and civic organizations, schools, churches, and many more organizations too numerous to list. This leadership in our community is part of who we are and what we do – it is true to our legacy.

Exchange Bank employees are passionate about doing what's right for our customers and the communities we serve. We are proud to say that giving back is a part of our 125-year legacy. Our employees volunteer and support fundraising efforts for programs that make a difference in our communities. In one of many large fundraising efforts in 2015, our employees raised over \$45,000 for the Human Race. Their selfless work defines our company and goes to the heart of Exchange Bank's mission and legacy. Our employees are the face of Exchange Bank for our customers and our community.

In recognition of our employees' exceptional work and dedication, and the commitment of our customers and shareholders, we are proud to report that, once again, we have been recognized as one of Sonoma County's "Best Places to Work", "Best Business Bank", and "Best Bank". In 2015 we were also a recipient of a "Corporate Philanthropy Award".

In 2015, we contributed to over 300 charitable organizations throughout Sonoma and Placer counties. Our dedicated employees continue to give back to our community with a commitment to thousands of volunteer hours annually to make this community a better place to live and work.

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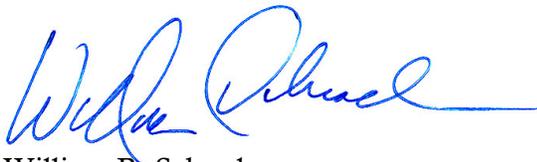
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On behalf of our Board of Directors and employees, we sincerely thank you for your commitment and confidence in Exchange Bank.

We would like to invite you to our Annual Shareholders' meeting on Friday, March 18, 2016 at 2:00 p.m. If you are unable to attend, we would request your proxy vote be given to management. In the interim, if you have any specific questions you would like answered, please direct them in writing to:

Marlene Soiland
Corporate Secretary
Exchange Bank
P.O. Box 403
Santa Rosa, CA 95402

You may also contact the chairman directly via email at schraderb@exchangebank.com.



William R. Schrader
Chairman of the Board

Sincerely,



Gary Hartwick
President and Chief Executive Officer



NOTICE OF ANNUAL SHAREHOLDERS MEETING TO BE HELD MARCH 18, 2016

February 26, 2016

Dear Shareholder:

The annual meeting of the shareholders of Exchange Bank will be held at the Andrew J. Shepard Administrative Services Building, second floor, 444 Aviation Boulevard, Santa Rosa, California on **Friday, March 18, 2016 at 2:00 p.m.** At the meeting, we will review our operating results for 2014 and attend to formal matters as follows:

1. To elect the following ten nominees to serve as directors for the ensuing year:

- | | |
|----------------------|-----------------------|
| ▪ Marlene K. Soiland | ▪ William R. Schrader |
| ▪ James M. Ryan | ▪ Richard W. Abbey |
| ▪ Dante B. Benedetti | ▪ Bruce E. DeCrona |
| ▪ Carlos G. Tamayo | ▪ Steven G. Dutton |
| ▪ Daniel G. Libarle | ▪ Gary T. Hartwick |

2. To transact such other business as may properly come before the meeting.

Shareholders of record at the close of business on February 19, 2016 are entitled to notice of and to vote at the meeting.

It is important that your shares be represented at the meeting in person or by proxy. The giving of such proxy will not affect your right to revoke such proxy or to vote in person should you later decide to attend the meeting. For this reason, please complete, sign, date and return the proxy card as promptly as possible in the postage prepaid envelope whether or not you plan to attend the meeting in person.

The following information is included in accordance with the Bank's bylaws:

Any common stock shareholder may nominate a person for election to the Board of Directors at any meeting of shareholders called for the election of directors, provided that the nomination is received by the President not less than thirty-five (35) or more than sixty (60) days prior to any such meeting. To be eligible, all nominees submitted by shareholders must satisfy the age and residency requirements in Section 3.2 of the bylaws and include the name and address of the nominee(s) and all other information required by the bylaws.



Notice of Annual Shareholders Meeting

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Section 3.3 of the Bank's bylaws provides: "Nominations, other than those made by the Board of Directors shall be made in writing and shall be delivered or mailed to the President of the Corporation not less than thirty-five (35) days nor more than sixty (60) days prior to any meeting of shareholders called for the election of directors, provided, however, that if less than twenty-one (21) days' notice of the meeting is given to shareholders, such nomination shall be mailed or delivered to the President of the Corporation not later than the close of business on the seventh (7th) day following the day on which the notice of meeting was mailed. Such notification shall contain the following information as to each proposed nominee and as to each person, acting alone or in conjunction with one or more other persons, in making such nomination or in organizing, directing or financing such nomination or solicitation of proxies to vote for the nominee: (a) the name, age, birthdate, residence address and business address of each proposed nominee and each such person and the date as of which such nominee commenced residency at such residence address; (b) the principal occupation or employment, the name, type of business and address of the organization or other entity in which such employment is carried on of each proposed nominee and of each such person; (c) if the proposed nominee is an attorney, a statement as to whether or not either he or she or any firm with whom he or she has a relationship as partner, associate, of counsel, employee, or otherwise, acts as legal counsel for any banking corporation, affiliate or subsidiary thereof, bank holding company, industrial loan company, savings bank or association or finance company, other than this Corporation or any affiliate or subsidiary of this Corporation; (d) a statement as to each proposed nominee and a statement as to each such person stating whether the nominee or person concerned has been a participant in any proxy contest within the past ten years, and, if so, the statement shall indicate the principals involved, the subject matter of the contest, the outcome thereof, and the relationship of the nominee or person to the principals; (e) the amount of stock of the Corporation owned beneficially, directly or indirectly, by each proposed nominee or by members of his or her family residing with him or her and the names of the registered owners thereof; (f) the amount of stock of the Corporation owned of record but not beneficially by each proposed nominee or by members of his or her family residing with him or her and by each such person or by members of his or her family residing with him or her and the names of the beneficial owners thereof; (g) if any shares specified in (e) or (f) above were acquired in the last two years, a statement of the dates of acquisition and amounts acquired on each date; (h) a statement showing the extent of any borrowings to purchase shares of the Corporation specified in (e) or (f) above acquired within the preceding two years, and if funds were borrowed otherwise than pursuant to a margin account or bank loan in the regular course of business of a bank, the material provisions of such borrowings and the names of the lenders; (i) the details of any contract, arrangement or understanding relating to the securities of the Corporation, to which each proposed nominee or to which each such person is a party, such as joint venture or option arrangements, puts or calls, guaranties against loss, or guaranties of profit or arrangements as to the division of losses or profits or with respect to the giving or withholding of proxies, and the name or names of the persons with whom such contracts, arrangements or understandings exist; (j) the details of any contract, arrangement, or understanding to which each proposed nominee or to which such person is a party with any banking corporation, affiliate or subsidiary thereof, bank holding company, industrial loan company, savings bank or association or finance company, other than this Corporation or any affiliate or subsidiary of this Corporation, or with any officer, director, employee, agent, nominee, attorney, or other representative of such covered entity; (k) a description of any arrangement or understanding of each proposed nominee

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and of each such person with any person regarding future employment or with respect to any future transaction to which the Corporation will or may be a party; 2) a statement as to each proposed nominee and a statement as to each such person as to whether or not the nominee or person concerned will bear any part of the expense incurred in any proxy solicitation, and, if so, the amount thereof; 3) a statement as to each proposed nominee and a statement as to each such person describing any conviction for a felony that occurred during the preceding ten years involving the unlawful possession, conversion or appropriation of money or other property, or the payment of taxes; 4) the total number of shares that will be voted for each proposed nominee; 5) the amount of stock, if any, owned, directly or indirectly, by each proposed nominee or by members of his or her family residing with him or her, in any banking corporation, affiliate or subsidiary thereof, bank holding company, industrial loan company, savings bank or association or finance company, other than this Corporation or any affiliate or subsidiary of this Corporation; and (a) the identity of any banking corporation, affiliate or subsidiary thereof, or bank holding company or industrial loan company, savings bank or association or finance company, other than this Corporation or any affiliate or subsidiary of this Corporation, as to which such nominee or any other such person serves as a director, officer, employee, agent, consultant, advisor, nominee or attorney, together with a description of such relationship.”

The Chairman of the Board (or other person presiding at the meeting in accordance with the bylaws) may, in his or her discretion, determine and declare to the meeting that a nomination not made in accordance with Sections 3.2 and 3.3 of the bylaws shall be disregarded.

If you have questions about the operations of the Bank, you may submit them in writing before the meeting. Any questions that cannot be answered within a reasonable time during the meeting will be responded to in a post meeting report mailed by the Corporate Secretary to all shareholders within 30 days of the Annual Meeting.

As required by FDIC regulations, the Bank's annual disclosure statement will be sent to any shareholder upon request. The first copy of the annual disclosure statement will be provided to a shareholder without charge. If you wish a copy of this information, please send a written request to my attention at the address below or you may call (707) 524-3121.

By Order of the Board of Directors,



Marlene K. Soiland
Corporate Secretary

MKS/ks

TRANSACTIONS WITH DIRECTORS AND OFFICERS

The Bank has had and expects in the future to have banking transactions in the ordinary course of its business with some of its Directors and Officers and their associates, including transactions with corporations or partnerships of which such persons are directors, officers, controlling shareholders, or partners on substantially the same terms (including interest rates and collateral) as those prevailing for comparable transactions with others. Management believes that in 2015 such transactions did not involve more than the normal risk of collectability or present other unfavorable features. Loans to Directors and Executive Officers of the Bank are subject to limitations prescribed by the Financial Code of the State of California as well as applicable federal law and regulations.

In addition, these transactions are disclosed as required by law.

EXCHANGE BANK BOARD OF DIRECTORS

Marlene K. Soiland

Ms. Soiland was elected to the Board in 1997 and is corporate secretary and chair of the board's Trust Committee. After graduation from Cal Poly in San Luis Obispo, she returned to Santa Rosa and her family business. She is currently president and owner of Soiland Management Co., Inc. Ms. Soiland is involved in several community groups such as the Sonoma County Alliance (Chair), Sonoma County Innovation Council, Institute for Family Business and Community Foundation Sonoma County.

James M. Ryan

Mr. Ryan was elected to the board in 1997 and now serves as vice-chairman. He was named a Doyle trustee in 2007. Mr. Ryan is a graduate of California State University Sacramento and is a licensed real estate broker, certified public accountant (inactive) and a licensed general contractor. Mr. Ryan is the owner and president of Ryan Mortgage Company, Inc. and Ryan Realty, Inc. in Santa Rosa. He has served as a director of the American Red Cross, Sonoma County Chapter and numerous trade associations.

Dante B. Benedetti

Mr. Benedetti was elected a director in 2002 and named a Doyle trustee in 2008. He is currently chair of the board's Compensation and Management Succession Committee. He attended Santa Rosa Junior College and Sonoma State University. Mr. Benedetti is the past president and past chairman of Clover Stornetta Farms, Inc. Active in the community, he is a former member of the board at Sonoma County Community Foundation, Hanna Boys Center, California Dairy Institute, Culinary Institute of America, California Independent Grocers Association and the Sonoma County Probation Department Advisory Board.

Carlos G. Tamayo

Mr. Tamayo was elected a director in 2004 and serves as chair of the board's Community Reinvestment Act Committee. He is a graduate of Arizona State University with a master's degree from American Graduate School of International Management. Mr. Tamayo is the chairman of La Tortilla Factory, a family owned business founded in Santa Rosa in 1977. He currently serves on the Church Council at Spring Hills Community Church. His past community activities include the Salvation Army, Hispanic Chamber of Commerce, Lions Club, the Sonoma County Community Foundation and various trade groups.

Daniel G. Libarle

Mr. Libarle was elected to the Board in 2007 and serves as chair of the board's Governance and Nominating Committee and Directors Loan Committee. A graduate of San Jose State University, he is president of their family-owned business, Lace House Linen, Inc. The Petaluma business has been in operation since 1915. Mr. Libarle has previous banking experience as the founding chairman of the Bank of Petaluma. That bank was bought by Greater Bay Bank and he served on their board until it was bought by Wells Fargo Bank. He has been very active in his community. His involvement includes the Rotary Club, Boys & Girls Club, Chamber of Commerce, United Way and several trade groups.

William R. Schrader

Mr. Schrader was elected to the board in 2008 when he was appointed president. He joined the Exchange Bank in 1978 and has served as senior loan officer, chief operating officer, and was president and chief executive officer when he retired from the bank in 2014. Today he serves as chairman of the board. Mr. Schrader is a graduate of St. Mary's College and received his master's from Golden Gate University. He is also a graduate of the Pacific Coast School of Banking. His community involvement includes past board chair and director positions for the YMCA, Diocesan School Board, NAMI, Santa Rosa Community Health Center, California Bankers Association and past vice-chair for the Committee for the Shelterless (COTS). Mr. Schrader currently serves as chair of the trustees for Hanna Boys Center.

Richard W. Abbey

Mr. Abbey was appointed to the board in 2010 and serves as chair of the board's Technology Committee. He received his degree from the University of California, Berkeley and his law degree from the University of California, Los Angeles. He has been a practicing attorney in Sonoma County since 1973 and presently is a member of the firm Abbey, Weitzenberg, Warren and Emery. He has been the general counsel for the Exchange Bank since the mid-1980s. Mr. Abbey's community involvement activities include the Redwood Empire Food Bank, YMCA, Social Advocates for Youth and Schools Plus Enrichment Foundation.

Bruce E. DeCrona

Mr. DeCrona was elected to the board in 2014 and serves as the board's Audit Committee Chair. He retired from Exchange Bank in 2013 after serving nearly 18 years in the roles of chief financial officer and chief operating officer. Before that he worked for 19 years at First Interstate Bank in Nevada and Arizona, prior to the bank's purchase by Wells Fargo Bank. He is a graduate of the University of Nevada as well as the Pacific Coast Banking School. In addition to being board member and treasurer for the Wells Fargo Center for the Arts, he is also an active volunteer for several other organizations, including the Council on Aging.

Steven G. Dutton

Mr. Dutton was appointed to the board in 2014. He is a fifth generation Sonoma County farmer and lifelong resident of Sebastopol. He is partners with Dan Goldfield in Dutton-Goldfield Winery and is also partners with his brother in Dutton Ranch Corp. and Dutton Bros. Farming. Mr. Dutton is actively involved in the agricultural community, contributing to many local associations and boards. His involvement includes the Russian River Valley Winegrowers Foundation, Sonoma County Farm Bureau, Sonoma County Farm Trails and he is also a member of the Santa Rosa Junior College Viticulture Advisory Committee.

Gary T. Hartwick

Mr. Hartwick was elected to the board in 2014 when he was appointed president and chief executive officer. He joined Exchange Bank in 2009 and has served as chief credit officer and chief operating officer. Mr. Hartwick is a graduate of California State University Sacramento and the Pacific Coast Banking School. His community activities include serving as a board member for the Volunteer Center of Sonoma County and the Redwood Empire Food Bank. He is also an Advisory Board member for the Boys & Girls Club of South Sonoma and Marin Counties and a former member of the board at the Wells Fargo Center for the Arts.

EXCHANGE BANK AND SUBSIDIARIES
Santa Rosa, California

CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2015 and 2014

EXCHANGE BANK AND SUBSIDIARIES
Santa Rosa, California

FINANCIAL STATEMENTS
December 31, 2015 and 2014

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INDEPENDENT AUDITOR'S REPORT

To the Stockholder's and
Board of Directors
Exchange Bank and Subsidiaries
Santa Rosa, California

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Exchange Bank and Subsidiaries, which comprise the consolidated balance sheets as of December 31, 2015 and 2014, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

(Continued)

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Exchange Bank and Subsidiaries as of December 31, 2015 and 2014, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Report on Other Legal and Regulatory Requirements

We have also examined in accordance with attestation standards established by the American Institute of Certified Public Accountants, Exchange Bank and Subsidiaries' internal control over financial reporting as of December 31, 2015 based on criteria established in the 2013 *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated February 17, 2016 expressed an unqualified opinion.



Crowe Horwath LLP

Sacramento, California
February 17, 2016

EXCHANGE BANK AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
December 31, 2015 and 2014
(In thousands, except share and par value amounts)

	<u>2015</u>	<u>2014</u>
ASSETS		
Cash and due from banks	\$ 122,705	\$ 97,016
Short-term investments	<u>227</u>	<u>227</u>
Total cash and cash equivalents	<u>122,932</u>	<u>97,243</u>
Interest-bearing deposits in other financial institutions	76,000	52,000
Available-for-sale investment securities	<u>495,250</u>	<u>437,427</u>
Loans and leases	1,278,905	1,221,951
Less allowance for loan and lease losses	<u>(37,830)</u>	<u>(37,653)</u>
Net loans and leases	<u>1,241,075</u>	<u>1,184,298</u>
Federal Home Loan Bank stock	9,036	8,962
Bank premises and equipment, net	16,478	16,232
Bank owned life insurance	42,080	36,125
Other real estate owned	564	2,544
Accrued interest receivable and other assets	<u>59,093</u>	<u>52,642</u>
Total assets	<u>\$ 2,062,508</u>	<u>\$ 1,887,473</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits:		
Non-interest bearing	\$ 677,539	\$ 617,410
Interest bearing	<u>1,161,438</u>	<u>1,050,990</u>
Total deposits	1,838,977	1,668,400
Federal Home Loan Bank advances and other long-term debt	8,000	22,000
Accrued interest payable and other liabilities	<u>42,423</u>	<u>37,205</u>
Total liabilities	<u>1,889,400</u>	<u>1,727,605</u>
Commitments and contingencies (Note 14)		
Stockholders' equity:		
Preferred stock, 1,000,000 shares authorized: none issued or outstanding	-	-
Common stock, \$2.50 par value; 3,000,000 shares authorized; 1,714,344 shares issued and outstanding	4,286	4,286
Additional paid-in capital	46,026	46,026
Retained earnings	129,582	112,326
Accumulated other comprehensive loss, net of taxes	<u>(6,786)</u>	<u>(2,770)</u>
Total stockholders' equity	<u>173,108</u>	<u>159,868</u>
Total liabilities and stockholders' equity	<u>\$ 2,062,508</u>	<u>\$ 1,887,473</u>

See accompanying notes to consolidated financial statements.

EXCHANGE BANK AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
For the Years Ended December 31, 2015 and 2014
(In thousands, except per share amounts)

	<u>2015</u>	<u>2014</u>
Interest income:		
Interest and fees on loans and leases	\$ 59,379	\$ 56,953
Interest on investment securities:		
Taxable	8,613	7,328
Exempt from Federal income taxes	<u>1,789</u>	<u>1,781</u>
Total interest income	<u>69,781</u>	<u>66,062</u>
Interest expense:		
Interest on deposits	1,018	1,504
Interest on borrowings	<u>753</u>	<u>1,007</u>
Total interest expense	<u>1,771</u>	<u>2,511</u>
Net interest income before provision for loan and lease losses	68,010	63,551
Provision for (reversal of) loan and lease losses	<u>(3,200)</u>	<u>-</u>
Net interest income after provision for loan and lease losses	<u>71,210</u>	<u>63,551</u>
Non-interest income:		
Service charges and fees	5,791	6,444
Trust income	6,105	5,860
Merchant discount and interchange fees	4,298	4,137
Income from bank owned life insurance	1,387	1,343
Other income	<u>3,475</u>	<u>3,215</u>
Total non-interest income	<u>21,056</u>	<u>20,999</u>
Non-interest expense:		
Salaries and employee benefits	31,212	29,839
Occupancy and equipment	6,913	6,720
Professional fees	6,202	6,666
Gain on sale of other real estate owned	(71)	(292)
FDIC assessments	1,335	1,307
Other expenses	<u>12,655</u>	<u>12,038</u>
Total non-interest expense	<u>58,246</u>	<u>56,278</u>
Income before provision for income taxes	34,020	28,272
Provision for income taxes	<u>12,992</u>	<u>10,563</u>
Net income	<u>\$ 21,028</u>	<u>\$ 17,709</u>
Basic earnings per common share	<u>\$ 12.27</u>	<u>\$ 10.25</u>

See accompanying notes to consolidated financial statements.

EXCHANGE BANK AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
For the Years Ended December 31, 2015 and 2014
(In thousands)

	<u>2015</u>	<u>2014</u>
Net Income	\$ 21,028	\$ 17,709
Other comprehensive income:		
Unrealized gains/losses on securities:		
Unrealized holding (losses) gains arising during the period	(1,373)	4,372
Tax effect	<u>567</u>	<u>(1,809)</u>
Changes in unrealized gain on available-for-sale Investment securities, net of tax	<u>(806)</u>	<u>2,563</u>
Defined benefit pension plans:		
Net losses arising during the period	(5,249)	(5,640)
Tax effect	<u>2,208</u>	<u>2,371</u>
Changes in defined benefit pension plans, net of tax	<u>(3,041)</u>	<u>(3,269)</u>
Change in deferred compensation trust liabilities	(293)	7
Tax effect	<u>124</u>	<u>(3)</u>
Changes in deferred compensation trust, net of tax	<u>(169)</u>	<u>4</u>
Other comprehensive (loss) income	<u>(4,016)</u>	<u>(702)</u>
Total Comprehensive Income	<u>\$ 17,012</u>	<u>\$ 17,007</u>

See accompanying notes to consolidated financial statements.

EXCHANGE BANK AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
For the Years Ended December 31, 2015 and 2014
(In thousands)

	Preferred Stock		Common Stock	Additional Paid-In Capital	Retained Earnings	Accum- ulated Other Compre- hensive (Loss) Income (Net of Taxes)	Total Stock- holders' Equity
	Series A	Series B					
Balance, January 1, 2014	\$ 7,000	\$ 2,150	\$ 4,286	\$ 46,026	\$ 97,411	\$ (2,069)	\$ 154,804
Net Income	-	-	-	-	17,709	-	17,709
Other comprehensive loss	-	-	-	-	-	(701)	(701)
Preferred stock repurchase	(7,000)	(2,150)	-	-	-	-	(9,150)
Cash dividends	-	-	-	-	(2,794)	-	(2,794)
Balance, December 31, 2014	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 4,286</u>	<u>\$ 46,026</u>	<u>\$ 112,326</u>	<u>\$ (2,770)</u>	<u>\$ 159,868</u>
Net Income	-	-	-	-	21,028	-	21,028
Other comprehensive loss	-	-	-	-	-	(4,016)	(4,016)
Cash Dividends	-	-	-	-	(3,772)	-	(3,772)
Balance, December 31, 2015	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 4,286</u>	<u>\$ 46,026</u>	<u>\$ 129,582</u>	<u>\$ (6,786)</u>	<u>\$ 173,108</u>

See accompanying notes to consolidated financial statements.

EXCHANGE BANK AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2015 and 2014
(In thousands)

	<u>2015</u>	<u>2014</u>
Cash flows from operating activities:		
Net Income	\$ 21,028	\$ 17,709
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,261	1,887
Provision for (reversal of) loan and lease losses	(3,200)	-
Provision for deferred income taxes	(338)	1,329
Gain on sale of loans	(1,279)	(977)
Gain on sale of other real estate owned	(71)	(292)
Accretion of discounts and amortization of premiums on investment securities	2,302	2,270
Net change in deferred loan origination fees	(49)	(824)
Net loans originated with intent to sell and sold	(1,573)	(11,710)
Increase in bank owned life insurance, net of expenses	(1,092)	(1,068)
Changes in operating assets and liabilities:		
Accrued interest receivable and other assets	(9,798)	(5,523)
Accrued interest payable and other liabilities	<u>6,257</u>	<u>9,889</u>
Net cash provided by operating activities	<u>14,448</u>	<u>12,690</u>
Cash flows from investing activities:		
Increase in Interest-bearing deposits in other financial institutions	(24,000)	(28,500)
Proceeds from sale of other real estate owned	2,259	6,252
Proceeds from maturities of investment securities	222,254	196,681
Purchase of investment securities	(283,751)	(171,631)
Purchase of Federal Home Loan Bank (FHLB) stock	(74)	(1,472)
Net increase in loans and leases	(50,881)	(79,163)
Purchase of bank premises and equipment	<u>(2,508)</u>	<u>(2,048)</u>
Net cash used in investing activities	<u>(136,701)</u>	<u>(79,881)</u>
Cash flows from financing activities:		
Net increase in demand, interest bearing and savings deposits	183,981	106,435
Net decrease in time deposits	(13,404)	(15,016)
Repayments of long-term FHLB advances	(2,000)	(2,000)
Repayment of long-term Subordinated debt	(12,000)	-
Repurchase of preferred stock	-	(9,150)
Purchase of bank owned life insurance	(4,863)	-
Cash paid for dividends	<u>(3,772)</u>	<u>(2,794)</u>
Net cash provided by financing activities	<u>147,942</u>	<u>77,475</u>
Increase in cash and cash equivalents	25,689	10,284
Cash and cash equivalents, beginning of year	<u>97,243</u>	<u>86,959</u>
Cash and cash equivalents, end of year	<u>\$ 122,932</u>	<u>\$ 97,243</u>
Supplemental disclosure of cash flow information:		
Cash paid during the year for:		
Interest expense	\$ 1,697	\$ 2,425
Income taxes	\$ 14,865	\$ 7,770
Non-cash investing activity:		
Transfer of loans to other real estate owned	\$ -	\$ 1,980

See accompanying notes to consolidated financial statements.

EXCHANGE BANK AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(In thousands, except per share amounts)
December 31, 2015 and 2014

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Nature of Operations: Exchange Bank (the "Bank"), a California corporation, and its wholly-owned subsidiaries, A. J. Ventures, Inc., AJV-Alderbrook LLC and AJV-Ripon LLC, conduct their business from their headquarters in Santa Rosa, California. The Bank is a full service bank providing a range of commercial and retail banking services to individuals and businesses. The Bank, through its loan portfolio, has geographically concentrated credit risk in Sonoma County. Additionally, the loan portfolio has a concentration in loans secured by real estate.

The accounting and reporting policies of the Bank and its subsidiaries conform with accounting principles generally accepted in the United States of America and prevailing practices within the financial services industry. A summary of the more significant accounting and reporting policies follows:

Principles of Consolidation: The consolidated financial statements include the accounts of the Bank and its wholly-owned subsidiaries, A. J. Ventures, Inc., AJV-Alderbrook LLC and AJV-Ripon LLC. The subsidiaries are used to hold real estate properties acquired through, or in lieu of, loan foreclosure. All intercompany accounts and transactions have been eliminated upon consolidation.

Use of Estimates: The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions based on available information. These estimates and assumptions affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents: For purposes of the consolidated statement of cash flows, the Bank considers all highly liquid investments with maturities of three months or less at date of acquisition to be cash equivalents. Cash equivalents include cash, due from banks, money market investments and Federal funds sold. Generally, Federal funds are sold for one-day periods. Net cash flows are reported for customer loan and deposit transactions, interest bearing deposits in other financial institutions, and federal funds purchased and sold.

Investment Securities: The Bank classifies its investment securities as either available-for-sale or held-to-maturity at the time of purchase. Available-for-sale investment securities are measured at fair value with a corresponding recognition of the net unrealized holding gain or loss, net of income taxes, within accumulated other comprehensive income (loss), which is a separate component of stockholders' equity, until realized. Held-to-maturity investment securities are measured at amortized cost, based on the Bank's positive intent and ability to hold such securities to maturity. At December 31, 2015 and 2014, the Bank did not hold any held-to-maturity investment securities.

Premiums and discounts are amortized or accreted over the life of the related investment security as an adjustment to interest income using a method that approximates the interest method. Interest income is recognized when earned. Realized gains and losses on the sale of investment securities are recorded on the trade date and are computed using the specific identification method for determining the cost of investment securities sold.

(Continued)

EXCHANGE BANK AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(In thousands, except per share amounts)
December 31, 2015 and 2014

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Management evaluates securities for other-than-temporary impairment ("OTTI") on at least a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, management considers the extent and duration of the unrealized loss, and the financial condition and near-term prospects of the issuer. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) OTTI related to credit loss, which must be recognized in the income statement and 2) other-than-temporary impairment (OTTI) related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis. For equity securities, the entire amount of impairment is recognized through earnings.

Federal Home Loan Bank (FHLB) Stock: The Bank is a member of the FHLB system. Members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. FHLB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of par value. Both cash and stock dividends are reported as income.

Loans and Leases: Loans that management has the ability and intent to hold for the foreseeable future or maturity or payoff are reported at the principal amounts outstanding, adjusted for unamortized discounts and premiums and net of deferred loan origination fees and costs, write-downs and the allowance for loan losses. Direct financing leases are carried net of unearned income. Income from leases is recognized by a method that approximates a level yield on the outstanding net investment in the lease.

The Bank charges fees for originating loans and leases. These origination and commitment fees, net of certain related direct loan and lease origination costs, are deferred. The net deferred fees or costs are recognized as an adjustment of yield over the contractual life of the loan or lease using the interest method. The unamortized balance of deferred fees and costs is reported as a component of net loans and leases.

For all classes of loans, interest is accrued daily based upon outstanding loan and lease balances. However, when, in the opinion of management, loans or leases become 90 days past due, unless the loan is well-secured and in process of collection, or are considered impaired and the future collectability of interest and principal is in serious doubt, a loan or lease is placed on nonaccrual status and the accrual of interest income is suspended. Any interest accrued but unpaid is charged against income. Payments received are applied to reduce principal to the extent necessary to ensure collection. Subsequent payments on these loans or leases, or payments received on nonaccrual loans or leases for which the ultimate collectability of principal is not in doubt, are applied first to earned but unpaid interest and then to principal. Generally, loans and leases are restored to accrual status when the obligation is brought current and has performed in accordance with the contractual terms for a reasonable period of time and the ultimate collectability of the total contractual principal and interest is no longer in doubt.

(Continued)

EXCHANGE BANK AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(In thousands, except per share amounts)
December 31, 2015 and 2014

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Loan Sales and Servicing: Included in the portfolio are loans guaranteed by the Small Business Administration (SBA) that may be sold in the secondary market. Loans held for sale are carried at the lower of cost or fair value. Fair value is determined by the specific identification method as of the balance sheet date or the date that the purchasers have committed to purchase the loans. At the time the loan is sold, the related right to service the loan is recorded at fair value with the Bank earning future servicing income. Gains and losses are recognized based on the difference between the selling price and the fair value of servicing assets or liabilities and the allocated carrying value of the loans sold. At December 31, 2015 and 2014 the balance of loans originated and unsold under the SBA program totaled \$5,385 and \$14,868, respectively. Management has determined that the unsold loans originated through the SBA program were not material for disclosure as held for sale at December 31, 2015 and 2014.

Loans held for sale subsequently transferred to the loan portfolio are transferred at the lower of cost or market value at the date of transfer. Any difference between the carrying amount of the loan and its outstanding principal balance is recognized as an adjustment to yield by the interest method.

Servicing rights acquired through 1) a purchase or 2) the origination of loans which are sold or securitized with servicing rights retained are recognized as separate assets or liabilities. Servicing assets or liabilities are recorded at fair value, and are subsequently amortized in proportion to and over the period of the related net servicing income or expense. SBA loans with unpaid balances of approximately \$59,587 and \$45,043 were being serviced for others at December 31, 2015 and 2014, respectively. Servicing assets at December 31, 2015 and 2014 were not material.

Allowance for Loan and Lease Losses: The allowance for loan and lease losses is a valuation allowance for probable incurred credit losses in the Bank's loan portfolio as of the balance-sheet date. For all loan classes the allowance is established through a provision for loan and lease losses which is charged to expense. Additions to the allowance are expected to maintain the adequacy of the total allowance after credit losses and loan growth. Credit exposures determined to be uncollectible are charged against the allowance. Cash received on previously charged off amounts is recorded as a recovery to the allowance. The overall allowance consists of two primary components, specific reserves related to impaired loans and general reserves related to loans that are not impaired.

For all loan classes, a loan or lease is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due, including principal and interest, according to the contractual terms of the original agreement. Loans and leases determined to be impaired are individually evaluated for impairment. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. When a loan or lease is impaired, the Bank measures impairment based on the present value of expected future cash flows discounted at the loan's effective interest rate, except that as a practical expedient, it may measure impairment based on a loan's observable market price, or the fair value of the collateral if the loan is collateral dependent. A loan is collateral dependent if the repayment of the loan is expected to be provided solely by the underlying collateral.

A restructuring of a debt constitutes a troubled debt restructuring (TDR) if the Bank for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. Restructured workout loans typically present an elevated level of credit risk as the borrowers are not able to perform according to the original contractual terms. Loans that are reported as TDRs are considered impaired and measured for impairment as described above.

(Continued)

EXCHANGE BANK AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(In thousands, except per share amounts)
December 31, 2015 and 2014

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The determination of the general reserve for loans and leases that are not impaired is based on estimates made by management, to include, but not limited to, consideration of historical losses by portfolio segment, internal asset classifications, and qualitative factors to include economic trends in the Bank's service areas, industry experience and trends, concentrations, estimated collateral values, the Bank's underwriting policies, the character of the loan portfolio, and probable losses in the portfolio taken as a whole.

The Bank maintains a separate allowance for each portfolio segment (loan type). These portfolio segments include real estate – commercial, real estate – construction, commercial, lease financing and consumer loans. The allowance for loan and lease losses attributable to each portfolio segment, which includes both impaired loans and loans that are not impaired, is combined to determine the Bank's overall allowance, which is included on the consolidated balance sheet.

The Bank assigns a risk rating to all loans except pools of homogeneous loans and periodically performs detailed reviews of all such loans over a certain threshold to identify credit risks and to assess the overall collectability of the portfolio. These risk ratings are also subject to examination by independent specialists engaged by the Bank and the Bank's regulators. During these internal reviews, management monitors and analyzes the financial condition of borrowers and guarantors, trends in the industries in which borrowers operate and the fair values of collateral securing these loans. These credit quality indicators are used to assign a risk rating to each individual loan. The risk ratings can be grouped into five major categories, defined as follows:

Pass – A pass loan is a strong credit with no existing or known potential weaknesses deserving of management's close attention.

Special Mention – A special mention loan has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or in the Bank's credit position at some future date. Special Mention loans are not adversely classified and do not expose the Bank to sufficient risk to warrant adverse classification.

Substandard – A substandard loan is not adequately protected by the current sound worth and paying capacity of the borrower or the value of the collateral pledged, if any. Loans classified as substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. Well defined weaknesses include a project's lack of marketability, inadequate cash flow or collateral support, failure to complete construction on time or the project's failure to fulfill economic expectations. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Doubtful – Loans classified doubtful have all the weaknesses inherent in those classified as substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable and improbable.

Loss – Loans classified as loss are considered uncollectible and charged off immediately.

The general reserve component of the allowance for loan and lease losses also consists of reserve factors that are based on management's assessment of the following for each portfolio segment: (1) inherent credit risk, (2) historical losses and (3) other qualitative factors. These reserve factors are inherently subjective and are driven by the repayment risk associated with each portfolio segment described below.

(Continued)

EXCHANGE BANK AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(In thousands, except per share amounts)
December 31, 2015 and 2014

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Real Estate–Commercial – This segment is comprised of loans used to finance the acquisition of commercial real property. These loans are secured by first liens against the underlying real property. The inherent risk is driven by the borrower's capacity to service the debt combined with the value of the property collateral relative to the loan balance. Economic trends including consumer spending, consumer confidence, market interest rates, and general economic growth are closely correlated to the credit quality of these loans. A sustained decline in the economy can impair a borrower's capacity to service the underlying debt.

Real Estate–Construction – This segment is comprised of loans used to acquire, develop, and/or construct residential housing or commercial property types, including office, industrial and retail. Inherent risk is high as this segment evidences construction risk and absorption risk. Economic trends including consumer spending, consumer confidence, business confidence, market interest rates, and general economic growth are closely correlated to the credit quality of these loans. A sustained decline in the economy can impair absorption and compromise the borrower's capacity to service the underlying debt.

Commercial – These loans are primarily for business purposes and are typically secured by personal property and in some cases by junior liens against real property. Credit risk is mitigated by financial covenants and financial reporting requirements. Economic trends including consumer spending, consumer confidence, market interest rates, and general economic growth are closely correlated to the credit quality of these loans. A sustained decline in the economy can impair a borrower's capacity to service the underlying debt.

Loans and receivables in homogeneous loan portfolio segments are not evaluated for specific impairment. Rather, the sole component of the allowance for these loan types is determined by collectively measuring impairment reserve factors based on management's assessment of the following for each homogeneous loan portfolio segment: (1) inherent credit risk, (2) historical losses and (3) other qualitative factors. These reserve factors are described in further detail below for each homogeneous loan portfolio segment.

Lease Financing – This segment is primarily comprised of smaller business purpose commitments used to finance an array of business equipment. Leases are amortized over a specific period of time. Economic trends including consumer spending, consumer confidence, market interest rates, and general economic growth are closely correlated to the credit quality of these loans. A sustained decline in the economy can impair a borrower's capacity to service the underlying debt.

Consumer – This segment is comprised of single family 1-4 residential mortgages, installment and home equity loans and lines used to finance direct consumer purchases and/or establish lines of credit for consumer purposes. Economic trends including consumer spending, consumer confidence, market interest rates, trends in housing values, and general economic growth are closely correlated to the credit quality of these loans. A sustained decline in the economy can impair a borrower's capacity to service the underlying debt.

Although management believes the allowance to be adequate, ultimate losses may vary from its estimates. At least quarterly, the Board of Directors reviews the adequacy of the allowance, including consideration of the relative risks in the portfolio, current economic conditions and other factors. If the Board of Directors and management determine that changes are warranted based on those reviews, the allowance is adjusted. In addition, the Bank's primary regulators, the FDIC and the California Department of Business Oversight, as an integral part of their examination process, review the adequacy of the allowance. These regulatory agencies may require additions to the allowance based on their judgment about information available at the time of their examinations.

(Continued)

EXCHANGE BANK AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(In thousands, except per share amounts)
December 31, 2015 and 2014

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Off-Balance-Sheet Commitments: The Bank also maintains a separate allowance for off-balance-sheet commitments. Management estimates anticipated losses using historical loss data and utilization assumptions. The allowance for off-balance-sheet commitments is included in accrued interest payable and other liabilities on the consolidated balance sheet and is not significant.

Other Real Estate Owned: Real estate properties acquired through, or in lieu of, loan foreclosure are expected to be sold and are initially recorded at the fair value of the property, less estimated costs to sell. The excess, if any, of the loan amount over the fair value is charged to the allowance for loan and lease losses. Subsequent declines in the fair value of real estate owned, along with related revenue and expenses from operations, are charged to noninterest expense as incurred.

Bank Premises and Equipment: Bank premises and equipment are carried at cost, less accumulated depreciation and amortization. Depreciation and amortization are computed on the straight-line basis over the lesser of the life of the lease or the estimated useful lives of the assets, ranging from 3 to 10 years for furniture and equipment, 5 to 10 years for leasehold improvements and 10 to 40 years for premises. When assets are sold or otherwise disposed of, the cost and related accumulated depreciation or amortization are removed from the accounts, and any resulting gain or loss is recognized in income for the period. The cost of maintenance and repairs is charged to expense as incurred. The Bank evaluates premises and equipment for financial impairment as events or changes in circumstances indicate that the carrying amount of such assets may not be fully recoverable.

Bank Owned Life Insurance: The Bank has purchased life insurance policies on certain key executives. Bank owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

Retirement Plan and Postretirement Healthcare Plan: The Bank has a defined benefit pension plan covering all qualified personnel employed for the minimum required term of one year. Benefits are based on years of service and compensation projected to the separation date. Contributions are intended to provide not only for benefits attributed to service to date but also for those expected to be earned in the future. It is the Bank's policy to contribute annually an amount at least equal to the minimum required by law. During 2007, the Plan was amended to freeze future benefit accruals for participants who have less than 15 years of service and age plus years of service less than 60. The plan was also amended to limit cost-of-living adjustments for continuing active participants. The amendments are expected to significantly reduce Plan liability and future net period pension costs.

(Continued)

EXCHANGE BANK AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(In thousands, except per share amounts)
December 31, 2015 and 2014

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

In addition, the Bank sponsors a defined benefit postretirement healthcare plan that covers both salaried and non-salaried employees. The Plan provides medical benefits through health maintenance organizations. The Plan is funded by a voluntary employee beneficiary association (VEBA) trust maintained by the Bank. The contribution level for a retiree is based on a percentage of premium that varies according to the retiree's years of service with the Bank. The Bank's contribution for dependents is 50% of the Bank's share of the retiree's annual premium. The portion paid by the Bank is limited to 200% of the 1991 premium. Future cost-sharing plans are not expected to change from the current stated policy in the written plan. In addition, for the group of retirees that retired prior to January 1, 1991, the retiree medical benefit will be paid fully by the Bank for the life of the retiree and dependent. For employees retiring prior to January 1, 1992, or active employees with more than 25 years of service as of December 31, 1991, the 200% limit on lifetime benefits will not apply and the Bank will pay 100% of the retiree's premium and 50% of the dependent's premium. Effective December 31, 2007, the Plan was amended to cover only active employees who have at least 15 years of service and age plus years of service more than 60. The Plan was also amended to limit the maximum reimbursement amount to grandfathered retirees. The amendments are expected to significantly reduce Plan liability and future net period pension costs.

Other Postretirement Benefits: The Bank has established deferred compensation and salary continuation agreements providing nonqualified defined benefit retirement income for certain executive officers of the Bank. In connection with establishing these agreements, the Bank purchased single premium life insurance policies on each participant. The salary continuation agreements are accounted for by accruing a liability based upon the present value of each individual's benefit at retirement age and recognizing the related cost of these benefits over the term of employment. The single payment premium for the life insurance policies is recorded based on the cash surrender values of the policies adjusted for income earned on the investment and expense related to mortality costs.

The Bank also has endorsement split-dollar life insurance agreements with certain employees whereby the Bank has effectively agreed to maintain a life insurance policy during the employees' postretirement period. The Bank is accruing, over the employees' service period, a liability for the actuarial present value of future costs to maintain life insurance during the employees' postretirement period.

Income Taxes: Income tax expense is the total of current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates which are expected to be applied to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. On the consolidated balance sheet, net deferred tax assets are included in accrued interest receivable and other assets.

(Continued)

EXCHANGE BANK AND SUBSIDIARIES
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NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The determination of the amount of deferred income tax assets which are more likely than not to be realized is primarily dependent on projections of future earnings, which are subject to uncertainty and estimates that may change given economic conditions and other factors. The realization of deferred income tax assets is assessed and a valuation allowance is recorded if it is "more likely than not" that all or a portion of the deferred tax asset will not be realized. "More likely than not" is defined as greater than a 50% chance. All available evidence, both positive and negative is considered to determine whether, based on the weight of that evidence, a valuation allowance is needed. Based upon their analysis of available evidence, management determined that it is "more likely than not" that all of the deferred income tax assets as of December 31, 2015 and 2014 will be fully realized and therefore no valuation allowance was recorded.

The Bank uses a comprehensive model for recognizing, measuring, presenting and disclosing in the financial statements tax positions taken or expected to be taken on a tax return. A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded. The Bank recognizes interest and/or penalties related to income tax matters in income tax expense.

Earnings Per Common Share: Earnings per common share is computed by dividing net income by the weighted average number of shares outstanding during the year, which was 1,714,344 for 2015 and 2014, respectively. There are no dilutive shares or share equivalents; therefore, diluted earnings per share is not presented.

Advertising: Advertising costs are charged to expense in the period incurred and totaled \$1,140 and \$910 for the years ended December 31, 2015 and 2014, respectively.

Subsequent Events: The Bank reviewed all events occurring from December 31, 2015 through February 17, 2016, the date the financial statements were available to be issued. There were no subsequent events that were considered necessary for disclosure and there were no subsequent events requiring accrual.

Adoption of New Accounting Standard: In 2014 the Financial Accounting Standards Board (FASB) amended existing guidance to eliminate the effective yield election and to permit reporting entities to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. The Bank adopted this standard during 2015. The adoption requires the cumulative effect of the change to be reflected retrospectively to the earliest period presented in the financial statements. The cumulative effect of the change was a \$206 decrease in stockholders' equity and is reflected as an adjustment to retained earnings as of January 1, 2014 on the consolidated statement of changes in stockholders' equity.

NOTE 2 – FAIR VALUE MEASUREMENTS

Fair Value Measurements

Fair Value Hierarchy - The Bank groups its assets and liabilities measured at fair value within three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. Valuations within these levels are based upon:

Level 1 – Quoted market prices for identical instruments traded in active exchange markets.

(Continued)

EXCHANGE BANK AND SUBSIDIARIES
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NOTE 2 – FAIR VALUE MEASUREMENTS (Continued)

Level 2 – Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable or can be corroborated by observable market data.

Level 3 – Model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect the Bank's estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include management judgment and estimation which may be significant.

Management monitors the availability of observable market data to assess the appropriate classification of financial instruments within the fair value hierarchy. Changes in economic conditions or model-based valuation techniques may require the transfer of financial instruments from one fair value level to another. In such instances, the transfer is reported at the beginning of the reporting period.

Management evaluates the significance of transfers between levels based upon the nature of the financial instrument and size of the transfer relative to total assets, total liabilities or total earnings.

Assets Recorded at Fair Value - The following tables present information about the Bank's assets and liabilities measured at fair value on a recurring and nonrecurring basis as of December 31, 2015 and 2014:

Recurring Basis

<u>Description</u>	<u>2015</u>			
	<u>Fair Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Debt securities:				
U.S. Government agencies	\$ 228,173	\$ -	\$ 228,173	\$ -
Obligations of states and political subdivisions	148,608	-	148,608	-
Government sponsored entities residential mortgage-backed securities	66,061	-	66,061	-
U.S. Treasuries	48,435	-	48,435	-
Other securities	3,973	-	3,973	-
Total assets measured at fair value	<u>\$ 495,250</u>	<u>\$ -</u>	<u>\$ 495,250</u>	<u>\$ -</u>

<u>Description</u>	<u>2014</u>			
	<u>Fair Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Debt securities:				
U.S. Government agencies	\$ 197,152	\$ -	\$ 197,152	\$ -
Obligations of states and political subdivisions	126,920	-	126,920	-
Government sponsored entities residential mortgage-backed securities	78,750	-	78,750	-
U.S. Treasuries	30,614	-	30,614	-
Other securities	3,991	-	3,991	-
Total assets measured at fair value	<u>\$ 437,427</u>	<u>\$ -</u>	<u>\$ 437,427</u>	<u>\$ -</u>

(Continued)

EXCHANGE BANK AND SUBSIDIARIES
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NOTE 2 – FAIR VALUE MEASUREMENTS (Continued)

Fair values for available-for-sale investment securities are based on quoted market prices for similar securities. During the years ended December 31, 2015 and 2014, there were no transfers between Level 1 and Level 2.

Non-recurring Basis

The Bank may be required, from time to time, to measure certain assets at fair value on a non-recurring basis. These include assets that are measured at the lower of cost or market value that were recognized at fair value which was below cost at the reporting date.

	2015			
	Fair Value	Level 1	Level 2	Level 3
Impaired loans:				
Real estate – commercial	\$ 24,077	\$ -	\$ -	\$ 24,077
Real estate – construction	434	-	-	434
Commercial	8,973	-	-	8,973
Lease financing	293	-	-	293
Consumer	4,643	-	-	4,643
Total assets measured at fair value on a non-recurring basis	\$ 38,420	\$ -	\$ -	\$ 38,420

	2014			
	Fair Value	Level 1	Level 2	Level 3
Impaired loans:				
Real estate – commercial	\$ 9,639	\$ -	\$ -	\$ 9,639
Real estate – construction	2,772	-	-	2,772
Commercial	2,271	-	-	2,271
Lease financing	104	-	-	104
Consumer	2,930	-	-	2,930
Other real estate owned:				
Raw land	564	-	-	564
Commercial real estate	1,980	-	-	1,980
Total assets measured at fair value on a non-recurring basis	\$ 20,260	\$ -	\$ -	\$ 20,260

Impaired loans are collateral dependent and have been adjusted to fair value based on the estimated fair value of the underlying collateral, less estimated selling costs. If the Bank determines that the value of an impaired loan is less than the recorded investment in the loan, the carrying value is adjusted through a charge-off recorded through the allowance for loan and lease losses. Total losses of \$981 and \$10,483 represent impairment charges recognized during the years ended December 31, 2015 and 2014, respectively, related to the above impaired loans.

Other real estate owned has been adjusted to estimated fair value, less estimated selling costs. At the time of foreclosure, assets are recorded at the estimated fair value less estimated selling costs. Any write-downs based on the asset's fair value at the date of acquisition are charged to the allowance for loan and lease losses. After foreclosure, management periodically obtains updated valuations of the foreclosed assets and, if additional impairments are deemed necessary, the impairment is recorded in other expenses on the consolidated statement of operations. Total losses of \$0 and \$3,434 represent

(Continued)

EXCHANGE BANK AND SUBSIDIARIES
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NOTE 2 – FAIR VALUE MEASUREMENTS (Continued)

impairment charges recognized during the year ended December 31, 2015 and 2014, respectively, related to the above other real estate owned.

The following methods were used to estimate the fair value of each class of assets above:

Impaired Loans – The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

Other Real Estate Owned (OREO) – OREO is measured at fair value, less costs to sell. Fair values are based on recent real estate appraisals. These appraisals may use a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

Appraisals for both collateral-dependent impaired loans and real estate owned are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed and verified by the Bank. Once received, a member of the credit administration department reviews the assumptions and approaches utilized in the appraisal as well as the overall resulting fair value in comparison with independent data sources such as recent market data or industry-wide statistics. On a quarterly basis, the Bank compares the actual selling price of collateral that has been sold to the most recent appraised value to determine what additional adjustment should be made to the appraisal value to arrive at fair value.

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NOTE 2 – FAIR VALUE MEASUREMENTS (Continued)

The following table presents quantitative information about Level 3 fair value measurements for impaired financial instruments measured at fair value on a non-recurring basis at December 31, 2015:

<u>Description</u>	<u>Fair Value</u>	<u>Valuation Technique</u>	<u>Significant Unobservable Input</u>	<u>Range (Weighted Average)</u>
Real Estate Commercial	\$ 24,077	Sales Comparison	a. Appraiser adjustments on sales comparable data can range up to 50%	.25% to 50% 6.3%
		Management estimates	b. Management adjustments for depreciation in values depending on property types	
Real Estate Construction	\$ 434	Income Approach	a. Appraisers required to apply a discounted cash flow approach as sales data is limited	1% to 5% 2.7%
		Management estimates	b. Management adjustments for depreciation in values depending on property types	
Commercial	\$ 8,973	Sales Comparison	a. Appraiser adjustments on sales comparable data can range from 5% to 10%	.30% to 25% 3.2%
		Management estimates	b. Management adjustments for depreciation in values depending on property types	
			c. Personal property collateral or unsecured loans are discounted based on management's estimate of loss given default	
Leasing	\$ 293	Management estimate	a. Personal property collateral is discounted based on management's assessment of probability of default	1.5% to 20% 15.7%
Consumer	\$ 4,643	Sales Comparison	a. Appraiser adjustments on sales comparable data can range up to 75%	.80% to 75% 10.2%
		Management estimates	b. Personal property collateral is discounted based on management's assessment of probability of default	

(Continued)

EXCHANGE BANK AND SUBSIDIARIES
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NOTE 2 – FAIR VALUE MEASUREMENTS (Continued)

The following table presents quantitative information about Level 3 fair value measurements for impaired financial instruments measured at fair value on a non-recurring basis at December 31, 2014:

<u>Description</u>	<u>Fair Value</u>	<u>Valuation Technique</u>	<u>Significant Unobservable Input</u>	<u>Range (Weighted Average)</u>
Real Estate Commercial	\$ 9,639	Sales Comparison	a. Appraiser adjustments on sales comparable data can range up to 50%	1% to 35% 12.7%
		Management estimates	b. Management adjustments for depreciation in values depending on property types	
Real Estate Construction	\$ 2,772	Income Approach	a. Appraisers required to apply a discounted cash flow approach as sales data is limited	5% to 11% 5.7%
		Management estimates	b. Management adjustments for depreciation in values depending on property types	
Commercial	\$ 2,271	Sales Comparison	a. Appraiser adjustments on sales comparable data can range from 5% to 10%	2% to 70% 16.8%
		Management estimates	b. Management adjustments for depreciation in values depending on property types	
			c. Personal property collateral or unsecured loans are discounted based on management's estimate of loss given default	
Leasing	\$ 104	Management estimate	a. Personal property collateral is discounted based on management's assessment of probability of default	15% to 25% 20.4%
Consumer	\$ 2,930	Sales Comparison	a. Appraiser adjustments on sales comparable data can range up to 75%	5% to 75% 21.6%
		Management estimates	b. Personal property collateral is discounted based on management's assessment of probability of default	
Other Real Estate	\$ 2,544	Sales Comparison	a. Appraiser adjustments on sales comparable data can on average range up to 50%	13% to 50% 27%
			b. Appraiser adjustments on land properties based on discounted cash flow approach	

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EXCHANGE BANK AND SUBSIDIARIES
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NOTE 2 – FAIR VALUE MEASUREMENTS (Continued)

Fair Value of Financial Instruments: The estimated carrying amounts and fair values of the Bank's financial instruments are as follows:

<u>December 31, 2015</u>	<u>Carrying Amount</u>	<u>Fair Value Measurements at Using:</u>				<u>Total</u>
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>		
Financial assets:						
Cash and due from banks, \$	122,932	\$ 122,932	\$ -	\$ -	\$ -	\$ 122,932
Interest-bearing deposits						
In banks	76,000	76,000	-	-	-	76,000
Available-for-sale securities	495,250	-	495,250	-	-	495,250
FHLB stock	9,036	N/A	N/A	N/A	N/A	N/A
Loans and leases, net	1,241,075	-	-	1,233,551	-	1,233,551
Accrued interest receivable	7,810	7,810	-	-	-	7,810
Financial liabilities:						
Deposits	\$ 1,838,977	\$ 1,623,747	\$ 214,144	\$ -	\$ -	\$ 1,837,891
FHLB Advances	8,000	-	8,736	-	-	8,736
Accrued interest payable	115	115	-	-	-	115

<u>December 31, 2014</u>	<u>Carrying Amount</u>	<u>Fair Value Measurements at Using:</u>				<u>Total</u>
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>		
Financial assets:						
Cash and due from banks, \$	97,243	\$ 97,243	\$ -	\$ -	\$ -	\$ 97,243
Interest-bearing deposits						
In banks	52,000	52,000	-	-	-	52,000
Available-for-sale securities	437,427	-	437,427	-	-	437,427
FHLB stock	8,962	N/A	N/A	N/A	N/A	N/A
Loans and leases, net	1,184,298	-	-	1,191,094	-	1,191,094
Accrued interest receivable	6,995	6,995	-	-	-	6,995
Financial liabilities:						
Deposits	\$ 1,668,400	\$ 1,440,493	\$ 227,548	\$ -	\$ -	\$ 1,668,041
FHLB Advances	10,000	-	11,266	-	-	11,266
Subordinated debentures	12,000	-	11,872	-	-	11,872
Accrued interest payable	171	171	-	-	-	171

Because no market exists for a significant portion of the Bank's financial instruments, fair value estimates are based on judgments regarding current economic conditions, risk characteristics of various financial instruments and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the fair values presented.

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EXCHANGE BANK AND SUBSIDIARIES
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NOTE 2 – FAIR VALUE MEASUREMENTS (Continued)

The following methods and assumptions were used by the Bank to estimate the fair values of its financial instruments at December 31, 2015 and 2014:

Cash and due from banks: The carrying amounts of cash and short-term instruments approximate fair values and are classified as Level 1.

Interest-bearing deposits in banks: The carrying amounts of interest-bearing deposits approximate fair values and are classified as Level 1.

Investment securities: For investment securities, fair values are based on quoted market prices, where available, and are classified as Level 1. If quoted market prices are not available, fair values are estimated using quoted market prices for similar securities and indications of value provided by brokers and are classified as Level 2.

Loans and leases: Fair values of loans, excluding loans held for sale, are estimated as follows: For variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values resulting in a Level 3 classification. Fair values for other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality also resulting in a Level 3 classification. The methods utilized to estimate the fair value of loans do not necessarily represent an exit price.

FHLB stock: It is not practicable to determine the fair value of FHLB stock due to restrictions placed on its transferability.

Deposits: The fair values disclosed for demand deposits are, by definition, equal to the amount payable on demand at the reporting date (i.e. their carrying amount) resulting in a Level 1 classification. Fair values for fixed rate time deposits are estimated using a discounted cash flows calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits resulting in a Level 2 classification.

Federal Home Loan Bank Advances: The fair value of FHLB advance are determined based on the current market for like-kind instruments of a similar maturity and structure and are classified as Level 2.

Accrued interest receivable and payable: The carrying amount of accrued interest receivable and payable approximates fair value resulting in a Level 1 classification.

The fair values of commitments to extend credit and standby letters of credit are estimated using the fees currently charged to enter into similar agreements and are not significant and, therefore, not included in the above table.

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EXCHANGE BANK AND SUBSIDIARIES
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NOTE 3 – AVAILABLE-FOR-SALE INVESTMENT SECURITIES

The amortized cost and estimated fair value of available-for-sale investment securities at December 31, 2015 and 2014 consisted of the following:

	2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Government agencies	\$ 228,396	\$ 308	\$ (531)	\$ 228,173
Obligations of states and political subdivisions	146,530	2,213	(135)	148,608
Government sponsored entities residential mortgage-backed securities	65,442	786	(167)	66,061
U.S. Treasuries	48,340	151	(56)	48,435
Other securities	4,000	-	(27)	3,973
	<u>\$ 492,708</u>	<u>\$ 3,458</u>	<u>\$ (916)</u>	<u>\$ 495,250</u>

	2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Government agencies	\$ 197,482	\$ 443	\$ (773)	\$ 197,152
Obligations of states and political subdivisions	124,245	2,965	(290)	126,920
Government sponsored entities residential mortgage-backed securities	77,279	1,524	(53)	78,750
U.S. Treasuries	30,506	141	(33)	30,614
Other securities	4,000	-	(9)	3,991
	<u>\$ 433,512</u>	<u>\$ 5,073</u>	<u>\$ (1,158)</u>	<u>\$ 437,427</u>

Net unrealized gains (losses) on available-for-sale investment securities totaling \$2,542 and \$3,915 were recorded, net of \$1,049 and \$1,616 in deferred tax liabilities, as accumulated other comprehensive income within stockholders' equity at December 31, 2015 and 2014, respectively. There were no sales of available-for-sale investments during the years ended December 31, 2015 and 2014. There were no transfers of available-for-sale investment securities for the years ended December 31, 2015 and 2014.

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EXCHANGE BANK AND SUBSIDIARIES
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 3 – AVAILABLE-FOR-SALE INVESTMENT SECURITIES (Continued)

Available-for-sale investment securities with unrealized losses at December 31, 2015 and 2014 are summarized and classified according to the duration of the loss period as follows:

	2015		2014	
	<u>Fair Value</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>	<u>Gross Unrealized Losses</u>
Less than twelve months:				
U.S. Government agencies	\$ 121,247	\$ (531)	\$ 52,742	\$ (150)
Obligations of states and political subdivisions	29,776	(96)	22,112	(105)
Government guaranteed mortgage backed securities	25,399	(167)	10,112	(27)
U.S. Treasury	20,074	(56)	2,025	(4)
Other securities	<u>1,974</u>	<u>(26)</u>	<u>-</u>	<u>-</u>
Greater than twelve months:				
U.S. Government agencies	\$ -	\$ -	\$ 53,058	\$ (624)
Obligations of states and political subdivisions	3,336	(39)	11,915	(185)
Government guaranteed mortgage backed securities	-	-	3,958	(26)
U.S. Treasury	-	-	3,101	(29)
Other securities	<u>1,999</u>	<u>(1)</u>	<u>1,991</u>	<u>(9)</u>
	<u>\$ 203,805</u>	<u>\$ (916)</u>	<u>\$ 161,014</u>	<u>\$ (1,158)</u>

U.S. Treasury and U.S. Government Agencies: Management believes that the unrealized losses on the Bank's investment in U.S. Treasuries and Government agencies are caused by the fluctuation in interest rates and are not attributable to changes in credit quality. Management intends to hold these investments until at least a recovery of fair value or until maturity. The Bank does not consider these investments to be other-than-temporarily impaired at December 31, 2015.

Obligations of States and Political Subdivisions: The Bank holds 362 securities issued by state and political subdivisions, of which 8 have been in a continuous loss position for less than 12 months and 69 have been in a continuous loss position for 12 months or longer. Management believes that the unrealized losses on the Bank's investment in obligations of states and political subdivisions are a result of the fluctuation in interest rates. The contractual cash flows of these investments are considered a general obligation of, or supported by specific revenues of, a state or local municipality and the Bank intends to hold these investments until at least a recovery of fair value or until maturity. Therefore, the Bank expects to collect all amounts due and does not consider these securities to be other-than-temporarily impaired at December 31, 2015.

Government Guaranteed Mortgage Backed Securities: Management believes that the unrealized losses on the Bank's investment in government guaranteed mortgage backed securities is caused by the fluctuation in interest rates and is not attributable to changes in credit quality. Management intends to hold these investments until at least a recovery of fair value or until maturity. The Bank does not consider these investments to be other-than-temporarily impaired at December 31, 2015.

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EXCHANGE BANK AND SUBSIDIARIES
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NOTE 3 – AVAILABLE-FOR-SALE INVESTMENT SECURITIES (Continued)

Other Securities: Management believes that the unrealized losses on the Bank's investment in other securities is caused by the fluctuation in interest rates and is not attributable to changes in credit quality. Management intends to hold these investments until at least a recovery of fair value or until maturity. The Bank does not consider these investments to be other-than-temporarily impaired at December 31, 2015.

Contractual Maturities: The amortized cost and estimated fair value of available-for-sale investment securities at December 31, 2015, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because the issuers of securities may have the right to call or prepay obligations with or without prepayment penalties.

	<u>Amortized Cost</u>	<u>Estimated Fair Value</u>
Within one year	\$ 28,060	\$ 28,272
After one year through five years	341,951	343,539
After five years through ten years	55,801	55,925
After ten years	<u>1,454</u>	<u>1,453</u>
Investment securities not due at a single maturity date:		
Government sponsored entities mortgage-backed securities	<u>65,442</u>	<u>66,061</u>
	<u>\$ 492,708</u>	<u>\$ 495,250</u>

The only significant concentration of investment securities (greater than 10% of stockholders' equity) in any individual security issuer at December 31, 2015 is certain U.S. Government sponsored entities mortgage-backed securities such as Federal National Mortgage Association and Federal Home Loan Mortgage Corporation and certain U.S. Government agencies such as Federal Home Loan Bank.

Investment securities with amortized costs of \$115,558 and \$133,174 and fair values of \$117,502 and \$136,494 as of December 31, 2015 and 2014, respectively, were pledged to secure public and trust deposits, FHLB borrowing arrangements (see Note 8) and for other purposes required or permitted by law.

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EXCHANGE BANK AND SUBSIDIARIES
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NOTE 4 – LOANS AND LEASES

Loans and leases are reported net of deferred loan origination fees of \$719 in 2015 and \$670 in 2014 and consist of the following at December 31:

	<u>2015</u>	<u>2014</u>
Real estate – commercial	\$ 623,032	\$ 553,330
Real estate – construction	24,440	25,250
Commercial	267,423	301,852
Lease financing	31,932	31,747
Consumer	<u>332,078</u>	<u>309,772</u>
Total	1,278,905	1,221,951
Less: Allowance for loan and lease losses	<u>(37,830)</u>	<u>(37,653)</u>
	<u>\$ 1,241,075</u>	<u>\$ 1,184,298</u>

The components of the Bank's leases receivable at December 31 are as follows:

	<u>2015</u>	<u>2014</u>
Future lease payments receivable	\$ 34,328	\$ 34,297
Residual interests	86	134
Deferred broker fees	938	946
Unearned income	<u>(3,420)</u>	<u>(3,630)</u>
Net lease financing receivable	<u>\$ 31,932</u>	<u>\$ 31,747</u>

Future lease payments receivable are as follows:

<u>Year Ending</u> <u>December 31,</u>	
2016	\$ 2,678
2017	3,884
2018	8,374
2019	8,274
2020	8,081
Thereafter	<u>3,037</u>
	<u>\$ 34,328</u>

Certain loans have been pledged to secure borrowing arrangements (see Note 8).

(Continued)

EXCHANGE BANK AND SUBSIDIARIES
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NOTE 4 – LOANS AND LEASES (Continued)

Activity in the allowance for loan and lease losses for the years ended December 31, 2015 and 2014 was as follows:

	<u>2015</u>	<u>2014</u>
Balance, beginning of year	\$ 37,653	\$ 36,946
Provision for (reversal of) loan and lease losses	(3,200)	-
Loans charged-off	(1,016)	(966)
Recoveries	<u>4,393</u>	<u>1,673</u>
Balance, end of year	<u>\$ 37,830</u>	<u>\$ 37,653</u>

The following tables show the activity of the allowance for loan and lease losses for the years ended December 31, 2015 and 2014 by portfolio segment, and the allocation of the allowance for loan and lease losses at December 31, 2015 and 2014 by portfolio segment and by impairment methodology:

	<u>December 31, 2015</u>					
	<u>Real Estate – Commercial</u>	<u>Real Estate – Construction</u>	<u>Commercial</u>	<u>Lease Financing</u>	<u>Consumer</u>	<u>Total</u>
<u>Allowance for Credit Losses</u>						
Beginning balance	\$ 16,755	\$ 5,682	\$ 11,539	\$ 1,102	\$ 2,575	\$ 37,653
Provision for loan and lease losses	(1,376)	(640)	(896)	(64)	(224)	(3,200)
Loans charged-off	(215)	-	(533)	(258)	(10)	(1,016)
Recoveries	<u>989</u>	<u>2,559</u>	<u>534</u>	<u>55</u>	<u>256</u>	<u>4,393</u>
Ending balance allocated to portfolio segments	<u>\$ 16,153</u>	<u>\$ 7,601</u>	<u>\$ 10,644</u>	<u>\$ 835</u>	<u>\$ 2,597</u>	<u>\$ 37,830</u>
Ending balance: individually evaluated for impairment	<u>\$ 1,656</u>	<u>\$ 12</u>	<u>\$ 295</u>	<u>\$ 55</u>	<u>\$ 525</u>	<u>\$ 2,543</u>
Ending balance: collectively evaluated for impairment	<u>\$ 14,497</u>	<u>\$ 7,589</u>	<u>\$ 10,349</u>	<u>\$ 780</u>	<u>\$ 2,072</u>	<u>\$ 35,287</u>
<u>Loans</u>						
Ending balance	<u>\$ 623,032</u>	<u>\$ 24,440</u>	<u>\$ 267,423</u>	<u>\$ 31,932</u>	<u>\$ 332,078</u>	<u>\$1,278,905</u>
Ending balance: individually evaluated for impairment	<u>\$ 25,733</u>	<u>\$ 446</u>	<u>\$ 9,269</u>	<u>\$ 348</u>	<u>\$ 5,168</u>	<u>\$ 40,964</u>
Ending balance: collectively evaluated for impairment	<u>\$ 597,299</u>	<u>\$ 23,994</u>	<u>\$ 258,154</u>	<u>\$ 31,584</u>	<u>\$ 326,910</u>	<u>\$1,237,941</u>

(Continued)

EXCHANGE BANK AND SUBSIDIARIES
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NOTE 4 – LOANS AND LEASES (Continued)

	December 31, 2014					
	Real Estate – Commercial	Real Estate – Construction	Commercial	Lease Financing	Consumer	Total
<u>Allowance for Credit Losses</u>						
Beginning balance	\$ 16,587	\$ 5,192	\$ 11,609	\$ 1,174	\$ 2,384	\$ 36,946
Provision for loan and lease losses	-	-	-	-	-	-
Loans charged-off	(92)	-	(645)	(168)	(61)	(966)
Recoveries	260	490	575	96	252	1,673
	<u>16,755</u>	<u>5,682</u>	<u>11,539</u>	<u>1,102</u>	<u>2,575</u>	<u>37,653</u>
Ending balance allocated to portfolio segments						
	<u>\$ 16,755</u>	<u>\$ 5,682</u>	<u>\$ 11,539</u>	<u>\$ 1,102</u>	<u>\$ 2,575</u>	<u>\$ 37,653</u>
Ending balance: individually evaluated for impairment	<u>\$ 1,841</u>	<u>\$ 778</u>	<u>\$ 718</u>	<u>\$ 29</u>	<u>\$ 839</u>	<u>\$ 4,205</u>
Ending balance: collectively evaluated for impairment	<u>\$ 14,914</u>	<u>\$ 4,904</u>	<u>\$ 10,821</u>	<u>\$ 1,073</u>	<u>\$ 1,736</u>	<u>\$ 33,448</u>
<u>Loans</u>						
Ending balance	<u>\$ 553,330</u>	<u>\$ 25,250</u>	<u>\$ 301,852</u>	<u>\$ 31,747</u>	<u>\$ 309,772</u>	<u>\$1,221,951</u>
Ending balance: individually evaluated for impairment	<u>\$ 25,363</u>	<u>\$ 12,059</u>	<u>\$ 10,248</u>	<u>\$ 209</u>	<u>\$ 6,142</u>	<u>\$ 54,021</u>
Ending balance: collectively evaluated for impairment	<u>\$ 527,967</u>	<u>\$ 13,191</u>	<u>\$ 291,604</u>	<u>\$ 31,538</u>	<u>\$ 303,630</u>	<u>\$1,167,930</u>

The following tables show the loan portfolio allocated by management's internal risk ratings at December 31, 2015 and 2014:

	December 31, 2015				
	Commercial Credit Exposure				
	Credit Risk Profile by Internally Assigned Grade				
	Real Estate – Commercial	Real Estate – Construction	Commercial	Lease Financing	Total
Grade:					
Pass	\$ 600,853	\$ 21,630	\$ 245,003	\$ 30,881	\$ 898,367
Special Mention	11,526	979	11,527	-	24,032
Substandard	10,653	1,831	10,893	1,051	24,428
Total	<u>\$ 623,032</u>	<u>\$ 24,440</u>	<u>\$ 267,423</u>	<u>\$ 31,932</u>	<u>\$ 946,827</u>

(Continued)

EXCHANGE BANK AND SUBSIDIARIES
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NOTE 4 – LOANS AND LEASES (Continued)

		December 31, 2015	
		Consumer Credit Exposure Credit Risk Profile Based on Payment Activity	
		Consumer	Total
Grade:			
	Performing	\$ 330,212	\$ 330,212
	Non-performing	1,866	1,866
	Total	\$ 332,078	\$ 332,078

		December 31, 2014				
		Commercial Credit Exposure Credit Risk Profile by Internally Assigned Grade				
		Real Estate – Commercial	Real Estate – Construction	Commercial	Lease Financing	Total
Grade:						
	Pass	\$ 521,743	\$ 15,180	\$ 285,636	\$ 31,498	\$ 854,057
	Special Mention	19,140	1,534	8,562	28	29,264
	Substandard	12,447	8,536	7,654	221	28,858
	Total	\$ 553,330	\$ 25,250	\$ 301,852	\$ 31,747	\$ 912,179

		December 31, 2014	
		Consumer Credit Exposure Credit Risk Profile Based on Payment Activity	
		Consumer	Total
Grade:			
	Performing	\$ 307,127	\$ 307,127
	Non-performing	2,645	2,645
	Total	\$ 309,772	\$ 309,772

The following tables show an aging analysis of the loan portfolio by the time past due at December 31, 2015 and 2014:

		December 31, 2015					
		30-89 Days Past Due	Greater Than 90 Days	Nonaccrual	Total Past Due	Current	Total Loans
Real estate – commercial		\$ -	\$ -	\$ 1,723	\$ 1,723	\$ 621,309	\$ 623,032
Real estate – construction		-	-	192	192	24,248	24,440
Commercial		299	-	486	785	266,638	267,423
Lease financing		221	114	-	335	31,597	31,932
Consumer		714	-	1,866	2,580	329,498	332,078
	Total	\$ 1,234	\$ 114	\$ 4,267	\$ 5,615	\$ 1,273,290	\$ 1,278,905

(Continued)

EXCHANGE BANK AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(In thousands, except per share amounts)
December 31, 2015 and 2014

NOTE 4 – LOANS AND LEASES (Continued)

	December 31, 2014					
	30-89 Days Past Due	Greater Than 90 Days	Nonaccrual	Total Past Due	Current	Total Loans
Real estate – commercial	\$ -	\$ -	\$ 5,851	\$ 5,851	\$ 547,479	\$ 553,330
Real estate – construction	-	-	2,939	2,939	22,311	25,250
Commercial	366	-	613	979	300,873	301,852
Lease financing	426	90	-	516	31,231	31,747
Consumer	517	-	2,645	3,162	306,610	309,772
Total	<u>\$ 1,309</u>	<u>\$ 90</u>	<u>\$ 12,048</u>	<u>\$ 13,447</u>	<u>\$ 1,208,504</u>	<u>\$ 1,221,951</u>

The following tables show information related to impaired loans at and for the years ended December 31, 2015 and 2014:

	December 31, 2015				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:	\$ -	\$ -	\$ -	\$ -	\$ -
With an allowance recorded:					
Real estate – commercial	\$ 25,733	\$ 26,096	\$ 1,656	\$ 27,840	\$ 1,222
Real estate – construction	\$ 446	\$ 670	\$ 12	\$ 3,750	\$ 47
Commercial	\$ 9,269	\$ 9,753	\$ 295	\$ 7,323	\$ 504
Lease financing	\$ 348	\$ 348	\$ 55	\$ 316	\$ 32
Consumer	\$ 5,168	\$ 5,714	\$ 525	\$ 8,388	\$ 265
Total:					
Real estate – commercial	\$ 25,733	\$ 26,096	\$ 1,656	\$ 27,840	\$ 1,222
Real estate – construction	\$ 446	\$ 670	\$ 12	\$ 3,750	\$ 47
Commercial	\$ 9,269	\$ 9,753	\$ 295	\$ 7,323	\$ 504
Lease financing	\$ 348	\$ 348	\$ 55	\$ 316	\$ 32
Consumer	\$ 5,168	\$ 5,714	\$ 525	\$ 8,388	\$ 265

(Continued)

EXCHANGE BANK AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(In thousands, except per share amounts)
December 31, 2015 and 2014

NOTE 4 – LOANS AND LEASES (Continued)

	December 31, 2014				
	<u>Recorded Investment</u>	<u>Unpaid Principal Balance</u>	<u>Related Allowance</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>
With no related allowance recorded:	\$ -	\$ -	\$ -	\$ -	\$ -
With an allowance recorded:					
Real estate – commercial	\$ 25,390	\$ 27,133	\$ 1,841	\$ 29,555	\$ 1,257
Real estate – construction	\$ 12,059	\$ 12,723	\$ 778	\$ 9,842	\$ 300
Commercial	\$ 9,272	\$ 9,702	\$ 718	\$ 7,637	\$ 509
Lease financing	\$ 209	\$ 209	\$ 29	\$ 279	\$ 21
Consumer	\$ 7,121	\$ 7,622	\$ 839	\$ 9,738	\$ 337
Total:					
Real estate – commercial	\$ 25,390	\$ 27,133	\$ 1,841	\$ 29,555	\$ 1,257
Real estate – construction	\$ 12,059	\$ 12,723	\$ 778	\$ 9,842	\$ 300
Commercial	\$ 9,272	\$ 9,702	\$ 718	\$ 7,637	\$ 509
Lease financing	\$ 209	\$ 209	\$ 29	\$ 279	\$ 21
Consumer	\$ 7,121	\$ 7,622	\$ 839	\$ 9,738	\$ 337

Non-accrual loans totaled \$4,266 and \$12,048 at December 31, 2015 and 2014, respectively. Accruing loans that were past due 90 days or more totaled \$114 at December 31, 2015, as compared to \$90 at December 31, 2014.

Included in the impaired loans above are 68 loans in the amount of \$40,098 and 86 loans in the amount of \$50,456 that were considered to be troubled debt restructurings at December 31, 2015 and 2014, respectively.

For the years ended December 31, 2015 and 2014, the average recorded investment in impaired loans was \$47,617 and \$57,051, respectively. The Bank had \$2,543 of specific allowance for loan and lease losses on impaired loans with a recorded investment of \$40,964 at December 31, 2015 as compared to \$4,205 of specific allowance for loan and lease losses on impaired loans with a recorded investment of \$54,051 at December 31, 2014. Interest income recognized on a cash basis was not significant. Foregone interest on non-accrual loans was \$(121) for the year ended December 31, 2015, compared with \$427 for the year ended December 31, 2014.

Salaries and employee benefits totaling \$2,942 and \$2,676 have been deferred as loan and lease origination costs for the years ended December 31, 2015 and 2014, respectively.

The Bank has allocated \$2,495 and \$3,181 of specific reserves to customers whose loan terms have been modified in troubled debt restructurings as of December 31, 2015 and 2014. The Bank has \$139 commitments to lend additional amounts to customers with outstanding loans classified as troubled debt restructurings, as of December 31, 2015.

During the periods ending December 31, 2015 and 2014, the terms of certain loans were modified as troubled debt restructurings. The modification of the terms of such loans included one or a combination of the following: a reduction of the stated interest rate of the loan; an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk; or a permanent reduction of the recorded investment in the loan.

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EXCHANGE BANK AND SUBSIDIARIES
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 (In thousands, except per share amounts)
 December 31, 2015 and 2014

NOTE 4 – LOANS AND LEASES (Continued)

Modifications involving a reduction of the stated interest rate of the loan were for periods ranging from 12 months to 5 years. Modifications involving an extension of the maturity date were for periods ranging from 6 months to 24 months.

The following table presents loans by class modified as troubled debt restructurings that occurred during the year ended December 31, 2015:

	<u>Number of Loans</u>	<u>Pre- Modification Outstanding Recorded Investment</u>	<u>Post- Modification Outstanding Recorded Investment</u>
Troubled debt restructurings:			
Real estate – commercial	2	\$ 7,256	\$ 7,256
Real estate – construction	1	255	255
Commercial	3	663	663
Lease financing	3	248	248
Consumer	0	-	-
	<u>9</u>	<u>\$ 8,422</u>	<u>\$ 8,422</u>
Total	<u>9</u>	<u>\$ 8,422</u>	<u>\$ 8,422</u>

The troubled debt restructurings described above increased the allowance for loan losses by \$2,544 and resulted in \$0 in charge offs during the year ended December 31, 2015.

The following table presents loans by class modified as troubled debt restructurings for which there was a payment default within twelve months following the modification during the year ended December 31, 2015:

	<u>Number of Loans</u>	<u>Recorded Investment</u>
Troubled debt restructurings that subsequently defaulted:		
Lease financing	<u>5</u>	<u>\$ 6,890</u>

A loan is considered to be in payment default once it is 30 days contractually past due under the modified terms.

The troubled debt restructurings that subsequently defaulted described above did not increase the allowance for loan losses and did not result in charge offs during the year ended December 31, 2015.

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EXCHANGE BANK AND SUBSIDIARIES
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 (In thousands, except per share amounts)
 December 31, 2015 and 2014

NOTE 4 – LOANS AND LEASES (Continued)

The following table presents loans by class modified as troubled debt restructurings that occurred during the year ended December 31, 2014:

	<u>Number of Loans</u>	<u>Pre- Modification Outstanding Recorded Investment</u>	<u>Post- Modification Outstanding Recorded Investment</u>
Troubled debt restructurings:			
Real estate – commercial	4	\$ 4,142	\$ 4,550
Real estate – construction	-	-	-
Commercial	8	1,498	932
Lease financing	3	149	149
Consumer	-	-	-
	<hr/>	<hr/>	<hr/>
Total	<u>15</u>	<u>\$ 5,789</u>	<u>\$ 5,631</u>

The troubled debt restructurings described above increased the allowance for loan losses by \$0 and resulted in \$0 charge offs during the year ended December 31, 2014.

The following table presents loans by class modified as troubled debt restructurings for which there was a payment default within twelve months following the modification during the year ended December 31, 2014:

	<u>Number of Loans</u>	<u>Recorded Investment</u>
Troubled debt restructurings that subsequently defaulted:		
Lease financing	<u>5</u>	<u>\$ 1,089</u>

A loan is considered to be in payment default once it is 30 days contractually past due under the modified terms.

The troubled debt restructurings that subsequently defaulted described above did not increase the allowance for loan losses and did not result in charge offs during the year ended December 31, 2014.

In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification. This evaluation is performed under the Bank's internal underwriting policy.

NOTE 5 – FEDERAL HOME LOAN BANK STOCK

As a member of the Federal Home Loan Bank of San Francisco (FHLB), the Bank is required to own capital stock in an amount specified by regulation. At December 31, 2015 and 2014, the Bank owned 90,361 and 89,617 shares of \$100 par value FHLB stock respectively. The stock is carried at cost and is redeemable at par with certain restrictions. The amount of stock required to be held is adjusted periodically based on a determination made by the FHLB.

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EXCHANGE BANK AND SUBSIDIARIES
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 (In thousands, except per share amounts)
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NOTE 6 – BANK PREMISES AND EQUIPMENT

Bank premises and equipment at December 31 consist of the following:

	<u>2015</u>	<u>2014</u>
Land	\$ 2,709	\$ 2,709
Buildings	24,919	24,639
Leasehold improvements	6,939	6,614
Equipment	20,344	19,368
Construction in progress	<u>1,171</u>	<u>705</u>
	56,082	54,035
Less: accumulated depreciation and amortization	<u>(39,604)</u>	<u>(37,803)</u>
	<u>\$ 16,478</u>	<u>\$ 16,232</u>

Depreciation and amortization expense were \$2,261 and \$1,887 for the years ended December 31, 2015 and 2014, respectively.

NOTE 7 – INTEREST-BEARING DEPOSITS

Interest-bearing deposits at December 31 consisted of the following:

	<u>2015</u>	<u>2014</u>
Savings	\$ 377,550	\$ 332,597
Money market	238,181	220,892
NOW accounts	331,563	269,953
Time that meet or exceed the FDIC insurance limit	47,414	44,307
Other time	<u>166,730</u>	<u>183,241</u>
	<u>\$ 1,161,438</u>	<u>\$ 1,050,990</u>

The Bank's other time deposits included brokered deposits which totaled \$5,489 or .3% and \$5,887 or .4% of total deposits, respectively, for the years ended December 31, 2015 and 2014. Brokered deposits were entirely under the Certificate of Deposit Account Registry Service (CDARS) program, which allows the Bank's deposit customers to have the entire balance of their certificate of deposit account insured by the FDIC. There were no wholesale brokered certificates of deposit at December 31, 2015 and 2014.

(Continued)

EXCHANGE BANK AND SUBSIDIARIES
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 7 – INTEREST-BEARING DEPOSITS (Continued)

Aggregate annual maturities of time deposits at December 31, 2015 are as follows:

<u>Year Ending December 31,</u>	
2016	\$ 182,928
2017	17,016
2018	8,393
2019	1,904
2020	<u>3,903</u>
	<u>\$ 214,144</u>

NOTE 8 – FEDERAL HOME LOAN BANK ADVANCES AND OTHER LONG-TERM DEBT

Federal Home Loan Bank Advances: The Bank may borrow from the Federal Home Loan Bank, on either a short-term or long-term basis, up to 30% of its assets provided that adequate collateral has been pledged. As of December 31, 2015, the Bank has pledged investment securities with a carrying value of \$43,792 and loans with a carrying value of \$783,562 to secure this borrowing arrangement.

The following is a summary of the Bank's outstanding advances from the Federal Home Loan Bank of San Francisco and the weighted-average interest rate at December 31, 2015 and 2014:

<u>2015</u>		<u>2014</u>	
<u>Amount</u>	<u>Weighted Average Rate</u>	<u>Amount</u>	<u>Weighted Average Rate</u>
\$ <u>8,000</u>	4.70%	\$ <u>10,000</u>	4.74%

The annual maturities of the advances were as follows:

<u>Year Ending</u>	<u>Amount</u>	<u>Weighted Average Rate</u>
2017	\$ 2,000	4.59%
2018	2,000	4.72%
2019	2,000	4.65%
2020	<u>2,000</u>	4.84%
	<u>\$ 8,000</u>	4.70%

(Continued)

EXCHANGE BANK AND SUBSIDIARIES
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NOTE 8 – FEDERAL HOME LOAN BANK ADVANCES AND OTHER LONG-TERM DEBT (Continued)

Subordinated Debentures: On June 15, 2005, the Bank issued \$12,000 of Floating Rate Junior Subordinated Debentures due June 15, 2020. The purpose for issuing this subordinated debt, which qualifies as capital under regulatory risk-based capital standards, was to increase the Bank's Tier 2 capital. The Bank is not considered the primary beneficiary of the trust (variable interest entity); therefore, the trust is not consolidated in the Bank's financial statements, but rather the subordinated debentures are shown as a liability. On June 15, 2015 the debenture of \$12,000 was redeemed in full.

Lines of Credit: The Bank has an unsecured line of credit of \$5,000 with its correspondent bank, Pacific Coast Bankers Bank as of December 31, 2015 and 2014.

NOTE 9 – INCOME TAXES

The expense from income taxes for the years ended December 31, 2015 and 2014 consisted of the following:

	<u>Federal</u>	<u>State</u>	<u>Total</u>
<u>2015</u>			
Current	\$ 9,755	\$ 3,575	\$ 13,330
Deferred	<u>(355)</u>	<u>17</u>	<u>(338)</u>
Provision for income taxes	<u>\$ 9,400</u>	<u>\$ 3,592</u>	<u>\$ 12,992</u>
<u>2014</u>			
Current	\$ 6,786	\$ 2,448	\$ 9,234
Deferred	<u>836</u>	<u>493</u>	<u>1,329</u>
Provision for income taxes	<u>\$ 7,622</u>	<u>\$ 2,941</u>	<u>\$ 10,563</u>

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EXCHANGE BANK AND SUBSIDIARIES
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NOTE 9 – INCOME TAXES (Continued)

Deferred tax assets (liabilities) are comprised of the following at December 31, 2015 and 2014:

	<u>2015</u>	<u>2014</u>
Deferred tax assets:		
Allowance for loan losses	\$ 15,489	\$ 14,937
Deferred compensation	6,823	6,356
Postretirement benefits	1,570	1,359
Restructuring reserve	241	396
Nonaccrual interest	680	1,416
OREO property	-	48
Bank premises and equipment	660	768
State taxes	1,198	864
Other	<u>225</u>	<u>328</u>
Total deferred tax assets	<u>26,886</u>	<u>26,472</u>
Deferred tax liabilities:		
Deferred loan costs	(1,200)	(1,106)
Unrealized gains on available-for-sale investment securities	(1,049)	(1,616)
Prepaid expenses	(434)	(591)
Pension expenses	(1,862)	(3,583)
FHLB stock dividends	(387)	(387)
Other	<u>(8)</u>	<u>(477)</u>
Total deferred tax liabilities	<u>(4,940)</u>	<u>(7,760)</u>
Net deferred tax assets	<u>\$ 21,946</u>	<u>\$ 18,712</u>

The effective tax rate, as a percentage of income before income taxes, differs from the statutory Federal income tax rate as follows:

	<u>Year Ended December 31,</u>	
	<u>2015</u>	<u>2014</u>
Federal income tax expense, at statutory rate	35.0%	35.0%
State franchise tax, net of Federal tax effect	6.9	6.8
Tax-exempt interest on obligations of states and political subdivisions	(1.8)	(2.3)
Cash surrender value of life insurance	(1.4)	(1.7)
Tax credits	(0.5)	(1.1)
Other	<u>-</u>	<u>0.7</u>
Effective tax rate	<u>38.2%</u>	<u>37.4%</u>

(Continued)

EXCHANGE BANK AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(In thousands, except per share amounts)
December 31, 2015 and 2014

NOTE 9 – INCOME TAXES (Continued)

The Bank files income tax returns in the United States jurisdiction and the State of California jurisdiction. The Bank is no longer subject to Federal income tax examinations by tax authorities for years before 2012. The Bank is no longer subject to California income tax examinations by tax authorities for years before 2011.

The Bank recognizes interest accrued and penalties related to unrecognized tax benefits in tax expense. During the years ended December 31, 2015 and 2014, the Bank recognized no interest or penalties.

NOTE 10 – RELATED PARTY TRANSACTIONS

During the normal course of business, the Bank enters into transactions with related parties, including Directors and executive officers. The following is a summary of the aggregate activity involving related party borrowers during 2015:

Balance, January 1, 2015	\$ 13,733
Disbursements	1,838
Amounts repaid	(2,152)
Change in relationship	<u>(503)</u>
Balance, December 31, 2015	\$ <u>12,916</u>
Undisbursed commitments to related parties, December 31, 2015	\$ <u>5,819</u>

NOTE 11 – COMPREHENSIVE INCOME

Comprehensive income includes net income and other comprehensive income. Other comprehensive income for the Bank includes unrealized gains and losses on investment securities classified as available-for-sale, and changes in the funded status of defined benefit pension plans and the deferred compensation trust.

(Continued)

EXCHANGE BANK AND SUBSIDIARIES
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NOTE 11 – COMPREHENSIVE INCOME (Continued)

Components of other comprehensive income and related tax effects for the years ended December 31, 2015 and 2014 are as follows:

	<u>2015</u>	<u>2014</u>
Net Income	\$ 21,028	\$ 17,709
Other comprehensive income:		
Unrealized gains/losses on securities:		
Unrealized holding (losses) gains arising during the period	(1,373)	4,372
Tax effect	<u>567</u>	<u>(1,809)</u>
Changes in unrealized gain on available-for-sale investment securities, net of tax	<u>(806)</u>	<u>2,563</u>
Defined benefit pension plans:		
Net losses arising during the period	(5,249)	(5,640)
Tax effect	<u>2,208</u>	<u>2,371</u>
Changes in defined benefit pension plans, net of tax	<u>(3,041)</u>	<u>(3,269)</u>
Change in deferred compensation trust liabilities	(293)	7
Tax effect	<u>124</u>	<u>(3)</u>
Changes in deferred compensation trust, net of tax	<u>(169)</u>	<u>4</u>
Other comprehensive (loss) income	<u>(4,016)</u>	<u>(702)</u>
Total Comprehensive Income	<u>\$ 17,012</u>	<u>\$ 17,007</u>

(Continued)

EXCHANGE BANK AND SUBSIDIARIES
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NOTE 12 – RETIREMENT PLAN

The following presents the reconciliations of plan benefit obligations and plan assets from beginning of year to end of year. The Bank uses a December 31 measurement date for the Plan.

	<u>2015</u>	<u>2014</u>
Change in benefit obligation:		
Benefit obligation at beginning of year	\$ 47,501	\$ 41,575
Service cost	750	642
Interest cost	1,888	2,003
Benefits paid	(1,899)	(2,061)
Actuarial loss	<u>1,120</u>	<u>5,342</u>
Benefit obligation at end of year	<u>\$ 49,360</u>	<u>\$ 47,501</u>
Change in plan assets:		
Fair value of plan assets at beginning of year	\$ 56,022	\$ 54,108
Employer contribution	-	-
Benefits paid	(2,022)	(2,061)
Actual return on plan assets	<u>(212)</u>	<u>3,975</u>
Fair value of plan assets at end of year	<u>\$ 53,788</u>	<u>\$ 56,022</u>
Funded status at end of year	<u>\$ 4,428</u>	<u>\$ 8,521</u>

Amounts recognized in accumulated other comprehensive income at December 31 consist of:

	<u>2015</u>	<u>2014</u>
Net actuarial loss	\$ 13,609	\$ 8,786
Prior service cost	<u>253</u>	<u>390</u>
	<u>\$ 13,862</u>	<u>\$ 9,176</u>

The accumulated benefit obligation was \$49,360 and \$47,501 at December 31, 2015 and 2014. The Bank does not expect to contribute to the Plan in 2016.

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EXCHANGE BANK AND SUBSIDIARIES
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NOTE 12 – RETIREMENT PLAN (Continued)

The following presents the Plan investments, including their fair value and method of fair value determination, as of December 31, 2015 and 2014.

<u>2015</u>	<u>Total</u>	Quoted Prices in Active Markets for Identical Assets (<u>Level 1</u>)	Other Observable Inputs (<u>Level 2</u>)	Significant Unobservable Inputs (<u>Level 3</u>)
Cash and equivalents	\$ 689	\$ 689	\$ -	\$ -
Equity securities:				
U.S. large-cap (a)	25,817	25,817	-	-
U.S. small-cap (b)	3,228	3,228	-	-
International large-cap (c)	6,071	6,071	-	-
Fixed income securities:				
U.S. government agencies (d)	1,188	-	1,188	-
U.S. corporate bond funds (e)	4,817	4,817	-	-
U.S. total bond market fund (f)	<u>11,978</u>	<u>11,978</u>	<u>-</u>	<u>-</u>
Total	<u>\$ 53,788</u>	<u>\$ 52,600</u>	<u>\$ 1,188</u>	<u>\$ -</u>

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EXCHANGE BANK AND SUBSIDIARIES
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NOTE 12 – RETIREMENT PLAN (Continued)

<u>2014</u>	<u>Total</u>	Quoted Prices in Active Markets for Identical Assets (<u>Level 1</u>)	Other Observable Inputs (<u>Level 2</u>)	Significant Unobservable Inputs (<u>Level 3</u>)
Cash and equivalents	\$ 530	\$ 530	\$ -	\$ -
Equity securities:				
U.S. large-cap (a)	27,417	27,417	-	-
U.S. small-cap (b)	3,414	3,414	-	-
International large-cap (c)	6,044	6,044	-	-
Fixed income securities:				
U.S. government agencies (d)	1,379	-	1,379	-
U.S. corporate bond funds (e)	4,902	4,902	-	-
U.S. total bond market fund (f)	<u>12,336</u>	<u>12,336</u>	-	-
Total	<u>\$ 56,022</u>	<u>\$ 54,643</u>	<u>\$ 1,379</u>	<u>\$ -</u>

- (a) This category comprises low-cost equity index funds not actively managed that track the S&P 500, as well as actively managed funds that track the Russell 100 value index.
- (b) This category represents low-cost actively managed and broadly diversified U.S. small cap equity funds.
- (c) This category represents low cost index enhanced and broadly diversified Non U.S. large cap international funds.
- (d) This category represents individual government agency fixed income debentures of a short to intermediate term to maturity.
- (e) This category represents low-cost actively managed U.S. investment grade bond funds.
- (f) This category represents a low-cost bond index fund passively managed to track the broad U.S. fixed income markets.

The fair values for equity securities and mutual funds are determined by quoted market prices, if available (Level 1). For securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2). Certain debt securities are valued at the closing price reported in the active market in which the bond is traded (Level 1 inputs). Other debt securities are valued based upon recent bid prices or the average of recent bid and asked prices when available (Level 2 inputs) and, if not available, they are valued through matrix pricing models developed by sources considered by management to be reliable. Matrix pricing, which is a mathematical technique commonly used to price debt securities that are not actively traded, values debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3). Discounted cash flows are calculated using spread to swap and LIBOR curves that are updated to incorporate loss severities, volatility, credit spread and optionality. During times when trading is more liquid, broker quotes are used (if available) to validate the model. Rating agency and industry research reports as well as defaults and deferrals on individual securities are reviewed and incorporated into the calculations.

(Continued)

EXCHANGE BANK AND SUBSIDIARIES
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 12 – RETIREMENT PLAN (Continued)

In accordance with the "Prudent Expert" rule, the Plan attempts to achieve a balance of risk and reward that will provide the Plan with the greatest risk-adjusted return on assets. The maximization of risk-adjusted return is accomplished by broadly diversifying assets within the major financial asset classes and by maintaining a discipline to the target asset allocation of the Plan. The Plan is managed through a relatively passive approach to asset allocation. The Investment Manager maintains the policy asset allocation listed below except for those unusual and well documented market related events that may dictate otherwise. Stated below is the policy asset allocation at market values of Plan assets. This is the long term asset allocation desired by the Board, which should approximate the actual average asset allocation over a three to five year period. In practice asset allocation is monitored on a monthly basis and at such time as any of the minimum or maximum target asset allocations are pierced, a rebalancing transaction is required to bring all asset allocations back to policy target ranges.

Also stated are the maximum and minimum asset allocation levels at market for each asset category as well as the weighted average expected return for each asset class.

	<u>Minimum</u>	<u>Policy</u>	<u>Maximum</u>	<u>Weighted Average Expected Return</u>
Equity	50%	65%	80%	6%
Fixed income	25%	35%	45%	2%
Cash and equivalents	0%	0%	5%	0%

The allocation by asset category of the pension plan assets at December 31 is as follows:

	<u>2015</u>	<u>2014</u>
Asset category:		
Equity	65%	66%
Fixed income	33%	33%
Other	<u>2%</u>	<u>1%</u>
Total	<u>100%</u>	<u>100%</u>

The primary investment objective for the Plan assets is to achieve maximum rates of return commensurate with safety of principal, given the asset mix, credit quality and diversification guidelines and restrictions approved by the retirement committee. The asset allocation is reviewed quarterly to determine whether the portfolio mix is within an acceptable range of target allocation. Target asset allocations are based on asset and liability studies with the goal to enhance the expected return of the retirement portfolio while maintaining acceptable levels of risk.

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EXCHANGE BANK AND SUBSIDIARIES
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NOTE 12 – RETIREMENT PLAN (Continued)

The components of 2015 and 2014 net periodic benefit cost are as follows:

	<u>2015</u>	<u>2014</u>
Service cost	\$ 750	\$ 642
Interest cost	1,888	2,003
Expected return on plan assets	(3,987)	(3,861)
Amortization of unrecognized prior service cost	137	114
Amortization of unrecognized actuarial loss	<u>619</u>	<u>-</u>
Total net periodic cost	<u>\$ (593)</u>	<u>\$ (1,102)</u>
Net loss	\$ 5,442	\$ 5,229
Prior service cost		
Amortization of prior service cost	(137)	(114)
Amortization of net loss	<u>(619)</u>	<u>-</u>
Total recognized in other comprehensive income	<u>4,686</u>	<u>5,115</u>
Total recognized in net periodic benefit cost and other comprehensive income	<u>\$ 4,093</u>	<u>\$ 4,013</u>

The estimated net loss and prior service costs for the defined benefit pension plan that will be amortized from accumulated other comprehensive income into net periodic benefit cost over the next fiscal year are \$756 and \$114 as of December 31, 2015 and 2014, respectively.

The weighted average assumptions used to determine benefit obligations at December 31:

	<u>2015</u>	<u>2014</u>
Discount rate	4.5%	4.0%
Rate of compensation increase	4.0%	4.0%

The weighted average assumptions used to determine net periodic benefit cost at December 31:

	<u>2015</u>	<u>2014</u>
Discount rate	4.0%	4.875%
Rate of compensation increase	4.0%	4.000%
Expected return of plan assets	7.25%	7.25%

The expected return on retirement plan assets is developed using inflation expectations and risk factors to arrive at a long-term nominal expected return for each asset class. The nominal expected return for each asset class is then weighted based on the target asset allocation to develop the expected long-term rate of return on plan assets.

(Continued)

EXCHANGE BANK AND SUBSIDIARIES
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NOTE 12 – RETIREMENT PLAN (Continued)

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid as follows:

<u>Year Ending December 31,</u>	<u>Pension Benefits</u>
2016	\$ 2,034
2017	\$ 2,197
2018	\$ 2,322
2019	\$ 2,477
2020	\$ 2,595
2021 through 2025	\$ 14,319

NOTE 13 – POSTRETIREMENT HEALTHCARE PLAN

The following presents the postretirement healthcare plan's combined funded status:

	<u>2015</u>	<u>2014</u>
Change in benefit obligation:		
Benefit obligation at beginning of year	\$ 5,308	\$ 4,924
Service cost	26	41
Interest cost	205	232
Benefits paid	(383)	(351)
Plan participant contribution	81	71
Actuarial gain	<u>129</u>	<u>391</u>
Benefit obligation at end of year	<u>\$ 5,366</u>	<u>\$ 5,308</u>
Change in plan assets:		
Fair value of plan assets at beginning of year	\$ 4,281	\$ 4,443
Other payments	(51)	(128)
Plan participant contribution	81	71
Benefits paid	(383)	(351)
Employer contribution	-	-
Actual return on plan assets	<u>(66)</u>	<u>246</u>
Fair value of plan assets at end of year	<u>\$ 3,862</u>	<u>\$ 4,281</u>
Plan assets less benefit obligation at end of year	<u>\$ (1,504)</u>	<u>\$ (1,027)</u>

(Continued)

EXCHANGE BANK AND SUBSIDIARIES
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NOTE 13 – POSTRETIREMENT HEALTHCARE PLAN (Continued)

Amounts recognized in accumulated other comprehensive income at December 31 consist of:

	<u>2015</u>	<u>2014</u>
Net actuarial loss	\$ 987	\$ 494
Prior service cost	<u>(206)</u>	<u>(276)</u>
	<u>\$ 781</u>	<u>\$ 218</u>

The accumulated benefit obligation was \$5,366 and \$5,308 at December 31, 2015 and 2014. The Bank does not expect to contribute to the Plan in 2016.

	<u>2015</u>	<u>2014</u>
Components of net periodic benefit cost:		
Service cost	\$ 26	\$ 41
Interest cost	205	232
Expected return on plan assets	(298)	(310)
Amortization of unrecognized prior service cost	<u>(70)</u>	<u>(70)</u>
Total net periodic benefit cost	\$ (137)	\$ (107)

	<u>2015</u>	<u>2014</u>
Net loss (gain)	\$ 493	\$ 455
Amortization of prior service cost	<u>70</u>	<u>70</u>
Total recognized in other comprehensive income	<u>563</u>	<u>525</u>
Total recognized in net periodic benefit cost and other comprehensive income	<u>\$ 426</u>	<u>\$ 418</u>

The estimated net loss and prior services costs for the defined benefit pension plan that will be amortized from accumulated other comprehensive income into net periodic benefit cost cover the next fiscal year is \$106 and \$0 as of December 31, 2015 and 2014, respectively.

The following table represents the assumed health care trend rates at December 31:

	<u>2015</u>	<u>2014</u>
Health care trend rate assumed for next year	5.50%	5.50%
Rate to which the cost trend rate is assumed to decline	5.50%	5.50%
Year that the rate reaches the ultimate trend rate	2010	2010

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NOTE 13 – POSTRETIREMENT HEALTHCARE PLAN (Continued)

The following presents the Plan investments, including their fair value and method of fair value determination, as of December 31, 2015 and 2014.

<u>2015</u>	<u>Total</u>	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash	\$ 42	\$ 42	\$ -	\$ -
Equity securities:				
U.S. large-cap (a)	2,240	2,240	-	-
U.S. small-cap (b)	284	284	-	-
International large-cap (c)	554	554	-	-
Fixed income securities:				
Obligations of states and political subdivisions (d)	<u>742</u>	<u>-</u>	<u>742</u>	<u>-</u>
Total	<u>\$ 3,862</u>	<u>\$ 3,120</u>	<u>\$ 742</u>	<u>\$ -</u>

<u>2014</u>	<u>Total</u>	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash	\$ 49	\$ 49	\$ -	\$ -
Equity securities:				
U.S. large-cap (a)	2,648	2,648	-	-
U.S. small-cap (b)	337	337	-	-
International large-cap (c)	570	570	-	-
Fixed income securities:				
Obligations of states and political subdivisions (d)	<u>677</u>	<u>-</u>	<u>677</u>	<u>-</u>
Total	<u>\$ 4,281</u>	<u>\$ 3,604</u>	<u>\$ 677</u>	<u>\$ -</u>

- (a) This category comprises low-cost equity index funds not actively managed that track the S&P 500.
(b) This category represents low-cost actively managed and broadly diversified U.S. small cap equity funds.
(c) This category represents low cost index enhanced and broadly diversified Non U.S. large cap international funds.
(d) This category represents individual tax exempt state, municipalities and local government agency fixed income debentures of a short to intermediate term to maturity.

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NOTE 13 – POSTRETIREMENT HEALTHCARE PLAN (Continued)

The fair values for equity securities and mutual funds are determined by quoted market prices, if available (Level 1). For securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2). Certain debt securities are valued at the closing price reported in the active market in which the bond is traded (Level 1 inputs). Other debt securities are valued based upon recent bid prices or the average of recent bid and asked prices when available (Level 2 inputs) and, if not available, they are valued through matrix pricing models developed by sources considered by management to be reliable. Matrix pricing, which is a mathematical technique commonly used to price debt securities that are not actively traded, values debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3). Discounted cash flows are calculated using spread to swap and LIBOR curves that are updated to incorporate loss severities, volatility, credit spread and optionality. During times when trading is more liquid, broker quotes are used (if available) to validate the model. Rating agency and industry research reports as well as defaults and deferrals on individual securities are reviewed and incorporated into the calculations.

In accordance with the "Prudent Expert" rule, the Plan attempts to achieve a balance of risk and reward that will provide the Plan with the greatest risk-adjusted return on assets. The maximization of risk-adjusted return is accomplished by broadly diversifying assets within the major financial asset classes and by maintaining a discipline to the target asset allocation of the Plan. The Plan is managed through a relatively passive approach to asset allocation. The Investment Manager maintains the policy asset allocation listed below except for those unusual and well documented market related events that may dictate otherwise. Stated below is the policy asset allocation at market values of plan assets. This is the long term asset allocation desired by the Board, which should approximate the actual average asset allocation over a three to five year period. In practice, asset allocation is monitored on a monthly basis and at such time as any of the minimum or maximum target asset allocations are pierced, a rebalancing transaction is required to bring all asset allocations back to policy target ranges.

Also stated are the maximum and minimum asset allocation levels at market for each asset category as well as the weighted average expected return for each asset class.

	<u>Minimum</u>	<u>Policy</u>	<u>Maximum</u>	<u>Weighted Average Expected Return</u>
Equity	70%	80%	90%	7%
Fixed income	10%	20%	30%	1%
Cash and equivalents	0%	0%	20%	0%

The allocation by asset category of the postretirement healthcare plan assets at December 31 is as follows:

	<u>2015</u>	<u>2014</u>
Asset category:		
Equity	80%	83%
Fixed income	19%	16%
Other	1%	1%
Total	<u>100%</u>	<u>100%</u>

(Continued)

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NOTE 13 – POSTRETIREMENT HEALTHCARE PLAN (Continued)

The primary investment objective for the Plan's assets is to achieve maximum rates of return commensurate with safety of principal, given the asset mix, credit quality and diversification guidelines and restrictions approved by the retirement committee. The asset allocation is reviewed quarterly to determine whether the portfolio mix is within an acceptable range of target allocation. Target asset allocations are based on asset and liability studies with the goal to enhance the expected return of the retirement portfolio while maintaining acceptable levels of risk. The target asset allocation for the portfolio is 80% equity and 20% fixed income.

The Bank uses a December 31 measurement date for the Plan. For measurement purposes, the healthcare trend rate of 5.5% was used in 2015 and 2014. They will remain at that level thereafter except where the Bank's contribution limit applies. The healthcare cost trend rate assumptions have a significant effect on the amounts reported, but their impact is lessened because the Bank limits its annual increase at twice the 1991 average premium rate. To illustrate, increasing the assumed healthcare cost trend rates by 1.0% in each year would not change the accumulated postretirement benefit obligation as of December 31, 2015 or 2014, respectively. In addition, the aggregate of the service and interest components of net periodic postretirement benefit cost would not change as of December 31, 2015 or 2014, respectively.

Further, decreasing the assumed healthcare cost trend rates by 1.0% in each year would not change the accumulated postretirement benefit obligation as of December 31, 2015 or 2014. In addition, the aggregate service and interest components of net periodic postretirement benefit cost for the year would not change as of December 31, 2015 or 2014, respectively.

The weighted average assumptions used to determine benefit obligations at December 31 are as follows:

	<u>2015</u>	<u>2014</u>
Discount rate	4.5%	4.0%
Rate of compensation increase	N/A	N/A

The weighted average assumptions used to determine net periodic benefit cost at December 31 are as follows:

	<u>2015</u>	<u>2014</u>
Discount rate	4.00%	4.875%
Expected return of plan assets	7.25%	7.250%
Rate of compensation increase	N/A	N/A

The expected return on retirement plan assets is developed using inflation expectations and risk factors to arrive at a long-term nominal expected return for each asset class. The nominal expected return for each asset class is then weighted based on the target asset allocation to develop the expected long-term rate of return on plan assets.

The plan assets are invested in a 501(c)(9) Voluntary Employees' Beneficiary Association trust which is subject to unrelated business income tax. The plan assets were funded by the Bank initially on December 31, 1991 and periodic contributions have been made since then. As of December 31, 2014, these investments included liquid investments, fixed income debt securities and equity securities.

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EXCHANGE BANK AND SUBSIDIARIES
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NOTE 13 – POSTRETIREMENT HEALTHCARE PLAN (Continued)

The Medicare Prescription Drug, Improvement and Modernization Act of 2003 was signed into law on December 8, 2003. The Plan was designed to provide only for healthcare premiums and, consequently, the measures of the postretirement benefit obligations and net periodic postretirement benefit cost do not reflect effects of the Act.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

<u>Year Ending December 31,</u>	<u>Pension Benefits</u>
2016	\$ 377
2017	\$ 382
2018	\$ 387
2019	\$ 394
2020	\$ 392
2021 through 2025	\$ 1,873

NOTE 14 – COMMITMENTS AND CONTINGENCIES

Financial Instruments With Off-Balance-Sheet Risk: The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments represent commitments to originate fixed and variable rate loans and lines of credit and involve, to varying degrees, elements of interest rate risk and credit risk in excess of the amount recognized in the Bank's consolidated balance sheet. The Bank's exposure to credit loss in the event of nonperformance by the other party for commitments to extend credit and letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments to originate loans and lines of credit as it does for on-balance sheet instruments.

The following financial instruments represent off-balance-sheet credit risk at December 31:

	<u>2015</u>	<u>2014</u>
Commitments to extend credit	\$ 326,599	\$ 259,723
Standby letters of credit	<u>29,833</u>	<u>27,379</u>
Total loan commitments	<u>\$ 356,432</u>	<u>\$ 287,102</u>

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Each customer's creditworthiness is evaluated on a case-by-case basis. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies, but may include deposit accounts, accounts receivable, inventory, equipment and deeds of trust on residential real estate, land held for development and income-producing commercial properties.

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NOTE 14 – COMMITMENTS AND CONTINGENCIES (Continued)

Standby letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. The credit risk involved in issuing standby letters of credit is essentially the same as that involved in extending loans to customers.

The fair value of the liability related to commitments to extend credit and standby letters of credit, which represents the fees received for issuing the guarantees, was not significant at December 31, 2015 and 2014. The Bank recognizes these fees as revenue over the term of the commitment or when the commitment is used.

Leases: The Bank leases certain branch premises under operating lease agreements. The leases expire on various dates through 2028 and have renewal options for up to five years. At December 31, 2015, minimum commitments under these noncancellable leases with initial or remaining terms of one year or more are as follows:

<u>Year Ending</u> <u>December 31,</u>		
2016	\$	1,782
2017		1,596
2018		1,266
2019		765
2020		416
Thereafter		797
	\$	6,622

Rent expense under operating leases was \$1,706 and \$1,742 for the years ended December 31, 2015 and 2014, respectively.

Federal Reserve Requirement: Federal Reserve Board regulations require the Bank to maintain reserve balances on deposit with the Federal Reserve Bank. The average amount of reserves required at the Federal Reserve Bank for the years ended December 31, 2015 and 2014 were \$1,467 and \$1,265, respectively.

Contingencies: The Bank is involved in legal proceedings arising in the normal course of business. In the opinion of management, the outcomes of such proceedings will not have a material adverse effect on the Bank's financial position or results of operations.

Uninsured Deposits: The Bank maintains funds on deposit with the Federal Home Loan Bank (FHLB) and other federally insured financial institutions under correspondent banking agreements. Uninsured deposits with the FHLB and correspondent banks totaled \$4,744 and \$3,533 at December 31, 2015 and 2014, respectively.

Postretirement Benefits: The Bank has salary continuation agreements in place to provide nonqualified defined benefit retirement income for certain executive officers of the Bank. In connection with establishing these agreements, the Bank purchased split-dollar single premium life insurance policies on each participant. The agreements provide that each executive will receive annual benefits over their lifetime commencing with the month following their normal retirement date.

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EXCHANGE BANK AND SUBSIDIARIES
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NOTE 14 – COMMITMENTS AND CONTINGENCIES (Continued)

The Bank accrues for these future benefits from the effective date of the agreements until the executives' expected final payment dates in a systematic and rational manner. As of December 31, 2015 and 2014, the Bank had accrued \$13,254 and \$12,498, respectively, for potential benefits payable. This payable approximates the then present value of the benefits expected to be provided at retirement. The expense recognized under these agreements totaled \$1,834 and \$1,413 for the years ended December 31, 2015 and 2014, respectively.

The Bank has also established a deferred compensation plan for certain members of management for the purpose of providing the opportunity to defer compensation. At December 31, 2015 and 2014, the liability for accrued deferred compensation, including interest earned, totaled \$2,920 and \$2,949, respectively.

The Bank has also executed split-dollar life insurance agreements with certain employees in connection with the salary continuation agreements and deferred compensation plan whereby the Bank has effectively agreed to maintain a life insurance policy during the employees' postretirement period. The Bank had accrued a liability at December 31, 2015 and 2014 in the amount of \$2,408 and \$2,332, respectively, representing the actuarial present value of the costs to maintain life insurance during the employees' postretirement period.

The cash surrender value of life insurance purchased in connection with these agreements totaled \$42,080 and \$36,125 as of December 31, 2015 and 2014, respectively.

NOTE 15 – REGULATORY MATTERS

Dividend Restrictions: The California Financial Code restricts the total dividend payment of any state banking association in any calendar year to the lesser of (1) the bank's retained earnings or (2) the bank's net income for its last three fiscal years, less distributions made to shareholders during the same three-year period. In addition, subject to prior regulatory approval, any state banking association may request an exception to this restriction.

Regulatory Capital: Banks are subject to regulatory capital requirements administered by federal and state banking agencies. Capital adequacy guidelines and prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can initiate regulatory action. The final rules implementing Basel Committee on Banking Supervision's capital guidelines for U.S. banks (Basel III rules) became effective for the Bank on January 1, 2015 with full compliance with all of the requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. The net unrealized gain or loss on available for sale securities and defined benefit plans are not included in computing regulatory capital. Capital amounts and ratios for December 31, 2014 are calculated using Basel I rules. Management believes as of December 31, 2015, the Bank met all capital adequacy requirements to which they were subject.

Prompt corrective action regulations provide five classifications; well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required. At year-end 2015 and 2014, the most recent regulatory notifications categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the Bank's category.

(Continued)

EXCHANGE BANK AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(In thousands, except per share amounts)
December 31, 2015 and 2014

NOTE 15 – REGULATORY MATTERS (Continued)

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Minimum Amount	Minimum Ratio	Minimum Amount	Minimum Ratio
<u>December 31, 2015</u>						
Total capital (to risk-weighted assets)	\$ 198,748	13.35%	\$ 119,127	8.0%	\$ 148,909	10.0%
Tier 1 capital (to risk-weighted assets)	\$ 179,896	12.08%	\$ 89,345	6.0%	\$ 119,127	8.0%
Common Tier 1 (CET I)	\$ 179,896	12.08%	\$ 67,009	4.5%	\$ 96,791	6.5%
Tier 1 capital (to average assets)	\$ 179,896	8.97%	\$ 80,224	4.0%	\$ 74,454	5.0%
<u>December 31, 2014</u>						
Total capital (to risk-weighted assets)	\$ 192,272	13.9%	\$ 110,333	8.0%	\$ 137,916	10.0%
Tier 1 capital (to risk-weighted assets)	\$ 162,780	11.8%	\$ 55,166	4.0%	\$ 82,749	6.0%
Tier 1 capital (to average assets)	\$ 162,780	8.9%	\$ 72,969	4.0%	\$ 69,858	5.0%

