Exchange Bank

March 1, 2011

Dear Shareholders:

The 2010 Consolidated Financial Statements for the Exchange Bank are enclosed. These pages reflect a significant improvement in earnings over operating losses incurred in 2008 and 2009. The Bank's $10.3 million in net income in 2010 is reflective of expense controls instituted in 2009, improving net interest margins and a reduction in loan loss provisions for problem credits.

During 2010, the U. S. economy continued its slow recovery with modest increases in consumer spending and real Gross Domestic Product. In this improving economic environment, the most significant parts of our credit portfolio have either stabilized or improved. Despite these encouraging signs of improvement, the levels of spending and production remain below their expansion peaks, and the local and national economic environment remains challenging. Most prominently, unemployment and underemployment levels are elevated and household debt levels are high, businesses remain reticent to hire and the local real estate markets remain stressed. The economic challenges within our local communities are deep and widespread as a significant number of long-time clients continue to struggle to survive financially. We established a special team of experienced lenders charged with finding practical solutions on a borrower by borrower basis. While their efforts to restore strength and quality back to our loan portfolio have not yet been fully completed, we are pleased with the progress.

Loan charge-offs declined by 61% in 2010 when compared to 2009. In addition, the Bank was able to reduce non-accrual loans and non-performing assets by $13.2 million and $10.4 million respectively. Our loan loss reserve was expanded by $4.4 million to a record year-end level equal to 3.15% of loans with the action reflecting a prudent acknowledgment of uncertainty in today's economic environment.

In this challenging period where growing revenue from quality loans is very difficult, we are very pleased with our efforts to control expenses while still delivering top service to our customers. A decline of $6 million in interest income was substantially offset by a reduction of $9.1 million in interest expense with a significant amount of this improvement credited to a favorable increase of core transaction accounts, an elimination of high cost deposits and a reduction of borrowings from the Federal Home Loan Bank. In preparing the Bank for a brighter future, we are also beginning to see cost savings realized from numerous initiatives, while still making prudent investments in systems and technology. As a result, our non-interest expense declined by 1% in 2010.

Looking forward, the banking environment and Sonoma County businesses will be influenced by the uneven and fragile economic recovery, the potential for financial turmoil and recent financial reforms including the Financial Reform Act. Regulatory changes enacted and anticipated in 2011, which impact overdraft fee income and debit card interchange revenue, are estimated to reduce the Bank's revenues by approximately $3 million on an annualized basis. California's budget deficit may spread or worsen and adversely affect employment and the confidence of consumers and businesses. In this uneasy environment, imposition of new U. S. and global financial regulations, especially significantly higher capital and liquidity standards and additional fees, will directly affect the banking industry and may have adverse effects on the pace of economic recovery.

While overall conditions improved this year, 2010 still presented a challenging environment for the banking industry. Despite these headwinds, Exchange Bank took important steps on a number of fronts to position the Bank well for the current environment and the future. We've strengthened the Bank's capital position to industry-leading levels and continue to maintain strong liquidity and significant untapped lines of credit available to us as substantial backup strength to respond to the lending needs that will inevitably resurface as our markets slowly recover. We have dealt with root causes of elevated credit losses, which we and our competitors are experiencing, and we have otherwise maintained strong operating results throughout the economic downturn. Due to these actions, we believe our prospects for success are strong as we move into 2011, a year that should provide for improved results, particularly in terms of credit.

As a further capital related matter, you will recall in the fall of 2008, the U.S. government launched a variety of programs to address the financial crisis. This included the Capital Repurchase Program (CPP), under which investments were made in healthy banks to maintain lending in their communities. Exchange Bank received an investment under the CPP of $43 million in preferred stock and associated warrants. We make quarterly dividend payments to Treasury of 5%. This dividend payment will reset to 9% in 2013 and we expect to repay the investment out of retained earnings, subject to regulatory approval, as soon as practical in a manner that considers the interests of all of our constituencies, including our shareholders. It is our intention to avoid any capital raises that would be dilutive to you our shareholders.

Our earnings performance in 2010 and continued focus on reducing problem credits paves the way toward a discussion on the future reinstatement of a shareholder cash dividend. Our capital levels are strong and we expect to readily meet and exceed proposed standards as they come into effect.

While the financial landscape and financial regulation continue to evolve, we believe our strengths in traditional community based lending and deposit-taking activities and our strong customer service position us very well to compete and succeed in the future.

We would like to invite you to our Annual Shareholders Meeting on Friday, March 25, 2011 at 2:00 p.m. If you are unable to attend, we would request that your proxy vote be given to management.

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 reinkingb@exchangebank.com.

On behalf of all of us, we thank you for the confidence you have placed in us.

Sincerely,

C. William Reinking
Chairman

William R. Schrader
President and Chief Executive Officer

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 2010 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 the Federal Institutions Regulatory and Interest Rate Control Act of 1978.

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

During calendar year 2010, the Bank engaged in transactions with Abbey, Weitzenberg, Warren & Emery, a California corporation, in which Richard W. Abbey, an Exchange Bank Director, has a material interest as a 12.5% shareholder. The amount of attorney's fees paid was in excess of $40,000.

Exchange Bank

NOTICE OF ANNUAL SHAREHOLDERS MEETING
TO BE HELD MARCH 25, 2011

March 1, 2011

Dear Shareholder:

The regular 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 25, 2010** at **2:00 p.m.** for the following purposes:

1. To receive the Chief Executive Officer's report of operations for the year 2010.

2. To receive the report of the Nominating Committee and to vote on the election of the following nominees as members of the Board of Directors for the ensuing year:

   - C. W. Reinking
   - M. K. Soiland
   - J. M. Ryan
   - D. B. Benedetti
   - C. G. Tamayo
   - D G. Libarle
   - W. R. Schrader
   - R. W. Abbey

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

Those entitled to receive notice of and vote at the meeting are shareholders of record at the close of business on February 23, 2011.

We would appreciate you signing and returning the enclosed proxy in the enclosed postage paid envelope as soon as possible. If you attend the meeting in person, the proxy will be null and void, and you may vote and participate in the meeting as though you had not signed the proxy.

The following information is included in accordance with the By-Laws:

> Nominations for election of members of the Board of Directors may be made by the Board of Directors or by any shareholder of any outstanding class of voting stock of the Corporation entitled to vote for the election of directors. Notice of intention to

make any nominations, other than by the Board of Directors, shall be made in writing and shall be received by the President of the Corporation no more than 60 days prior to any meeting of shareholders called for the election of directors, and no more than 10 days after the date the notice of such meeting is sent to shareholders pursuant to Article II, Section 2(a) of these By-Laws; provided, however, that if only 10 days' notice of the meeting is given to shareholders, such notice of intention to nominate shall be received by the President of the Corporation not later than the time fixed in the notice of the meeting for the opening of the meeting. Such notification shall contain the following information to the extent known to the notifying shareholder: (A) the name and address of each proposed nominee; (B) the principal occupation of each proposed nominee; (C) the number of shares of voting stock of the Corporation owned by each proposed nominee; (D) the name and residence address of the notifying shareholder; and (E) the number of shares of voting stock of the Corporation owned by the notifying shareholder. Nominations not made in accordance herewith shall be disregarded by the then Chairman of the meeting, and the Inspectors of Election shall then disregard all votes cast for each nominee.

If you have questions about the operations of the Bank, you may submit them in writing before the Annual 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.

The following information is provided to you in accordance with the Federal Deposit Insurance Corporation:

F.D.I.C. regulations require that certain financial information, supplementing that contained in your annual report, be made available upon request.

This additional data is available now. If you wish a copy of this information, please send a written request to my attention or you may call (707) 524-3121.

By Order of the Board of Directors,

Marlene Soiland

Marlene K. Soiland
Corporate Secretary

MKS/ks

EXCHANGE BANK
BOARD OF DIRECTORS

C. William Reinking

Mr. Reinking was elected to the Board in 1985 when he was appointed President and Chief Operating Officer. He has been with the Bank for 46 years. He retired in 2003 and at that time became Chairman of the Board. In 2008, he was again employed by the Bank as Chief Executive Officer and remained Chairman. On December 31, 2009, he retired again as Chief Executive Officer and remains as Chairman. In 2010, he was named a Doyle Trustee. Mr. Reinking is a graduate of the University of Oregon and the Pacific Coast Banking School. His community involvement, current and past, includes Becoming Independent, Canine Companions, Sonoma County Community Foundation, Chamber of Commerce, the Luther Burbank Center and the Active 20-30 Club.

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 industry organizations such as the Sonoma County Alliance, Sonoma County Innovation Council, Institute for Family Business, and California Construction and Industrial Materials Association.

James M. Ryan

Mr. Ryan was elected to the Board in 1997 and named a Doyle Trustee in 2007. He now serves as Vice Chairman of the Board and Chairs the Board's Audit and Nominating Committees. He is a graduate of California State University Sacramento and is a licensed Real Estate Broker, Certified Public Accountant 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 Committee. He attended Santa Rosa Junior College and graduated from Sonoma State University. Mr. Benedetti is the Past President of Clover Stornetta Farms, Inc. and is now Chairman of the Board of that company. Active in the community, he is on the President's Advisory Board at Santa Rosa Junior College and Sonoma State University, 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 Masters Degree from American Graduate School of International Management. Mr. Tamayo is the President and Chairman of La Tortilla Factory, a family owned business founded in 1977. His 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 Loan and Corporate Governance Committees. A graduate of San Jose State University, he is President of their family owned business, Lace House Linen, Inc. The business has been in operation since 1915 in Petaluma. 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. Currently he is President and Chief Executive Officer. He joined the Bank in 1978 and has served as Senior Loan Officer and Chief Operating Officer. Mr. Schrader is a graduate of St. Mary's College and received his Master from Golden Gate University. He is also a graduate of the Pacific Coast School of Banking. His community involvement includes the YMCA, Diocesan School Board, the Santa Rosa Community Health Center, the Chamber of Commerce Education Leadership Committee and a Regent 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 has his own firm, Abbey, Weitzenberg, Warren and Emery. He has been the general counsel for the Exchange Bank since the mid 1980's. Mr. Abbey's community involvement activities include the Redwood Empire Food Bank, YMCA, Habitat for Humanity, the Santa Rosa Junior College Foundation and Schools Plus Enrichment Foundation.

EXCHANGE BANK AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2010 AND 2009 AND

FOR THE YEARS THEN ENDED

AND

INDEPENDENT AUDITOR'S REPORT

PERRY-SMITH
THE POWER OF CONFIDENCE

Perry-Smith LLP
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Sacramento, CA 95814
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916.441.1000

INDEPENDENT AUDITOR'S REPORT

The Stockholders and
Board of Directors
Exchange Bank and Subsidiaries

We have audited the accompanying consolidated balance sheet of Exchange Bank and Subsidiaries (the "Bank") as of December 31, 2010 and 2009 and the related consolidated statements of operations, changes in stockholders' equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Bank's management. 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 audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

We have also audited in accordance with attestation standards established by the American Institute of Certified Public Accountants, Exchange Bank's internal control over financial reporting as of December 31, 2010 based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated February 15, 2011 expressed an unqualified opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Exchange Bank and Subsidiaries as of December 31, 2010 and 2009 and the consolidated results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Perry-Smith LLP

February 15, 2011

EXCHANGE BANK AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET

December 31, 2010 and 2009

(In thousands, except share and par value amounts)

	2010	2009
ASSETS		
Cash and due from banks	$ 39,551	$ 32,613
Short-term investments	226	6,218
Total cash and cash equivalents	39,777	38,831
Available-for-sale investment securities	318,376	304,032
Loans and leases	1,051,833	1,091,527
Less allowance for loan and lease losses	(33,144)	(28,781)
Net loans and leases	1,018,689	1,062,746
Federal Home Loan Bank stock	8,438	9,494
Bank premises and equipment, net	17,606	19,170
Bank owned life insurance	32,741	31,518
Other real estate owned	17,070	14,315
Accrued interest receivable and other assets	68,084	71,960
Total assets	$ 1,520,781	$ 1,552,066
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits:		
Non-interest bearing	$ 424,371	$ 427,850
Interest bearing	860,781	888,998
Total deposits	1,285,152	1,316,848
Federal Home Loan Bank advances and other long-term debt	47,000	51,000
Accrued interest payable and other liabilities	31,403	34,068
Total liabilities	1,363,555	1,401,916
Commitments and contingencies (Note 13)		
Stockholders' equity:		
Preferred stock, 1,000,000 shares authorized:		
Series A, noncumulative, $1,000 per share liquidation preference; 43,000 shares issued and outstanding	41,710	41,280
Series B, noncumulative, $1,000 per share liquidation preference; 2,150 shares issued and outstanding	2,150	2,150
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	64,155	56,088
Accumulated other comprehensive (loss) income, net of taxes	(1,101)	320
Total stockholders' equity	157,226	150,150
Total liabilities and stockholders' equity	$ 1,520,781	$ 1,552,066

The accompanying notes are an integral
part of these consolidated financial statements.

EXCHANGE BANK AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF OPERATIONS

For the Years Ended December 31, 2010 and 2009

(In thousands, except per share amounts)

	2010	2009
Interest income:		
Interest and fees on loans and leases	$ 66,376	$ 69,199
Interest on investment securities:		
Taxable	5,661	8,317
Exempt from Federal income taxes	4,084	4,563
Total interest income	76,121	82,079
Interest expense:		
Interest on deposits	4,792	12,002
Interest on borrowings	1,962	3,858
Total interest expense	6,754	15,860
Net interest income before provision for loan and lease losses	69,366	66,219
Provision for loan and lease losses	19,500	41,000
Net interest income after provision for loan and lease losses	49,866	25,219
Non-interest income:		
Service charges and fees	8,456	8,884
Trust income	4,781	4,170
Merchant discount and interchange fees	3,483	3,110
Gain on sale of investment securities		1,112
Income from bank owned life insurance	1,340	1,382
Other income	2,317	1,950
Total non-interest income	20,377	20,608
Non-interest expense:		
Salaries and employee benefits	27,406	28,585
Occupancy and equipment	6,888	6,407
Professional fees	5,932	6,716
Loss on sale of other real estate owned	3,141	3,652
FDIC assessments	3,094	2,571
Other expenses	9,820	8,820
Total non-interest expense	56,281	56,751
Income (loss) before provision for (benefit from) income taxes	13,962	(10,924)
Provision for (benefit from) income taxes	3,706	(7,061)
Net income (loss)	$ 10,256	$ (3,863)
Basic and diluted earnings (loss) per common share (Note 1)	$ 4.96	$ (3.49)

The accompanying notes are an integral part of these consolidated financial statements.

EXCHANGE BANK AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

For the Years Ended December 31, 2010 and 2009

(In thousands)

	Preferred Stock Series A	Preferred Stock Series B	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive (Loss) Income (Net of Taxes)	Total Stockholders' Equity
Balance, January 1, 2009	$ 40,850	$ 2,150	$ 4,286	$ 46,026	$ 62,503	$ (2,042)	$ 153,773
Comprehensive loss:							
Net loss					(3,863)		(3,863)
Other comprehensive income:							
Net change in unrealized gain on available-for-sale investment securities (net of $55 in tax provision)						77	77
Defined benefit pension plans:							
Amortization of prior service costs included in net periodic pension costs (net of $95 in tax benefits)						(210)	(210)
Net gain arising during period (net of $972 in tax provision)						2,155	2,155
Change in unrealized gain on deferred compensation trust (net of $229 in tax provision)						340	340
Total comprehensive loss							(1,501)
Preferred stock dividends					(2,122)		(2,122)
Amortization of preferred stock discount	430				(430)		
Balance, December 31, 2009	41,280	2,150	4,286	46,026	56,088	320	150,150
Comprehensive loss:							
Net Income					10,256		10,256
Other comprehensive income:							
Net change in unrealized gain on available-for-sale investment securities (net of $1,276 in tax benefits)						(1,815)	(1,815)
Defined benefit pension plans:							
Amortization of prior service costs included in net periodic pension costs (net of $126 in tax benefits)						(78)	(78)
Net gain arising during period (net of $435 in tax provision)						275	275
Change in unrealized gain on deferred compensation trust (net of $132 in tax provision)						197	197
Total comprehensive income							8,835
Preferred stock dividends					(1,759)		(1,759)
Amortization of preferred stock discount	430				(430)		
Balance, December 31, 2010	$ 41,710	$ 2,150	$ 4,286	$ 46,026	$ 64,155	$ (1,101)	$ 157,226

The accompanying notes are an integral
part of these consolidated financial statements.

EXCHANGE BANK AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CASH FLOWS

For the Years Ended December 31, 2010 and 2009

(In thousands)

	2010	2009
Cash flows from operating activities:		
Net Income (loss)	$ 10,256	$ (3,863)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Valuation allowance on other real estate owned	2,648	2,135
Depreciation and amortization	2,507	2,720
Provision for loan losses	19,500	41,000
Net realized gain on sale of available-for-sale investment securities		(1,112)
Gain on sale of loans	(525)	
Loss on sale of other real estate owned	494	1,529
Accretion of discounts and amortization of premiums on investment securities	1,975	551
Net change in deferred loan origination fees	108	(450)
Increase in bank owned life insurance, net of expenses	(1,223)	(1,094)
Changes in operating assets and liabilities:		
Accrued interest receivable and other assets	5,583	(13,233)
Accrued interest payable and other liabilities	(2,665)	(6,057)
Net cash provided by operating activities	38,658	22,126
Cash flows from investing activities:		
Proceeds from sale of other real estate owned	3,744	10,730
Senior debt assumed for other real estate owned		(1,287)
Proceeds from maturities of investment securities	166,478	111,260
Proceeds from sales and calls of investment securities		17,231
Purchase of investment securities	(185,437)	(99,483)
Purchase of Federal Home Loan Bank (FHLB) stock	1,056	
Proceeds from sale of loans	5,784	
Net decrease in loans and leases	9,060	13,004
Purchase of bank premises and equipment	(943)	(934)
Net cash (used in) provided by investing activities	(258)	50,521
Cash flows from financing activities:		
Net increase in demand, interest bearing and savings deposits	35,823	59,688
Net decrease in time deposits	(67,518)	(30,881)
Net decrease in short-term FHLB advances		(55,000)
Proceeds from long-term FHLB advances		10,000
Repayments of long-term FHLB advances	(4,000)	(55,000)
Cash paid for dividends	(1,759)	(2,122)
Net cash used in financing activities	(37,454)	(73,315)
Increase (decrease) in cash and cash equivalents	946	(668)
Cash and cash equivalents, beginning of year	38,831	39,499
Cash and cash equivalents, end of year	$ 39,777	$ 38,831
Supplemental disclosure of cash flow information:		
Cash paid (received) during the year for:		
Interest expense	$ 7,020	$ 16,874
Income taxes	$ 3,112	$ (10,696)
Non-cash investing activity:		
Net change in unrealized gain on available-for-sale investment securities, defined compensation trust and defined benefit plans	$ (2,256)	$ 3,523
Transfer of loans to other real estate owned	$ 10,134	$ 18,370

The accompanying notes are an integral part of these consolidated financial statements.

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. and AJV-Ripon LLC, conduct their business from 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. 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. 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.

Reclassifications

Certain reclassifications have been made to prior year's balances to conform to classifications used in 2010.

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.

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 $2,874 at December 31, 2010.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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.

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 computed using the specific identification method for determining the cost of investment securities sold.

An investment security is impaired when its carrying value is greater than its fair value. Investment securities that are impaired are evaluated on at least a quarterly basis and more frequently when economic or market conditions warrant such an evaluation to determine whether such a decline in their fair value is other than temporary. Management utilizes criteria such as the magnitude and duration of the decline and the intent and ability of the Bank to retain its investment in the securities for a period of time sufficient to allow for an anticipated recovery in fair value, in addition to the reasons underlying the decline, to determine whether the loss in value is other than temporary. The term "other than temporary" is not intended to indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value is not necessarily favorable, or that there is a lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. Once a decline in value is determined to be other than temporary, and management does not intend to sell the security or it is more likely than not that the Bank will not be required to sell the security before recovery, only the portion of the impairment loss representing credit exposure is recognized as a charge to earnings, with the balance recognized as a charge to other comprehensive income. If management intends to sell the security or it is more likely than not that the Bank will be required to sell the security before recovering its forecasted cost, the entire impairment loss is recognized as a charge to earnings.

Loans and Leases

Loans 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.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

<u>Loans and Leases</u>

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.

Interest is accrued daily based upon outstanding loan and lease balances. However, when, in the opinion of management, loans or leases are considered impaired and the future collectibility 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 collectibility 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 collectibility of the total contractual principal and interest is no longer in doubt.

<u>Loan Sales and Servicing</u>

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 market value. Market 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 after a 90 day warranty period and are calculated 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, 2010 the balance of loans originated and unsold under the SBA program totaled $3,771. There were no unsold loans at December 31, 2009. Management has determined that the unsold loans originated through the SBA program were not material for disclosure as held for sale at December 31, 2010.

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.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Loan Sales and Servicing (Continued)

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 the difference between the contractual servicing fees and adequate compensation for performing the servicing, 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 $5,806 were being serviced for others at December 31, 2010. There were no loans serviced for others at December 31, 2009. Servicing assets are periodically evaluated for impairment. Servicing assets at December 31, 2010 and 2009 were not significant.

Allowance for Loan and Lease Losses

The allowance for loan and lease losses is an estimate of credit losses inherent in the Bank's loan portfolio that have been incurred as of the balance-sheet date. 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 for inherent losses related to loans that are not impaired.

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. 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.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Loan and Lease Losses (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 inherent 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.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Loan and Lease Losses (Continued)

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.

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.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Loan and Lease Losses (Continued)

Individual 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 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 Financial Institutions, 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.

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.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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. Other real estate held by the Bank and it's subsidiaries totaled $17,070 and $14,315 at December 31, 2010 and 2009, respectively.

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.

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.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Retirement Plan and Postretirement Healthcare Plan (Continued)

In addition, the Bank sponsors a defined benefit postretirement healthcare plan that covers both salaried and nonsalaried 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.

The Pension Protection Act (PPA) of 2006 became effective in 2008 and reforms U.S. pension funding laws. Some key provisions of the PPA related to funding requirements include the requirement to fund 100% of all liabilities accrued to participants and beneficiaries; changes to the calculation of minimum required contributions; changes to interest rate assumptions used to value benefit obligations; and the requirement to use new mortality tables. Management has incorporated the provisions of the PPA within their accounting for their retirement plans. See footnotes 11 and 12.

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.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Income Taxes

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.

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, 2010 and 2009 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.

Earnings (Loss) Per Share

Earnings (loss) per share is computed by dividing net income (loss), less preferred stock dividends, by the weighted average number of shares outstanding during the year, which was 1,714,344 for 2010 and 2009. There were $1,759 and $2,122 in preferred stock dividends paid in 2010 and 2009, respectively. In addition, there were no dilutive securities; therefore, basic and diluted earnings (loss) per share are equivalent.

Advertising

Advertising costs are charged to expense in the period incurred and totaled $505 and $335 for the years ended December 31, 2010 and 2009, respectively.

(In thousands, except per share amounts)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Comprehensive (Loss) Income

Comprehensive (loss) income includes net (loss) income and other comprehensive income (loss). Other comprehensive income (loss) for the Bank includes unrealized gains and losses on investment securities classified as available-for-sale, defined benefit pension plans and the deferred compensation trust.

Components of other comprehensive (loss) income and related tax effects for the years ended December 31, 2010 and 2009 are as follows:

	2010	2009
Change in unrealized gain on available-for-sale investment securities	$ (3,091)	$ 132
Tax effect	1,276	(55)
Changes in unrealized gain on available-for-sale investment securities, net of tax	(1,815)	77
Changes in defined benefit pension plan liabilities	506	2,822
Tax effect	(309)	(877)
Changes in defined benefit pension plans, net of tax	197	1,945
Change in deferred compensation trust liabilities	329	569
Tax effect	(132)	(229)
Changes in deferred compensation trust, net of tax	197	340
Accumulated other comprehensive income (loss)	$ (1,421)	$ 2,362

Subsequent Events

The Bank considered all events occurring from December 31, 2010 through February 15, 2011, the date the consolidated financial statements were available to be issued for disclosure and accrual in these consolidated financial statements and no subsequent events occurred requiring accrual or disclosure.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Impact of New Financial Accounting Standards

Transfers of Financial Assets

In June 2009, the Financial Accounting Standards Board ("FASB") issued FASB Accounting Standards Update ("ASU") 2009-16*, Accounting for Transfers of Financial Assets (Statement 166)*, which amends previously issued accounting guidance to enhance accounting and reporting for transfers of financial assets, including securitizations or continuing exposure to the risks related to transferred financial assets. Prior to the issuance of Statement 166, transfers under participation agreements and other partial loan sales fell under the general guidance for transfers of financial assets. Statement 166 introduces a new definition for a participating interest along with the requirement for partial loan sales to meet the definition of a participating interest for sale treatment to occur. If a participation or other partial loan sale does not meet the definition, the portion sold should remain on the books and the proceeds recorded as a secured borrowing until the definition is met. Additionally, existing provisions that require the transferred assets to be isolated from the originating institution (transferor), that the transferor does not maintain effective control through certain agreements to repurchase or redeem the transferred assets and that the purchasing institution (transferee) has the right to pledge or exchange the assets acquired were retained. The new provisions became effective on January 1, 2010. Under this new standard, the Bank's loan participations were not affected, and the Bank was not required to defer any gains or record secured borrowings as there were no loans sold that were within the warranty period as of December 31, 2010.

Fair Value Measurements

In January 2010, the FASB issued FASB ASU 2010-06*, Improving Disclosures about Fair Value Measurements,* which amends and clarifies existing standards to require additional disclosures regarding fair value measurements. Specifically, the standard requires disclosure of the amounts of significant transfers between Level 1 and Level 2 of the fair value hierarchy and the reasons for these transfers, the reasons for any transfers in or out of Level 3, and information in the reconciliation of recurring Level 3 measurements about purchases, sales, issuances and settlements on a gross basis. This standard clarifies that reporting entities are required to provide fair value measurement disclosures for each class of assets and liabilities. Previously separate fair value disclosures were required for each major category of assets and liabilities. This standard also clarifies the requirement to disclose information about both the valuation techniques and inputs used in estimating Level 2 and Level 3 fair value measurements. Except for the requirement to disclose information about purchases, sales, issuances, and settlements in the reconciliation of recurring Level 3 measurements on a gross basis, these disclosures are effective for the year ended December 31, 2010. The requirement to separately disclose purchases, sales, issuances, and settlements of recurring Level 3 measurements becomes effective on January 1, 2011. The Bank adopted this new accounting standard as of January 1, 2010 and the impact of adoption was not material to the consolidated financial statements.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Impact of New Financial Accounting Standards (Continued)

Disclosures about Credit Quality

In July 2010, the FASB issued FASB ASU 2010-20, *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*. ASU 2010-20 requires more robust and disaggregated disclosures about the credit quality of financing receivables (loans) and allowances for loan losses, including disclosure about credit quality indicators, past due information and modifications of finance receivables. The disclosures as of the end of a reporting period are effective for interim and annual reporting periods ending on and after December 15, 2010. The disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after December 15, 2010. The adoption of this guidance has significantly expanded disclosure requirements related to the allowance for loan losses but did not have an impact on the Bank's financial position, results of operation or cash flows. See Note 4, Loans and Leases.

Improving Disclosures about Fair Value Measurements

In January 2010, the FASB issued FASB ASU 2010-06, *Fair Value Measurements and Disclosures (Topic 820) – Improving Disclosures about Fair Value Measurements*. ASU 2010-06 affects all entities that are required to make disclosures about recurring and nonrecurring fair value measurements under FASB ASC Topic 820, originally issued as FASB Statement No. 157, *Fair Value Measurements*. The ASU requires certain new disclosures and clarifies two existing disclosure requirements. The new disclosures and clarifications of existing disclosures are effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. Management is assessing the impact of this standard on the Bank's financial condition, results of operations and disclosures.

(In thousands, except per share amounts)

2. FAIR VALUE MEASUREMENTS

Fair Value of Financial Instruments

The estimated carrying amounts and fair values of the Company's financial instruments are as follows:

	December 31, 2010		December 31, 2009	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:				
Cash and cash equivalents	$ 39,777	$ 39,777	$ 38,831	$ 38,831
Available-for-sale investment securities	318,376	318,376	304,032	304,032
Loans and leases, net	1,018,689	1,021,977	1,062,746	1,058,785
FHLB stock	8,438	8,438	9,494	9,494
Cash surrender value of bank owned life insurance	32,741	32,741	31,518	31,518
Accrued interest receivable	7,237	7,237	7,613	7,613
Financial liabilities:				
Deposits	1,285,152	1,285,524	1,316,848	1,317,768
Federal Home Loan Bank advances	35,000	38,024	39,000	41,449
Subordinated debentures	12,000	11,874	12,000	11,873
Accrued interest payable	458	458	712	712

These estimates do not reflect any premium or discount that could result from offering the Bank's entire holdings of a particular financial instrument for sale at one time, nor do they attempt to estimate the value of anticipated future business related to the instruments. In addition, the tax ramifications related to the realization of unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of these estimates.

2. FAIR VALUE MEASUREMENTS (Continued)

Fair Value of Financial Instruments (Continued)

The following methods and assumptions were used to estimate the fair value of financial instruments. For cash and cash equivalents, variable-rate loans and leases, accrued interest receivable and payable, FHLB stock, demand deposits and short-term FHLB advances, the carrying amount is estimated to be fair value. For available-for-sale investment securities, fair values are based on quoted market prices, quoted market prices for similar securities and indications of value provided by brokers. The fair values for fixed-rate loans and leases are estimated using discounted cash flow analyses, using interest rates currently being offered at each reporting date for loans with similar terms to borrowers of comparable creditworthiness. The fair value of bank owned life insurance policies is based on cash surrender values at each reporting date as provided by insurers. Fair values for fixed-rate certificates of deposit are estimated using discounted cash flow analyses using interest rates offered at each reporting date by the Bank for certificates with similar remaining maturities. The fair value of subordinated debentures and long-term FHLB advances are determined based on the current market for like-kind instruments of a similar maturity and structure. 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.

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.

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.

(In thousands, except per share amounts)

2. FAIR VALUE MEASUREMENTS (Continued)

Fair Value Measurements (Continued)

Fair Value Hierarchy (Continued)

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, 2010 and 2009:

Recurring Basis

	2010			
Description	Fair Value	Level 1	Level 2	Level 3
Debt securities:				
U.S. Government agencies	$ 120,333		$ 120,333	
Obligations of states and political subdivisions	132,812		132,812	
Government guaranteed mortgage-backed securities	55,895		55,895	
U.S. Treasuries	3,583		3,583	
Other securities	5,753		5,753	
Total assets measured at fair value	$ 318,376	$ -	$ 318,376	$ -

	2009			
Description	Fair Value	Level 1	Level 2	Level 3
Debt securities:				
U.S. Government agencies	$ 108,362		$ 108,362	
Obligations of states and political subdivisions	122,515		122,515	
Government guaranteed mortgage-backed securities	66,332		66,332	
U.S. Treasuries	1,085		1,085	
Other securities	5,738		5,738	
Total assets measured at fair value	$ 304,032	$ -	$ 304,032	$ -

Fair values for available-for-sale investment securities are based on quoted market prices for similar securities. During the years ended December 31, 2010 and 2009, there were no significant transfers in or out of Levels 1 and 2.

(In thousands, except per share amounts)

2. FAIR VALUE MEASUREMENTS (Continued)

Fair Value Measurements (Continued)

Assets Recorded at Fair Value (Continued)

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.

	2010				
	Fair Value	Level 1	Level 2	Level 3	Total Losses
Impaired loans	$ 56,100		$ 56,100		$ (12,706)
Other real estate owned	17,070		17,070		(2,713)
Total assets measured at fair value on a non-recurring basis	$ 73,170	$ -	$ 73,170	$ -	$ (15,419)

	2009				
	Fair Value	Level 1	Level 2	Level 3	Total Losses
Impaired loans	$ 45,761		$ 42,576	$ 3,185	$ (11,134)
Other real estate owned	14,315		14,315		(65)
Total assets measured at fair value on a non-recurring basis	$ 60,076	$ -	$ 56,891	$ 3,185	$ (11,199)

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 $12,706 and $11,134 represent impairment charges recognized during the years ended December 31, 2010 and 2009, respectively related to the above impaired loans.

(In thousands, except per share amounts)

2. FAIR VALUE MEASUREMENTS (Continued)

Fair Value Measurements (Continued)

Assets Recorded at Fair Value (Continued)

Non-recurring Basis (Continued)

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 lower of the carrying amount of the loan or 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 $2,713 and $65 represent impairment charges recognized during the year ended December 31, 2010 and 2009, 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 Level 2 impaired loans is based on the fair value of the collateral, obtained through property appraisals, for collateral dependent loans and for other impaired loans estimated using a discounted cash flow model. Selected impaired loans have been categorized as Level 3 due to the ongoing real estate market conditions resulting in inactive market data, which in turn required the use of significant unobservable inputs and assumptions in fair value measurements.

Other Real Estate Owned – The fair value of other real estate owned is based on the values obtained through property appraisals.

3. AVAILABLE-FOR-SALE INVESTMENT SECURITIES

The amortized cost and estimated fair value of available-for-sale investment securities at December 31, 2010 and 2009 consisted of the following:

	2010			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Government agencies	$ 120,185	$ 485	$ (337)	$ 120,333
Obligations of states and political subdivisions	128,925	4,763	(876)	132,812
Government guaranteed mortgage-backed securities	53,468	2,504	(77)	55,895
U.S. Treasuries	3,568	20	(5)	3,583
Other securities	5,345	408		5,753
	$ 311,491	$ 8,180	$ (1,295)	$ 318,376

(In thousands, except per share amounts)

3. AVAILABLE-FOR-SALE INVESTMENT SECURITIES (Continued)

	2009			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Government agencies	$ 107,306	$ 1,353	$ (297)	$ 108,362
Obligations of states and political subdivisions	116,624	5,892	(1)	122,515
Government guaranteed mortgage-backed securities	63,692	2,640		66,332
U.S. Treasuries	1,082	3		1,085
Other securities	5,352	386		5,738
	$ 294,056	$ 10,274	$ (298)	$ 304,032

Net unrealized gains on available-for-sale investment securities totaling $6,885 and $9,976 were recorded, net of $2,851 and $4,127 in tax liabilities, as accumulated other comprehensive income within stockholders' equity at December 31, 2010 and 2009, respectively. There were no sales of available-for-sale investments during the year ended December 31, 2010. Proceeds from sales of available-for-sale investment securities totaled $17,231 in 2009 with a gross realized gain of $1,112. There were no transfers of available-for-sale investment securities for the years ended December 31, 2010 and 2009.

Available-for-sale Investment securities with unrealized losses at December 31, 2010 and 2009 are summarized and classified according to the duration of the loss period as follows:

	2010		2009	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Less than twelve months:				
U.S. Government agencies	$ 47,832	$ (337)	$ 37,943	$ (297)
Obligations of states and political subdivisions	20,531	(876)	284	(1)
Government guaranteed mortgage-backed securities	7,773	(77)		
U.S. Treasuries	1,014	(5)		
	$ 77,150	$ (1,295)	$ 38,227	$ (298)

For the years ended December 31, 2010 and 2009, no securities were in a loss position for more than twelve months.

3. AVAILABLE-FOR-SALE INVESTMENT SECURITIES (Continued)

U.S. Government Agencies

Management believes that the unrealized losses on the Bank's investment in U.S. Government agencies is caused by the fluctuation in interest rates and is not attributable to changes in credit quality. Additionally, the contractual cash flows of those investments are guaranteed by an agency of the U.S. Government. 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, 2010.

Obligations of States and Political Subdivisions

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, 2010.

Government Guaranteed Mortgage-Backed Securities

Management believes that the unrealized losses on the Bank's investment in mortgage-backed securities is caused by the fluctuation in interest rates and is not attributable to changes in credit quality. The contractual cash flows of these investments are guaranteed by the U.S. Government. 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 by December 31, 2010.

U.S. Treasuries

Management believes that the unrealized losses on the Bank's investment in U.S. Government agencies is caused by the fluctuation in interest rates and is not attributable to changes in credit quality. Additionally, the contractual cash flows of the investments are guaranteed by United States Treasury department. 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, 2010.

(In thousands, except per share amounts)

3. AVAILABLE-FOR-SALE INVESTMENT SECURITIES (Continued)

Contractual Maturities

The amortized cost and estimated fair value of available-for-sale investment securities at December 31, 2010, 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.

	Amortized Cost	Estimated Fair Value
Within one year	$ 20,673	$ 20,856
After one year through five years	127,069	130,421
After five years through ten years	110,281	111,204
	258,023	262,481
Investment securities not due at a single maturity date:		
Government guaranteed mortgage-backed securities	53,468	55,895
	$ 311,491	$ 318,376

The only significant concentration of investment securities (greater than 10% of stockholders' equity) in any individual security issuer at December 31, 2010 is certain U.S. Government agency mortgage-backed securities such as Federal Home Loan Bank, Federal National Mortgage Association and Federal Home Loan Mortgage Corporation.

Investment securities with amortized costs of $179,872 and $246,475 and fair values of $186,813 and $255,580 as of December 31, 2010 and 2009, respectively, were pledged to secure public and trust deposits, FHLB borrowing arrangements (see Note 8) and for other purposes required or permitted by law.

(In thousands, except per share amounts)

4. LOANS AND LEASES

Loans and leases are reported net of deferred loan origination fees and costs of $542 in 2010 and $424 in 2009 and consist of the following:

	December 31, 2010	December 31, 2009
Real estate – commercial	$ 649,105	$ 627,856
Real estate – construction	100,932	132,249
Commercial	162,169	174,616
Lease financing	39,793	44,496
Consumer	99,834	112,310
Total	1,051,833	1,091,527
Less: Allowance for loan and lease losses	(33,144)	(28,781)
	$ 1,018,689	$ 1,062,746

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

	December 31, 2010	December 31, 2009
Future lease payments receivable	$ 45,111	$ 50,875
Residual interests	300	372
Unearned income	(5,618)	(6,751)
Net lease financing receivable	$ 39,793	$ 44,496

Future lease payments receivable are as follows:

Year Ending December 31,	
2011	$ 3,088
2012	7,088
2013	11,392
2014	12,993
2015	8,703
Thereafter	1,847
	$ 45,111

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

(In thousands, except per share amounts)

4. LOANS AND LEASES (Continued)

Activity in the allowance for loan and lease losses for the years ended December 31, 2010 and 2009 was as follows:

	2010	2009
Balance, beginning of year	$ 28,781	$ 27,180
Losses charged to the allowance	(17,533)	(41,661)
Recoveries	2,396	2,262
Provision for loan and lease losses	19,500	41,000
Balance, end of year	$ 33,144	$ 28,781

The following table shows the allocation of the allowance for loan and lease losses at and for the year ended December 31, 2010 by portfolio segment and by impairment methodology:

	Real Estate – Commercial	Real Estate – Construction	Commercial	Lease Financing	Consumer	Total
Allowance for Credit Losses						
Ending balance allocated to portfolio segments	$ 17,500	$ 4,000	$ 9,140	$ 860	$ 1,644	$ 33,144
Ending balance: individually evaluated for impairment	$ 4,849	$ 1,026	$ 816	$ 80	$ 137	$ 6,908
Ending balance: collectively evaluated for impairment	$ 12,651	$ 2,974	$ 8,324	$ 780	$ 1,507	$ 26,236
Loans						
Ending balance	$ 649,105	$ 100,932	$ 162,169	$ 39,793	$ 99,834	$ 1,051,833
Ending balance: individually evaluated for impairment	$ 29,990	$ 23,542	$ 7,854	$ 1,888	$ 1,148	$ 64,422
Ending balance: collectively evaluated for impairment	$ 619,115	$ 77,390	$ 154,315	$ 37,905	$ 98,686	$ 987,411

(In thousands, except per share amounts)

4. LOANS AND LEASES (Continued)

The following table shows the loan portfolio allocated by management's internal risk ratings at December 31, 2010:

	Commercial Credit Exposure Credit Risk Profile by Internally Assigned Grade				
	Real Estate – Commercial	Real Estate – Construction	Commercial	Lease Financing	Total
Grade:					
Pass	$ 545,536	$ 47,562	$ 121,114	$ 36,923	$ 751,135
Special Mention	45,279	22,521	13,549	1,723	83,072
Substandard	58,290	30,849	27,506	1,147	117,792
Total	$ 649,105	$ 100,932	$ 162,169	$ 39,793	$ 951,999

	Consumer Credit Exposure Credit Risk Profile Based on Payment Activity	
	Consumer	Total
Grade:		
Performing	$ 99,028	$ 99,028
Non-performing	806	806
Total	$ 99,834	$ 99,834

The following table shows an aging analysis of the loan portfolio by the time past due at December 31, 2010:

	30-89 Days Past Due	Greater Than 90 Days	Nonaccrual	Total Past Due	Current	Total Loans
Real estate – commercial	$ 341		$ 19,149	$ 19,490	$ 556,722	$ 576,212
Real estate – construction			14,199	14,199	88,896	103,095
Commercial	33		1,793	1,826	230,059	231,885
Lease financing	763	$ 28	473	1,264	39,543	40,807
Consumer	260		20	280		
Total	$ 1,397	$ 28	$ 35,634	$ 37,059	$ 1,014,774	$ 1,051,833

(In thousands, except per share amounts)

4. LOANS AND LEASES (Continued)

The following table shows information related to impaired loans at and for the year ended December 31, 2010:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Consumer	$ 118	$ 117		$ 108	
With an allowance recorded:					
Real estate – commercial	$ 35,656	$ 36,224	$ 4,849	$ 32,738	$ 3,366
Real estate – construction	$ 25,969	$ 39,202	$ 1,026	$ 23,843	$ 479
Commercial	$ 3,652	$ 3,698	$ 816	$ 3,353	$ 299
Leasing financing	$ 1,521	$ 1,521	$ 80	$ 1,397	
Consumer	$ 892	$ 916	$ 102	$ 819	$ 52
Total:					
Real estate – commercial	$ 35,656	$ 36,224	$ 4,849	$ 32,738	$ 3,366
Real estate – construction	$ 25,969	$ 39,202	$ 1,026	$ 23,843	$ 479
Commercial	$ 3,652	$ 3,698	$ 816	$ 3,353	$ 299
Leasing financing	$ 1,521	$ 1,521	$ 80	$ 1,397	
Consumer	$ 1,010	$ 1,033	$ 102	$ 927	$ 52

Non-accrual loans totaled $35,634 and $48,874 at December 31, 2010 and 2009, respectively. Accruing loans that were past due 90 days or more totaled $28 at December 31, 2010 as compared to $52 at December 31, 2009.

Included in the impaired and nonaccrual loans above are 75 loans in the amount of $47,306 that were considered to be troubled debt restructurings at December 31, 2010. There were $3,299 in unfunded commitments to lend additional funds to these borrowers as of December 31, 2010.

For the years ended December 31, 2010 and 2009, the average recorded investment in impaired loans was $62,258 and $56,707, respectively. The Bank had $6,908 of specific allowance for loan and lease losses on impaired loans with a recorded investment of $67,808 at December 31, 2010 as compared to $2,284 of specific allowance for loan and lease losses on impaired loans of $48,874 at December 31, 2009. Interest income on a cash basis was not significant. Foregone interest on non-accrual loans was $2,874 for the year ended December 31, 2010, compared with $4,811 for the year ended December 31, 2009.

Salaries and employee benefits totaling $1,125 and $1,097 have been deferred as loan and lease origination costs for the years ended December 31, 2010 and 2009, respectively.

(In thousands, except per share amounts)

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, 2010 and 2009, the Bank owned 84,379 and 94,940 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.

6. BANK PREMISES AND EQUIPMENT

Bank premises and equipment consist of the following:

	December 31,	
	2010	2009
Land	$ 2,815	$ 2,815
Buildings	23,673	23,600
Leasehold improvements	6,545	6,907
Equipment	18,523	18,441
Construction in progress	645	792
	52,201	52,555
Less: accumulated depreciation and amortization	(34,595)	(33,385)
	$ 17,606	$ 19,170

Depreciation and amortization expense were $2,507 and $2,720 for the years ended December 31, 2010 and 2009, respectively.

7. INTEREST-BEARING DEPOSITS

Interest-bearing deposits consisted of the following:

	December 31,	
	2010	2009
Savings	$ 218,349	$ 196,546
Money market	195,819	205,624
NOW accounts	164,758	137,455
Time, $100,000 or more	164,083	207,057
Other time	117,772	142,316
	$ 860,781	$ 888,998

(In thousands, except per share amounts)

7. INTEREST-BEARING DEPOSITS (Continued)

At December 31, 2010, the Bank's other time deposits included brokered deposits which totaled $11,141 or 0.9% of total deposits. 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, 2010. The Bank had brokered deposits, comprised of $20,140 under the CDARS program and $9,876 wholesale brokered certificates of deposits, totaling $30,016, or 2.3% of total deposits at December 31, 2009.

Aggregate annual maturities of time deposits at December 31, 2010 are as follows:

Year Ending December 31,	
2011	$ 214,874
2012	26,100
2013	5,824
2014	10,876
2015	24,181
	$ 281,855

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 20% of its assets provided that adequate collateral has been pledged. As of December 31, 2010, the Bank has pledged investment securities with a carrying value of $53,922 and loans with a carrying value of $491,421 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, 2010 and 2009:

2010		2009	
Amount	Weighted Average Rate	Amount	Weighted Average Rate
$ 35,000	4.48%	$ 39,000	4.42%

(In thousands, except per share amounts)

8. FEDERAL HOME LOAN BANK ADVANCES AND OTHER LONG-TERM DEBT (Continued)

Federal Home Loan Bank Advances (Continued)

The annual maturities of the advances were as follows:

Year Ending	Amount	Weighted Average Rate
2011	$ 6,000	4.38%
2012	3,000	4.77%
2013	8,000	3.97%
2014	2,000	4.43%
2015	2,000	4.52%
Thereafter	14,000	4.75%
	$ 35,000	4.48%

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 interest rate on the debentures is reset quarterly at the 3 Month LIBOR rate plus 1.80%, which was 2.10% at December 31, 2010. Payment on the debentures is interest only, payable quarterly, with all principal due at maturity. The Bank has the right to redeem all or any part of the debentures in multiples of $1 on any interest payment date on or after the interest payment date in June 2010. The bonds may be redeemed at par at a minimum of at least 30 and not more than 60 days prior to the redemption date. In addition, the Bank's ability to pay dividends is subject to certain covenants contained in the indenture related to the Bank's issuance of the debentures. The Bank is in compliance with all covenants as of December 31, 2010.

Lines of Credit

The Bank has no unsecured lines of credit with its correspondent banks as of December 31, 2010 and 2009.

(In thousands, except per share amounts)

9. INCOME TAXES

The benefit from income taxes for the years ended December 31, 2010 and 2009 consisted of the following:

	Federal	State	Total
2010			
Current	$ 2,997	$ 2,201	$ 5,198
Deferred	(707)	(785)	(1,492)
Provision for income taxes	$ 2,290	$ 1,416	$ 3,706
2009			
Current	$ (4,240)	$ 2	$ (4,238)
Deferred	(1,537)	(1,286)	(2,823)
Benefit from income taxes	$ (5,777)	$ (1,284)	$ (7,061)

Deferred tax assets (liabilities) are comprised of the following at December 31, 2010 and 2009:

	2010	2009
Deferred tax assets:		
Allowance for loan losses	$ 14,127	$ 12,311
Deferred compensation	5,165	5,239
Postretirement benefits	1,388	1,632
Restructuring reserve	695	695
Net operating loss	3,221	7,611
Tax credits	4,917	3,798
Nonaccrual interest	1,860	2,232
Bank premises and equipment	440	477
OREO property	1,432	
State taxes	770	
Total deferred tax assets	34,015	33,995
Deferred tax liabilities:		
Deferred loan costs	(469)	(526)
Unrealized gains on available-for-sale investment securities	(2,851)	(4,127)
Prepaid expenses	(343)	(1,510)
Pension expenses	(2,428)	(2,378)
FHLB stock dividends	(510)	(592)
Other	(331)	(107)
Total deferred tax liabilities	(6,932)	(9,240)
Net deferred tax assets	$ 27,083	$ 24,755

(In thousands, except per share amounts)

9. INCOME TAXES (Continued)

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

	Year Ended December 31,	
	2010	2009
Federal income tax expense, at statutory rate	35.0%	(35.0)%
State franchise tax, net of Federal tax effect	7.0	(7.6)
Tax-exempt interest on obligations of states and political subdivisions	(10.2)	(14.1)
Cash surrender value of life insurance	(4.0)	(3.6)
Tax credits	(2.1)	(4.7)
Other	0.8	0.4
Effective tax rate	26.5%	(64.6)%

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 2007. The Bank is no longer subject to California income tax examinations by tax authorities for years before 2006.

For the year ended December 31, 2010, the Bank has available for carryover $45.7 million of state net operating losses. The state net operating losses expire in 2029. The Bank also has available for carryover $2.7 million of federal minimum tax credits and $2.2 million of federal general business credits. The general business credits expire beginning in 2027. The minimum tax credits may be carried forward indefinitely.

The Bank recognizes interest accrued and penalties related to unrecognized tax benefits in tax expense. During the years ended December 31, 2010 and 2009, the Bank recognized no interest or penalties.

(In thousands, except per share amounts)

10. RELATED PARTY TRANSACTIONS

During the normal course of business, the Bank enters into transactions with related parties, including Directors and executive officers. These transactions include borrowings with substantially the same terms, including rates and collateral, as loans to unrelated parties. The following is a summary of the aggregate activity involving related party borrowers during 2010:

Balance, January 1, 2010	$ 10,852
Disbursements	3,120
Amounts repaid	(3,066)
Balance, December 31, 2010	$ 10,906
Undisbursed commitments to related parties, December 31, 2010	$ 4,833

11. 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.

	2010	2009
Change in benefit obligation:		
Benefit obligation at beginning of year	$ 33,833	$ 31,855
Service cost	691	608
Interest cost	1,888	1,849
Benefits paid	(1,532)	(1,295)
Actuarial loss	1,977	816
Benefit obligation at end of year	$ 36,857	$ 33,833
Change in plan assets:		
Fair value of plan assets at beginning of year	$ 39,291	$ 23,134
Employer contribution		12,952
Benefits paid	(1,532)	(1,295)
Actual return on plan assets	5,338	4,500
Fair value of plan assets at end of year	$ 43,097	$ 39,291
Funded assets at end of year	$ 6,240	$ 5,458

(In thousands, except per share amounts)

11. RETIREMENT PLAN (Continued)

The following presents the Plan investments, including their fair value and method of fair value determination, as of December 31, 2010.

Asset Category	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash and equivalents	$ 553	$ 553		
Equity securities:				
U.S. large-cap (a)	18,718	18,718		
U.S. large-cap balanced fund (b)	6,462	6,462		
U.S. small-cap (c)	2,522	2,522		
International large-cap (d)	4,441	4,441		
Fixed income securities:				
U.S. Government agencies (e)	1,671		$ 1,671	
U.S. corporate bond funds (f)	1,885	1,885		
U.S. Total Bond Market fund (g)	6,845	6,845		
Total	$ 43,097	$ 41,426	$ 1,671	$ -

(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 includes a tactical asset allocation fund with a target of approximately 60% equities and 40% bonds. The allocation between a passively managed U.S. large cap equity fund and a long term bond fund is actively managed to overweight the broad asset class deemed to be most undervalued on a relative basis.
(c) This category represents low-cost actively managed and broadly diversified U.S. small cap equity funds.
(d) This category represents low cost index enhanced and broadly diversified Non U.S. large cap international funds.
(e) This category represents individual government agency fixed income debentures of a short to intermediate term to maturity.
(f) This category represents low-cost actively managed U.S. investment grade bond funds.
(g) This category represents a low-cost bond index fund passively managed to track the broad U.S. fixed income markets.

(In thousands, except per share amounts)

11. 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.

	Minimum	Policy	Maximum
Equity	50%	65%	80%
Fixed income	25%	35%	45%
Cash and equivalents	0%	0%	5%

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

	2010	2009
Asset category:		
Equity	75%	66%
Fixed income	24%	27%
Other	1%	7%
Total	100%	100%

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.

(In thousands, except per share amounts)

11. RETIREMENT PLAN (Continued)

The components of 2010 and 2009 net periodic benefit cost are as follows:

	2010	2009
Service cost	$ 691	$ 608
Interest cost	1,888	1,849
Expected loss of plan assets	(3,101)	(1,623)
Amortization of unrecognized prior service cost	(283)	(283)
Amortization of unrecognized actuarial loss	808	1,266
Total net periodic cost	$ 3	$ 1,817

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

	2010	2009
Discount rate	5.25%	5.75%
Rate of compensation increase	4.00%	4.00%

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

	2010	2009
Discount rate	5.75%	6.00%
Rate of compensation increase	4.00%	4.00%
Expected return of plan assets	8.00%	7.00%

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

Year Ending December 31,	Pension Benefits
2011	$ 1,319
2012	$ 1,459
2013	$ 1,618
2014	$ 1,813
2015	$ 1,964
2016 through 2010	$ 11,558

(In thousands, except per share amounts)

12. POSTRETIREMENT HEALTHCARE PLAN

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

	2010	2009
Change in benefit obligation:		
Benefit obligation at beginning of year	$ 4,727	$ 4,448
Service cost	70	72
Interest cost	244	258
Benefits paid	(301)	(287)
Plan participant contribution	48	64
Actuarial (gain) loss	(15)	172
Benefit obligation at end of year	$ 4,773	$ 4,727
Change in plan assets:		
Fair value of plan assets at beginning of year	$ 2,681	$ 2,032
Employer contribution		400
Other payments	41	(16)
Plan participant contribution	48	64
Benefits paid	(301)	(287)
Actual return on plan assets	293	488
Fair value of plan assets at end of year	$ 2,762	$ 2,681
Unfunded liability at end of year	$ 2,011	$ 2,046
Components of net periodic benefit costs:		
Service cost	$ 70	$ 72
Interest cost	244	258
Expected loss on plan assets	(140)	(125)
Amortization of unrecognized prior service cost	(70)	(70)
Amortization of net actuarial loss	52	103
Total net periodic benefit cost	$ 156	$ 238

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

	2010	2009
Health care trend rate assumed for next year	5.50%	6.00%
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

(In thousands, except per share amounts)

12. POSTRETIREMENT HEALTHCARE PLAN (Continued)

The following presents the Plan investments, including their fair value and method of fair value determination, as of December 31, 2010.

Asset Category	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash	$ 81	$ 81		
Equity securities:				
U.S. large-cap (a)	1,629	1,629		
U.S. small-cap (b)	223	223		
International large-cap (c)	364	364		
Fixed income securities:				
Obligations of states and political subdivisions (d)	465		$ 465	
Total	$ 2,762	$ 2,297	$ 465	$ -

(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.

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.

(In thousands, except per share amounts)

12. POSTRETIREMENT HEALTHCARE PLAN (Continued)

Also stated are the maximum and minimum asset allocation levels at market for each asset category.

	Minimum	Policy	Maximum
Equity	70%	80%	90%
Fixed income	10%	20%	30%
Cash and equivalents	0%	0%	20%

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

	2010	2009
Asset category:		
Equity	80%	78%
Fixed income	17%	21%
Other	3%	1%
Total	100%	100%

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 and, for measurement purposes; the rates were assumed to decrease from a 6.00% annual rate in 2009 to 5.5% in 2010. 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, 2010 or December 31, 2009. In addition, the aggregate of the service and interest components of net periodic postretirement benefit cost would not change as of December 31, 2010 or December 31, 2009.

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, 2010 or 2009. In addition, the aggregate service and interest components of net periodic postretirement benefit cost for the year would not change as of December 31, 2010 or December 31, 2009.

(In thousands, except per share amounts)

12. POSTRETIREMENT HEALTHCARE PLAN (Continued)

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

	2010	2009
Discount rate	5.00%	5.50%
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:

	2010	2009
Discount rate	5.50%	6.00%
Expected return of plan assets	5.50%	5.50%
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, 2010, these investments included liquid investments, fixed income debt securities and equity securities.

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:

Year Ending December 31,	Pension Benefits
2011	$ 301
2012	$ 310
2013	$ 318
2014	$ 329
2015	$ 345
2016 through 2020	$ 1,827

(In thousands, except per share amounts)

13. 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:

	December 31,	
	2010	2009
Commitments to extend credit	$ 193,086	$ 186,352
Standby letters of credit	41,151	42,477
Total loan commitments	$ 234,237	$ 228,829

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.

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, 2010 and 2009. The Bank recognizes these fees as revenue over the term of the commitment or when the commitment is used.

(In thousands, except per share amounts)

13. COMMITMENTS AND CONTINGENCIES (Continued)

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, 2010, minimum commitments under these noncancellable leases with initial or remaining terms of one year or more are as follows:

Year Ending December 31,		
2011	$	1,589
2012		1,492
2013		1,424
2014		1,378
2015		1,193
Thereafter		2,846
	$	9,922

Rent expense under operating leases was $1,631 and $1,697 for the years ended December 31, 2010 and 2009, 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, 2010 and 2009 were $3,091 and $2,932, respectively.

Correspondent Banking Agreements

The Bank maintains funds on deposit with other federally insured financial institutions under correspondent banking agreements. Those insured financial institutions have elected to participate in the FDIC sponsored Transaction Account Guarantee Program. Under that program, through December 31, 2010, all noninterest-bearing transaction accounts are fully guaranteed by the FDIC for the entire amount in the account. Coverage under the Transaction Account Guarantee Program is in addition to and separate from the coverage available under the FDIC's general deposit insurance rules.

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.

13. COMMITMENTS AND CONTINGENCIES (Continued)

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.

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, 2010 and 2009, the Bank had accrued $9,220 and $9,024, 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 $691 and $483 for the years ended December 31, 2010 and 2009, 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, 2010 and 2009, the liability for accrued deferred compensation, including interest earned, totaled $3,244 and $3,303, 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, 2010 and 2009 in the amount of $2,011 and $1,853 respectively, representing the actuarial present value of the costs to maintain life insurance during the employees' postretirement period. In addition to the $1,551 cumulative pre-tax effect adjustment charged to retained earnings on January 1, 2008 upon adoption of *Accounting for Deferral Compensation and Postretirement Benefit Aspects of Endorsed Split-Dollar Life Insurance Arrangements*, the Bank expensed an additional $158 during 2010 and $187 during 2009.

The cash surrender value of life insurance purchased in connection with these agreements totaled $32,741 and $31,518 as of December 31, 2010 and 2009, respectively.

Restructuring Activities

During 2008, the Bank recorded a restructuring liability of $2,129, included in interest payable and other liabilities, consisting of estimated discounted future costs of closing/restructuring two branch operations. In 2009, the Bank decided to keep one of the two branches and as a result reversed $998 of the liability.

13. COMMITMENTS AND CONTINGENCIES (Continued)

Restructuring Activities (Continued)

The primary categories of future costs are lease payments for branch buildings net of estimated future sublease income, the book value of unamortized tenant improvements, the book value of furniture and equipment net of estimated salvage proceeds, and other direct costs associated with restructuring these operations. These future costs will be charged against the liability each month as they are incurred. The restructuring liability totaled $1,132 and $707 at December 31, 2010 and December 31, 2009, respectively.

14. REGULATORY MATTERS

Troubled Asset Relief Program (TARP)

On December 19, 2008, the Bank entered into a Letter Agreement (the "Purchase Agreement") with the United States Department of the Treasury (Treasury), pursuant to which the Bank issued and sold (i) 43,000 shares of the Bank's Fixed Rate Non-Cumulative Perpetual Preferred Stock, Series A (the "Series A Preferred Stock") for a purchase price of $43,000 and (ii) warrants to purchase 2,150 shares of the Bank's Fixed Rate Non-Cumulative Perpetual Preferred Stock, Series B stock, (the "Series B Preferred Stock") for $0.01 per warrant. The Series B Preferred Stock has a redemption cost of $1,000 per share for a total of $2,150. The Treasury exercised the warrants on December 19, 2008.

The Series A Preferred Stock qualifies as Tier 1 capital and will pay non-cumulative dividends quarterly at a rate of 5% per annum for the first five years, and 9% per annum thereafter. The Series B Preferred Stock also qualifies as Tier 1 capital and will pay non-cumulative dividends at a rate of 9% per annum until redemption. Either series may be redeemed by the Bank after three years; however, the Series B Preferred Stock may not be redeemed until after all the Series A Preferred Stock has been redeemed. Prior to the end of three years, the Series A Preferred Stock and the Series B Preferred Stock may be redeemed by the Bank only with proceeds from the sale of qualifying equity securities of the Bank (a Qualified Equity Offering).

The Series A Preferred Stock and the Series B Preferred Stock were issued in a private placement exempt from registration pursuant to Section 4(2) of the Securities Act of 1933, as amended. Neither the Series A Preferred Stock nor the Series B Preferred Stock will be subject to any contractual restrictions on transfer, except that the Treasury and its transferees shall not effect any transfer of the Series A or Series B Preferred Stock which would require the Bank to become subject to the periodic reporting requirements of Section 13 or 15(d) of the Exchange Act.

The Series A and Series B Preferred Stock are non-voting, other than class voting rights on (i) any authorization or issuance of shares ranking senior to the Series A and Series B Preferred Stock, (ii) any amendment to the rights of the Series A and Series B Preferred Stock, or (iii) any merger, exchange or similar transaction which would adversely affect the rights of the Series A and Series B Preferred Stock.

14. REGULATORY MATTERS (Continued)

Troubled Asset Relief Program (TARP) (Continued)

If dividends on the Series A and Series B Preferred Stock are not paid in full for six dividend periods, whether or not consecutive, the holders of the Series A and Series B Preferred Stock will have the right to elect two directors. The right to elect directors will end when full dividends have been paid for four consecutive dividend periods.

In the Purchase Agreement, the Bank agreed that, until such time as the Treasury ceases to own any debt or equity securities of the Bank acquired pursuant to the Purchase Agreement, the Bank will take all necessary action to ensure that its benefit plans with respect to its senior executive officers comply with Section 111(b) of the Emergency Economic Stabilization Act of 2008 (the "EESA") as implemented by any guidance or regulation under the EESA that has been issued and is in effect as of the date of issuance of the Series A Preferred Stock and the Series B Preferred Stock, and has agreed to not adopt any benefit plans with respect to, or which covers, its senior executive officers that do not comply with the EESA, and the applicable executives have consented to the foregoing. Furthermore, the Purchase Agreement allows the Treasury to unilaterally amend the terms of the agreement.

With respect to dividends on the Bank's common stock, the Treasury's consent shall be required for any increase in common dividends per share until the third anniversary of the date of its investment unless prior to such third anniversary the Series A Preferred Stock and the Series B Preferred Stock are redeemed in whole or the Treasury has transferred all of the Senior Preferred Series A Preferred Stock and Series B Preferred Stock to third parties. After the third anniversary and prior to the tenth anniversary, the Treasury's consent shall be required for any increase in aggregate common dividends per share greater than 3% per annum; provided that no increase in common dividends may be made as a result of any dividend paid in common shares, any stock split or similar transaction. From and after the tenth anniversary, the Bank shall be prohibited from paying common dividends or repurchasing any equity securities or trust preferred securities until all equity securities held by the Treasury are redeemed in whole or the Treasury has transferred all of such equity securities to third parties.

Furthermore, for as long as any Series A Preferred Stock or Series B Preferred Stock is outstanding, no dividends may be declared or paid on junior preferred shares, preferred shares ranking pari passu with the Series A Preferred Stock or Series B Preferred Stock, or common shares (other than in the case of pari passu preferred shares, dividends on a pro rata basis with the Series A Preferred Stock or Series B Preferred Stock), nor may the Bank repurchase or redeem any junior preferred shares, preferred shares ranking pari passu with the Series A Preferred Stock or Series B Preferred Stock, unless (i) in the case of non-cumulative Series A Preferred Stock and the non-cumulative Series B Preferred Stock the full dividend for the latest completed dividend period has been declared and paid in full.

14. REGULATORY MATTERS (Continued)

Troubled Asset Relief Program (TARP) (Continued)

The Bank recorded a discount on the Series A Preferred Stock at approximately the liquidation preference of the Series B Preferred Stock, which approximates the relative fair value of the two instruments. The discount recorded on the Series A Preferred Stock will be amortized on the level-yield method over five years.

Dividend Restrictions

The Bank is subject to restrictions on declaring dividends without the prior approval of the California Department of Financial Institutions and the FDIC.

Regulatory Capital

The Bank is subject to certain regulatory capital requirements administered by the FDIC. Failure to meet these minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Bank's consolidated financial statements.

Under capital adequacy guidelines, the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. These quantitative measures are established by regulation and require that minimum amounts and ratios of total and Tier 1 capital to risk-weighted assets and of Tier 1 capital to average assets be maintained. Capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

The Bank is also subject to additional capital guidelines under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the following table. The most recent notification from the FDIC categorized the Bank as well capitalized under these guidelines. Management believes that the Bank met all its capital adequacy requirements under prompt corrective action as of December 31, 2010 and 2009. As a result of a regulatory examination in 2009, the Bank also became subject to a Tier 1 capital to average assets ratio of 9%. At December 31, 2010, this ratio was 9.2%.

(In thousands, except per share amounts)

14. REGULATORY MATTERS (Continued)

Regulatory Capital (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
December 31, 2010						
Total capital (to risk-weighted assets)	$ 164,135	13.4%	$ 97,681	8.0%	$ 122,101	10.0%
Tier 1 capital (to risk-weighted assets)	$ 139,046	11.4%	$ 48,840	4.0%	$ 73,261	6.0%
Tier 1 capital (to average assets)	$ 139,046	9.2%	$ 60,280	4.0%	$ 75,350	5.0%
December 31, 2009						
Total capital (to risk-weighted assets)	$ 158,376	12.3%	$ 103,169	8.0%	$ 128,961	10.0%
Tier 1 capital (to risk-weighted assets)	$ 130,093	10.1%	$ 51,584	4.0%	$ 77,377	6.0%
Tier 1 capital (to average assets)	$ 130,093	8.4%	$ 61,677	4.0%	$ 77,097	5.0%