Exchange Bank

February 28, 2014

Dear Shareholders:

We are pleased to report that 2013 was a very positive year for our Bank. Virtually every important part of our Bank showed improvement from earnings to capital, growth in the balance sheet, asset quality, and our customer service. The following highlights some of our accomplishments for the year:

- Increased profitability
- Strong growth in core deposits and loans
- Dramatic decline in loan losses
- Expanded investments in both electronic services and branch design
- Substantial reduction in preferred shares

Net income for 2013 was $15.7 million, representing a 28% increase over the $12.2 million we achieved in 2012. The improvement in earnings was attributable to reduced loan loss provisioning of $6.6 million, loan growth of $86 million, and deposit growth of $117 million.

We ended the year with $1.1 billion in loans and $1.6 billion in deposits, up 8.2 and 8.0 percent, respectively, over the prior year end. We are pleased with our growth and view it as an endorsement of the relevance and importance of local community banking. 2013 also marked the first year since the economic downturn that we produced meaningful loan growth.

As it has impacted virtually all banks, our performance was again significantly influenced by prevailing historical low interest rates. Particular to us, our results were positively impacted by gains from the sale of foreclosed properties of $2 million and proceeds from insurance investments of $1.4 million, with this experience somewhat offset by our election to fully fund all post-retirement accruals of $1 million.

The most significant reduction in expenses last year was a by-product of our successful work to substantially improve loan quality. Our level of criticized loans and non-performing assets was reduced by 25% and 8% respectively. As we have resolved problem credits or prudently reserved for residual exposure on those remaining in a workout status, it has allowed us to systematically reduce the monthly expenditures that are directed to our loan loss reserve. Foundational to this improvement, in this last year

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we reduced net losses to $1.2 million versus $5.3 million in 2012. This experience was complemented by a marked slowdown of loans migrating to a criticized status and a generally improved outlook for the economy. In all, the reserve ended the year at 3.4% of loans. Our position supported our decision in August to suspend our monthly loan loss provision. For all of 2013 the provision expense was $2.5 million versus $9.1 million in 2012.

Improved operating performance and loan quality provided strength to our capital and our $117 million in deposit growth provided the liquidity to support our ability to retire $16 million in preferred stock in 2013. What began as a $45 million obligation from the government as part of the Capital Purchase Program was reduced down to $9.15 million in preferred shares held by private investors as of December 31, 2013. We are pleased to report that as of February 14, 2014, we retired the remaining balance of the preferred shares, completing our obligation to pay back the capital we received to help us weather the economic downtown. Even with the clearing of all preferred shares, our capital levels remain strong and above current regulatory requirements and those proposed in the phase in of the BASEL III capital standards.

We are pleased with the outcome of 2013 and look forward to prospects of future success in 2014 and beyond. Throughout our history we have taken pride in the fact that we have maintained a special relationship with all parts of our community and we remain committed to finding practical, innovative solutions to the everyday financial challenges faced by our households and businesses. This year we launched an advertising campaign that captures this intention in a new tagline. “Let’s make it happen” is our new tagline and it will be reinforced in all of our communication as well as being the heart of our corporate brand. In every respect, we intend to back up our commitment with expanded investments in technology, plans to upgrade the look of our branches and, most importantly, a continued investment in the training of our people.

We continue to invest in electronic products and services that best meet consumers’ expectations of being able to bank with us anytime and anywhere. Today we have over 25,000 customers who bank on-line with us and our new mobile banking suite of products has been adopted by 31% of our active on-line customers. All of our branches have been configured with internet café connections and capabilities with this serving as a foundation of delivering access to more of our expertise and quicker information to our customers.

Our investments in technology also help us lower our expenses. Virtual desktop technology has been deployed in all branches. This technology shifts programming from the hundreds of individual computers to one centralized location in our Operations Center. It means less expensive future hardware requirements, lower maintenance costs and better security. Complementing this project, we expanded our storage network and its capacity should serve us for another five years.

While managing risk has been a responsible part of banking since its inception, we are all, however, frequently reminded that today's technology has created new risk challenges for us manifesting itself in the form of cyber-crime. Defending our confidential records from computer hackers has become a complex, around-the-clock activity for us. In the hope of illegally transferring funds, revealing confidential information or simply trying to wreak havoc by slowing down the ability of our customers to get into our sites (denial of service attacks), hackers are constantly looking for the weakest links in a network chain. Each year we dedicate an ever-expanding amount of human resources and technology to protect our customers and ourselves. To continue to do it right, this investment will likely grow in 2014 and beyond.

Every bit of the pride, hope and aspirations we have for this Bank are intimately tied to the health and vitality of our community and we recognize the future will require the special leadership and sustaining energy from our local non-profit organizations. We are proud to support their important work and we will continue to invest heavily in our communities through charitable contributions and with the expenditure of time in an effort to make a difference where we work and live. Last year over 300 local non-profits were the beneficiary of our support. This commitment will continue. In addition, with the reinstatement of our cash dividend, the Doyle Trust is once again able to provide funding for scholarships to local students attending Santa Rosa Junior College.

The positive outlook that we have for our Bank is unquestionably tied to the confidence and trust we have with our employees. We have an exceptional bank because we have exceptional men and women who are dedicated to keeping this organization safe and sound every day. Each understands the importance of teamwork and each is committed to superior service. As recognition of their great work, we were again pleased to have been recognized as one of Sonoma County's "Best Places to Work" and it's "Best Business Bank".

At the Board level, we are also grateful to have a stellar team of dedicated professionals that are committed to the Bank's long-term mission. In January, we added two new members to the Board. Bruce DeCrona and Steve Dutton each reflect the values and leadership so important in setting the course of our future. Each has a long history with our Bank and each understands the important work we do significantly makes a difference in the community. We are pleased to welcome them both.

On a personal note, Bill Reinking will be retiring from the Bank in March after a career here of nearly 50 years. Replacing Bill Reinking will be Bill Schrader who is retiring as our President and CEO. Bill Schrader, as the new Chairman, brings 36 years of experience with our Bank. Replacing Bill Schrader as our new President and CEO will be Gary Hartwick. Gary has been in banking for 37 years and came to work for us in January 2009 as our

Chief Credit Officer. He is currently our Chief Operating Officer. Gary played a large part in helping the Bank through one of the most difficult environments of our entire banking careers. Gary has worked closely with the Board these past years and we feel confident in his ability to guide us through these still challenging times.

We deeply appreciate the commitment and confidence you have steadily maintained in this Bank and with us personally.

We would like to invite you to our Annual Shareholders' meeting on Friday, March 21, 2014 at 2:00 p.m. If you are unable to attend, we would request your proxy vote be given to management. In the interim, if you have any specific questions you would like answered, please direct them in writing to:

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

You may also contact the Chairman directly via email at reinkingb@exchangebank.com.

Please note that the northbound Airport Boulevard overpass exit is closed due to construction activity and that you should take the Fulton or Shiloh exit as an alternative.

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

Sincerely,

C. William Reinking
Chairman

William R. Schrader
President and Chief Executive Officer

Exchange Bank

NOTICE OF ANNUAL SHAREHOLDERS MEETING
TO BE HELD MARCH 21, 2014

February 28, 2014

Dear Shareholder:

The annual meeting of the shareholders of Exchange Bank will be held at the Andrew J. Shepard Administrative Services Building, second floor, 444 Aviation Boulevard, Santa Rosa, California on **Friday, March 21, 2014** at **2:00 p.m.** At the meeting, we will review our operating results for 2013 and attend to formal matters as follows:

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

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

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

Shareholders of record at the close of business on February 21, 2014 are entitled to notice of and to vote at the meeting.

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

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

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

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

Corporation, or with any officer, director, employee, agent, nominee, attorney, or other representative of such covered entity; 2) a description of any arrangement or understanding of each proposed nominee and of each such person with any person regarding future employment or with respect to any future transaction to which the Corporation will or may be a party; 3) a statement as to each proposed nominee and a statement as to each such person as to whether or not the nominee or person concerned will bear any part of the expense incurred in any proxy solicitation, and, if so, the amount thereof; 4) a statement as to each proposed nominee and a statement as to each such person describing any conviction for a felony that occurred during the preceding ten years involving the unlawful possession, conversion or appropriation of money or other property, or the payment of taxes; 5) the total number of shares that will be voted for each proposed nominee; 6) the amount of stock, if any, owned, directly or indirectly, by each proposed nominee or by members of his or her family residing with him or her, in any banking corporation, affiliate or subsidiary thereof, bank holding company, industrial loan company, savings bank or association or finance company, other than this Corporation or any affiliate or subsidiary of this Corporation; and (a) the identity of any banking corporation, affiliate or subsidiary thereof, or bank holding company or industrial loan company, savings bank or association or finance company, other than this Corporation or any affiliate or subsidiary of this Corporation, as to which such nominee or any other such person serves as a director, officer, employee, agent, consultant, advisor, nominee or attorney, together with a description of such relationship."

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

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

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

By Order of the Board of Directors,

Marlene Soiland

Marlene K. Soiland
Corporate Secretary

MKS/ks

TRANSACTIONS WITH DIRECTORS AND OFFICERS

The Bank has had and expects in the future to have banking transactions in the ordinary course of its business with some of its Directors and Officers and their associates, including transactions with corporations or partnerships of which such persons are directors, officers, controlling shareholders, or partners on substantially the same terms (including interest rates and collateral) as those prevailing for comparable transactions with others. Management believes that in 2013 such transactions did not involve more than the normal risk of collectability or present other unfavorable features. Loans to Directors and Executive Officers of the Bank are subject to limitations prescribed by the Financial Code of the State of California as well as applicable federal law and regulations.

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

During calendar year 2013 the Bank engaged in transactions with the law firm of Abbey, Weitzenberg, Warren & Emery, a Professional corporation, in which Richard W. Abbey, an Exchange Bank Director, has a material interest as a 12.5% shareholder of the firm. The amount of attorney's fees paid was in excess of $40,000.

EXCHANGE BANK
BOARD OF DIRECTORS

Marlene K. Soiland
Ms. Soiland was elected to the Board in 1997 and is Corporate Secretary and Chair of the Board's Trust Committee. After graduation from Cal Poly in San Luis Obispo, she returned to Santa Rosa and her family business. She is currently President and owner of Soiland Management Co., Inc. Ms. Soiland is involved in several 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 master's degree from American Graduate School of International Management. Mr. Tamayo is the Chairman of La Tortilla Factory, a family owned business founded in Santa Rosa in 1977. 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 Petaluma business has been in operation since 1915. Mr. Libarle has previous banking experience as the founding Chairman of the Bank of Petaluma. That bank was bought by Greater Bay Bank and he served on their Board until it was bought by Wells Fargo Bank. He has been very active in his community. His involvement includes the Rotary Club, Boys & Girls Club, Chamber of Commerce, United Way and several trade groups.

William R. Schrader

Mr. Schrader was elected to the Board in 2008 when he was appointed President. 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's 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.

Bruce E. DeCrona

Mr. DeCrona was elected to the Board in January 2014. Bruce retired from Exchange Bank in 2013 after serving nearly 18 years in the roles of Chief Financial Officer and Chief Operating Officer. Before that he worked for 19 years at First Interstate Bank in Nevada and Arizona, prior to the bank's purchase by Wells Fargo Bank. He is a graduate of the University of Nevada as well as Pacific Coast Banking School. In addition to being Board member and Treasurer for the Wells Fargo Center for the Arts, he is also an active volunteer for several other organizations, including the Council on Aging.

Steven G. Dutton

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

Gary T. Hartwick

Mr. Hartwick joined Exchange Bank in 2009 and has served as Executive Vice President and Chief Credit Officer, and most recently as Chief Operating Officer. In October 2013 the Board appointed Mr. Hartwick to President and Chief Executive Officer effective March 21, 2014. Mr. Hartwick is a graduate of California State University Sacramento and the Pacific Coast Banking School. His community activities include the Volunteer Center of Sonoma County and a former member of the Board at the Wells Fargo Center for the Arts.

EXCHANGE BANK AND SUBSIDIARIES
Santa Rosa, California

CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012

EXCHANGE BANK AND SUBSIDIARIES
Santa Rosa, California

FINANCIAL STATEMENTS
December 31, 2013 and 2012

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Crowe Horwath LLP
Independent Member Crowe Horwath International

INDEPENDENT AUDITOR'S REPORT

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

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Exchange Bank and Subsidiaries, which comprise the consolidated balance sheets as of December 31, 2013 and 2012, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

(Continued)

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Exchange Bank and Subsidiaries as of December 31, 2013 and 2012, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Report on Other Legal and Regulatory Requirements

We have also audited in accordance with attestation standards established by the American Institute of Certified Public Accountants, Exchange Bank and Subsidiaries' internal control over financial reporting as of December 31, 2013 based on criteria established in the 1992 *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated February 19, 2014 expressed an unqualified opinion.

Crowe Horwath LLP

Crowe Horwath LLP

Sacramento, California
February 19, 2014

EXCHANGE BANK AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
December 31, 2013 and 2012
(In thousands, except share and par value amounts)

	2013	2012
ASSETS		
Cash and due from banks	$ 86,732	$ 139,322
Short-term investments	227	226
Total cash and cash equivalents	86,959	139,548
Interest-bearing deposits in other financial institutions	23,500	16,000
Available-for-sale investment securities	460,374	395,495
Loans and leases	1,130,550	1,044,869
Less allowance for loan and lease losses	(36,946)	(35,631)
Net loans and leases	1,093,604	1,009,238
Federal Home Loan Bank stock	7,490	6,401
Bank premises and equipment, net	16,071	16,485
Bank owned life insurance	35,057	35,041
Other real estate owned	6,523	12,154
Accrued interest receivable and other assets	53,825	68,495
Total assets	$ 1,783,403	$ 1,698,857
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits:		
Non-interest bearing	$ 567,877	$ 516,757
Interest bearing	1,009,104	943,000
Total deposits	1,576,981	1,459,757
Federal Home Loan Bank advances and other long-term debt	24,000	38,000
Accrued interest payable and other liabilities	27,412	44,676
Total liabilities	1,628,393	1,542,433
Commitments and contingencies (Note 14)		
Stockholders' equity:		
Preferred stock, 1,000,000 shares authorized:		
Series A, noncumulative, $1,000 per share liquidation preference; 7,000 and 23,000 shares issued and outstanding as of December 31, 2013 and 2012	7,000	22,570
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	97,617	84,937
Accumulated other comprehensive loss, net of taxes	(2,069)	(3,545)
Total stockholders' equity	155,010	156,424
Total liabilities and stockholders' equity	$ 1,783,403	$ 1,698,857

See accompanying notes to consolidated financial statements.

EXCHANGE BANK AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
For the Years Ended December 31, 2013 and 2012
(In thousands, except per share amounts)

	2013	2012
Interest income:		
Interest and fees on loans and leases	$ 54,669	$ 59,247
Interest on investment securities:		
Taxable	6,043	5,043
Exempt from Federal income taxes	2,304	3,012
Total interest income	63,016	67,302
Interest expense:		
Interest on deposits	1,771	2,313
Interest on borrowings	1,692	1,518
Total interest expense	3,463	3,831
Net interest income before provision for loan and lease losses	59,553	63,471
Provision for loan and lease losses	2,500	9,150
Net interest income after provision for loan and lease losses	57,053	54,321
Non-interest income:		
Service charges and fees	7,117	8,060
Trust income	5,153	4,924
Merchant discount and interchange fees	4,119	4,044
Income from bank owned life insurance	2,778	1,402
Other income	3,715	3,359
Total non-interest income	22,882	21,789
Non-interest expense:		
Salaries and employee benefits	31,348	31,283
Occupancy and equipment	6,586	6,689
Professional fees	6,819	6,235
(Gain) loss on sale of other real estate owned	(2,006)	812
FDIC assessments	1,350	1,478
Other expenses	11,890	11,222
Total non-interest expense	55,987	57,719
Income before provision for income taxes	23,948	18,391
Provision for income taxes	8,219	6,129
Net income	$ 15,729	$ 12,262
Basic and diluted earnings per common share	$ 8.60	$ 5.93

See accompanying notes to consolidated financial statements.

EXCHANGE BANK AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
For the Years Ended December 31, 2013 and 2012
(In thousands)

	2013	2012
Net Income	$ 15,729	$ 12,262
Other comprehensive income:		
Unrealized gains/losses on securities:		
Unrealized holding gains arising during the period	(10,299)	(539)
Reclassification adjustment for losses (gains)	-	-
Tax effect	4,332	226
Changes in unrealized gain on available-for-sale investment securities, net of tax	(5,967)	(313)
Defined benefit pension plans:		
Net gain arising during the period	12,494	2,979
Reclassification adjustment for amortization of prior service cost and net gain/loss included in net periodic pension cost	15	14
Tax effect	(5,260)	(1,372)
Changes in defined benefit pension plans, net of tax	7,249	1,621
Change in deferred compensation trust liabilities	335	503
Tax effect	(141)	(212)
Changes in deferred compensation trust, net of tax	194	291
Other comprehensive income	1,476	1,599
Total Comprehensive Income	$ 17,205	$ 13,861

See accompanying notes to consolidated financial statements.

EXCHANGE BANK AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
For the Years Ended December 31, 2013 and 2012
(In thousands)

	Preferred Stock					Accum-ulated Other Compre-hensive (Loss) Income (Net of Taxes)	Total Stock-holders' Equity
	Series A	Series B	Common Stock	Additional Paid-In Capital	Retained Earnings		
Balance, January 1, 2012	$ 42,140	$ 2,150	$ 4,286	$ 46,026	$ 73,561	$ (5,144)	$ 163,019
Net Income	-	-	-	-	12,262	-	12,262
Other comprehensive income:							
Net change in unrealized gain on available-for-sale investment securities (net of $226 in tax provision)	-	-	-	-	-	(313)	(313)
Defined benefit pension plans:							
Amortization of prior service costs included in net periodic pension costs (net of $6 in tax benefits)	-	-	-	-	-	8	8
Net gain arising during period (net of $1,366 in tax provision)	-	-	-	-	-	1,613	1,613
Change in unrealized gain on deferred compensation trust (net of $212 in tax benefit)	-	-	-	-	-	291	291
Preferred stock repurchase	(20,000)	-	-	-	2,495	-	(17,505)
Cash dividends	-	-	-	-	(2,951)	-	(2,951)
Accretion of preferred stock discount	430	-	-	-	(430)	-	-
Balance, December 31, 2012	$ 22,570	$ 2,150	$ 4,286	$ 46,026	$ 84,937	$ (3,545)	$ 156,424
Net Income	-	-	-	-	15,729	-	15,729
Other comprehensive income:							
Net change in unrealized gain on available-for-sale investment securities (net of $4,332 in tax provision)	-	-	-	-	-	(5,967)	(5,967)
Defined benefit pension plans:							
Amortization of prior service costs included in net periodic pension costs (net of $6 in tax provision)	-	-	-	-	-	9	9
Net gain arising during period (net of $5,254 in tax provision)	-	-	-	-	-	7,240	7,240
Change in unrealized gain on deferred compensation trust (net of $141 in tax benefit)	-	-	-	-	-	194	194
Preferred stock repurchase	(16,000)	-	-	-	249	-	(15,751)
Cash dividends	-	-	-	-	(2,868)	-	(2,868)
Accretion of preferred stock discount	430	-	-	-	(430)	-	-
Balance, December 31, 2013	$ 7,000	$ 2,150	$ 4,286	$ 46,026	$ 97,617	$ (2,069)	$ 155,010

See accompanying notes to consolidated financial statements.

EXCHANGE BANK AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2013 and 2012
(In thousands)

	2013	2012
Cash flows from operating activities:		
Net Income	$ 15,729	$ 12,262
Adjustments to reconcile net income to net cash provided by operating activities:		
Valuation allowance on other real estate owned	41	645
Depreciation and amortization	2,020	2,357
Provision for loan losses	2,500	9,150
Provision for Deferred Income Taxes	3,017	1,233
Gain on sale of Bank premises and equipment		
Gain on sale of loans	(871)	(1,231)
(Gain) loss on sale of other real estate owned	(2,047)	167
Accretion of discounts and amortization of premiums on investment securities	2,985	3,018
Net change in deferred loan origination fees	137	35
Net loans originated with intent to sell	(5,991)	(579)
Increase in bank owned life insurance, net of expenses	(16)	(1,134)
Changes in operating assets and liabilities:		
Accrued interest receivable and other assets	11,239	3,020
Accrued interest payable and other liabilities	(5,075)	1,158
Net cash provided by operating activities	23,668	30,101
Cash flows from investing activities:		
Increase in Interest-bearing deposits in other financial institutions	(7,500)	(16,000)
Proceeds from sale of other real estate owned	11,070	5,675
Proceeds from maturities of investment securities	127,018	240,225
Purchase of investment securities	(205,182)	(294,346)
Redemptions of Federal Home Loan Bank (FHLB) stock	-	667
Purchase of Federal Home Loan Bank (FHLB) stock	(1,089)	-
Net increase in loans and leases	(83,574)	(5,470)
Purchase of bank premises and equipment	(1,609)	(1,070)
Net cash used in investing activities	(160,862)	(70,319)
Cash flows from financing activities:		
Net increase in demand, interest bearing and savings deposits	123,991	128,361
Net decrease in time deposits	(6,767)	(19,487)
Repayments of long-term FHLB advances	(14,000)	(3,000)
Repurchase of Preferred Stock	(15,751)	(17,505)
Cash paid for dividends	(2,868)	(2,951)
Net cash provided by financing activities	84,605	85,418
(Decrease) increase in cash and cash equivalents	(52,589)	45,200
Cash and cash equivalents, beginning of year	139,548	94,348
Cash and cash equivalents, end of year	$ 86,959	$ 139,548
Supplemental disclosure of cash flow information:		
Cash paid during the year for:		
Interest expense	$ 3,463	$ 3,831
Income taxes	$ 4,100	$ 7,432
Non-cash investing activity:		
Transfer of loans to other real estate owned	$ 3,433	$ 9,860

See accompanying notes to consolidated financial statements.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

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

Use of Estimates: The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions. 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. The allowance for loan and lease losses, deferred tax assets, retirement plans and fair value of financial instruments are particularly subject to change.

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 $7,351 and $323 at December 31, 2013 and 2012, respectively.

Investment Securities: The Bank classifies its investment securities as either available-for-sale or held-to-maturity at the time of purchase. Available-for-sale investment securities are measured at fair value with a corresponding recognition of the net unrealized holding gain or loss, net of income taxes, within accumulated other comprehensive income (loss), which is a separate component of stockholders' equity, until realized. Held-to-maturity investment securities are measured at amortized cost, based on the Bank's positive intent and ability to hold such securities to maturity. At December 31, 2013 and 2012, the Bank did not hold any held-to-maturity investment securities.

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

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

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

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

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

For all classes of loans, interest is accrued daily based upon outstanding loan and lease balances. However, when, in the opinion of management, loans or leases become 90 days past due or 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.

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Loan Sales and Servicing: Included in the portfolio are loans guaranteed by the Small Business Administration (SBA) that may be sold in the secondary market. Loans held for sale are carried at the lower of cost or market value. Fair value is determined by the specific identification method as of the balance sheet date or the date that the purchasers have committed to purchase the loans. At the time the loan is sold, the related right to service the loan is recorded at fair value with the Bank earning future servicing income. Gains and losses are recognized based on the difference between the selling price and the fair value of servicing assets or liabilities and the allocated carrying value of the loans sold. At December 31, 2013 and 2012 the balance of loans originated and unsold under the SBA program totaled $5,991 and $579, respectively. Management has determined that the unsold loans originated through the SBA program were not material for disclosure as held for sale at December 31, 2013 and 2012.

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

Servicing rights acquired through 1) a purchase or 2) the origination of loans which are sold or securitized with servicing rights retained are recognized as separate assets or liabilities. Servicing assets or liabilities are recorded at fair value, and are subsequently amortized in proportion to and over the period of the related net servicing income or expense. SBA loans with unpaid balances of approximately $38,392 and $30,408 were being serviced for others at December 31, 2013 and 2012, respectively. Servicing assets at December 31, 2013 and 2012 were not significant.

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

For all classes of the portfolio, 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.

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

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

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

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

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

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

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

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

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

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

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

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

Other Real Estate Owned: Real estate properties acquired through, or in lieu of, loan foreclosure are expected to be sold and are initially recorded at the fair value of the property, less estimated costs to sell. The excess, if any, of the loan amount over the fair value is charged to the allowance for loan and lease losses. Subsequent declines in the fair value of real estate owned, along with related revenue and expenses from operations, are charged to noninterest expense as incurred. Other real estate held by the Bank and its subsidiaries totaled $6,523 and $12,154 at December 31, 2013 and 2012, 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.

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

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

(Continued)

NOTE 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.

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

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

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

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Income Taxes (Continued)

The determination of the amount of deferred income tax assets which are more likely than not to be realized is primarily dependent on projections of future earnings, which are subject to uncertainty and estimates that may change given economic conditions and other factors. The realization of deferred income tax assets is assessed and a valuation allowance is recorded if it is "more likely than not" that all or a portion of the deferred tax asset will not be realized. "More likely than not" is defined as greater than a 50% chance. All available evidence, both positive and negative is considered to determine whether, based on the weight of that evidence, a valuation allowance is needed. Based upon their analysis of available evidence, management determined that it is "more likely than not" that all of the deferred income tax assets as of December 31, 2013 and 2012 will be fully realized and therefore no valuation allowance was recorded.

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

Earnings Per Share: Earnings per share is computed by dividing net income, less preferred stock dividends and accretion, by the weighted average number of shares outstanding during the year, which was 1,714,344 for 2013 and 2012. There were $982 and $2,094 in preferred stock dividends and accretion paid in 2013 and 2012, respectively. In addition, there were no dilutive securities; therefore, basic and diluted earnings per share are equivalent.

Advertising: Advertising costs are charged to expense in the period incurred and totaled $989 and $799 for the years ended December 31, 2013 and 2012, respectively.

Reclassifications: Some items in the prior year financial statements were reclassified to conform to the current presentation. Reclassifications had no effect on prior year net income or shareholders' equity.

Subsequent Events: On January 15, 2014 the Bank provided 30 days' notice to all existing preferred shareholders that it will redeem all of the remaining 7,000 outstanding shares of its Series A Preferred Shares and all remaining 2,150 outstanding shares of its Series B Preferred Shares on February 14, 2014, at which time all shares will be retired. As of February 14, 2014 there were no remaining Exchange Bank Preferred Shares outstanding. The Bank considered all other events occurring from December 31, 2013 through February 19, 2014, the date the consolidated financial statements were available to be issued for disclosure and accrual in these consolidated financial statements.

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Adoption of New Accounting Standards

In February 2013, the FASB amended existing guidance related to reporting amounts reclassified out of accumulated other comprehensive income. These amendments do not change the current requirements for reporting net income or other comprehensive income in financial statements. These amendments require an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required under U.S. GAAP that provide additional details about those amounts. These amendments are effective prospectively for fiscal years, and interim periods within those years, beginning after December 15, 2013. The effect of adopting this standard is not expected to have a material effect on the Bank's operating results or financial condition.

NOTE 2 – FAIR VALUE MEASUREMENTS

Fair Value Measurements

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

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

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

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

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

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

(Continued)

(In thousands, except per share amounts)

NOTE 2 – FAIR VALUE MEASUREMENTS (Continued)

Fair Value Measurements (Continued)

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, 2013 and 2012:

Recurring Basis

	2013			
Description	Fair Value	Level 1	Level 2	Level 3
Debt securities:				
U.S. Government agencies	$ 253,864	$ -	$ 253,864	$ -
Obligations of states and political subdivisions	112,871	-	112,871	-
Government sponsored entities residential mortgage-backed securities	75,394	-	75,394	-
U.S. Treasuries	13,298	-	13,298	-
Other securities	4,947	-	4,947	-
Total assets measured at fair value	$ 460,374	$ -	$ 460,374	$ -

	2012			
Description	Fair Value	Level 1	Level 2	Level 3
Debt securities:				
U.S. Government agencies	$ 216,241	$ -	$ 216,241	$ -
Obligations of states and political subdivisions	117,775	-	117,775	-
Government sponsored entities residential mortgage-backed securities	57,379	-	57,379	-
U.S. Treasuries	1,013	-	1,013	-
Other securities	3,087	-	3,087	-
Total assets measured at fair value	$ 395,495	$ -	$ 395,495	$ -

Fair values for available-for-sale investment securities are based on quoted market prices for similar securities. During the years ended December 31, 2013 and 2012, there were no significant transfers between Level 1 and Level 2.

(Continued)

(In thousands, except per share amounts)

NOTE 2 – FAIR VALUE MEASUREMENTS (Continued)

Fair Value Measurements (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.

	2013			
	Fair Value	Level 1	Level 2	Level 3
Impaired loans:				
Real estate – commercial	$ 23,381	$ -	$ -	$ 23,381
Real estate – construction	6,671	-	-	6,671
Commercial	3,407	-	-	3,407
Lease financing	148	-	-	148
Consumer	5,497	-	-	5,497
Other real estate owned:				
Raw land	3,193	-	-	3,193
Commercial real estate	3,330	-	-	3,330
Total assets measured at fair value on a non-recurring basis	$ 45,627	$ -	$ -	$ 45,627

	2012			
	Fair Value	Level 1	Level 2	Level 3
Impaired loans:				
Real estate – commercial	$ 15,684	$ -	$ -	$ 15,684
Real estate – construction	4,698	-	-	4,698
Commercial	7,549	-	-	7,549
Lease financing	99	-	-	99
Consumer	4,435	-	-	4,435
Other real estate owned:				
Raw land	4,213	-	-	4,213
Commercial real estate	7,941	-	-	7,941
Total assets measured at fair value on a non-recurring basis	$ 44,619	$ -	$ -	$ 44,619

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 $2,712 and $4,244 represent impairment charges recognized during the years ended December 31, 2013 and 2012, respectively related to the above impaired loans.

(Continued)

NOTE 2 – FAIR VALUE MEASUREMENTS (Continued)

Fair Value Measurements (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 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 $1,257 and $2,021 represent impairment charges recognized during the year ended December 31, 2013 and 2012, respectively related to the above other real estate owned.

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

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

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

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

(Continued)

(In thousands, except per share amounts)

NOTE 2 – FAIR VALUE MEASUREMENTS (Continued)

Fair Value Measurements (Continued)

The following table presents quantitative information about Level 3 fair value measurements for impaired financial instruments measured at fair value on a non-recurring basis at December 31, 2013:

Description	Fair Value	Valuation Technique	Significant Unobservable Input	Range (Weighted Average)
Real Estate Commercial	$ 23,381	Sales Comparison	a. Appraiser adjustments on sales comparable data can range up to 50%	2.5% to 50% (9.1%)
		Management estimates	b. Management adjustments for depreciation in values depending on property types	
			c. Values adjusted for selling and holding costs typically set at 10%	
Real Estate Construction	$ 6,671	Income Approach	a. Appraisers required to apply a discounted cash flow approach as sales data is limited	19% to 22% (21.4%)
		Management estimates	b. Management adjustments for depreciation in values depending on property types	
			c. Values adjusted for selling and holding costs typically set at 10%	
Commercial	$ 3,407	Sales Comparison	a. Appraiser adjustments on sales comparable data can range from 5% to 10%	2.5% to 50% (21.1%)
		Management estimates	b. Management adjustments for depreciation in values depending on property types	
			c. Selling and holding costs	
			d. Personal property collateral or unsecured loans are discounted based on management's estimate of loss given default	
Leasing	$ 148	Management estimate	a. Personal property collateral is discounted based on management's assessment of probability of default	15% to 25% (21.7%)
Consumer	$ 5,497	Sales Comparison	a. Appraiser adjustments on sales comparable data can range up to 75%	4.5% to 75% (19.1%)
		Management estimates	b. Personal property collateral is discounted based on management's assessment of probability of default	
Other Real Estate:	$ 6,523	Sales Comparison	a. Appraiser adjustments on sales comparable data can on average range up to 50%	13% to 50% (27%)
			b. Appraiser adjustments on land properties based on discounted cash flow approach	
			c. Selling and holding costs	

(Continued)

(In thousands, except per share amounts)

NOTE 2 – FAIR VALUE MEASUREMENTS (Continued)

Fair Value Measurements (Continued)

The following table presents quantitative information about Level 3 fair value measurements for impaired financial instruments measured at fair value on a non-recurring basis at December 31, 2012:

Description	Fair Value	Valuation Technique	Significant Unobservable Input	Range (Weighted Average)
Real Estate Commercial	$ 15,684	Sales Comparison	a. Appraiser adjustments on sales comparable data can range up to 75%to 10%	5% to 75% (16%)
		Management estimates	b. Management adjustments for depreciation in values depending on property types	
			c. Values adjusted for selling and holding costs typically set at 10%	
Real Estate Construction	4,698	Income Approach	a. Appraisers required to apply a discounted cash flow approach as sales data is limited	2% to 22% (8%)
		Management estimates	b. Management adjustments for depreciation in values depending on property types	
			c. Values adjusted for selling and holding costs typically set at 10%	
Commercial	7,549	Sales Comparison	a. Appraiser adjustments on sales comparable data can range up to 50%	5% to 50% (20%)
		Management estimates	b. Management adjustments for depreciation in values depending on property types	
			c. Selling and holding costs	
			d. Personal property collateral or unsecured loans are discounted based on management's estimate of loss given default	
Leasing	99	Management estimate	a. Personal property collateral is discounted based on management’s assessment of probability of default	10% to 35% (15%)
Consumer	4,435	Sales Comparison	a. Appraiser adjustments on sales comparable data can range up to 50%	15% to 50% (19%)
		Management estimates	b. Personal property collateral is discounted based on management’s assessment of probability of default	
Other Real Estate:				
Raw Land	4,213	Sales Comparison	a. Appraiser adjustments on sales comp data can on average range up to 10%	13% to 50% (27%)
Commercial Real Estate	7,941	Sales Comparison	b. Appraiser adjustments on land properties based on discounted cash flow approach	
			c. Selling and holding costs	

(Continued)

(In thousands, except per share amounts)

NOTE 2 – FAIR VALUE MEASUREMENTS (Continued)

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

December 31, 2013	Carrying Amount	Fair Value Measurements at Using: Level 1	Level 2	Level 3	Total
Financial assets:					
Cash and due from banks,	$ 86,959	$ 86,959	$ -	$ -	$ 86,959
Interest-bearing deposits In banks	23,500	23,500	-	-	23,500
Available-for-sale securities	460,374	-	460,374	-	460,374
FHLB stock	7,490	N/A	N/A	N/A	N/A
Loans and leases, net	1,093,604	-	-	1,093,144	1,093,144
Accrued interest receivable	6,900	-	-	-	6,900
Financial liabilities:					
Deposits	$ 1,576,981	$ 1,334,417	$ 242,635	$ -	$ 1,577,052
FHLB Advances	12,000	-	13,632	-	13,632
Subordinated debentures	12,000	-	11,873	-	11,873
Accrued interest payable	200	200	-	-	200

December 31, 2012	Carrying Amount	Fair Value Measurements at Using: Level 1	Level 2	Level 3	Total
Financial assets:					
Cash and due from banks,	$ 139,548	$ 139,548	$ -	$ -	$ 139,548
Interest-bearing deposits In banks	16,000	16,000	-	-	16,000
Available-for-sale securities	395,495	-	395,495	-	395,495
FHLB stock	6,401	N/A	N/A	N/A	N/A
Loans and leases, net	1,009,238	-	-	1,029,545	1,029,545
Accrued interest receivable	6,591	-	-	-	6,591
Financial liabilities:					
Deposits	$ 1,459,757	$ 1,210,427	$ 250,769	$ -	$ 1,461,196
FHLB Advances	26,000	-	29,195	-	29,195
Subordinated debentures	12,000	-	11,873	-	11,873
Accrued interest payable	272	272	-	-	272

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

(Continued)

NOTE 2 – FAIR VALUE MEASUREMENTS (Continued)

The following methods and assumptions were used by the Bank to estimate the fair values of its financial instruments at December 31, 2013 and December 31, 2012:

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

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

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

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

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

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

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

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

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

(In thousands, except per share amounts)

NOTE 3 – AVAILABLE-FOR-SALE INVESTMENT SECURITIES

The amortized cost and estimated fair value of available-for-sale investment securities at December 31, 2013 and 2012 consisted of the following:

2013	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Government agencies	$ 258,182	$ 257	$ (4,575)	$ 253,864
Obligations of states and political subdivisions	109,853	3,761	(743)	112,871
Government sponsored entities residential mortgage-backed securities	74,421	1,304	(331)	75,394
U.S. Treasuries	13,373	26	(101)	13,298
Other securities	5,002	16	(71)	4,947
	$ 460,831	$ 5,364	$ (5,821)	$ 460,374

2012	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Government agencies	$ 215,534	$ 780	$ (73)	$ 216,241
Obligations of states and political subdivisions	111,091	6,707	(23)	117,775
Government sponsored entities residential mortgage-backed securities	55,026	2,353	-	57,379
U.S. Treasuries	1,007	6	-	1,013
Other securities	2,996	91	-	3,087
	$ 385,654	$ 9,937	$ (96)	$ 395,495

Net unrealized (losses)/gains on available-for-sale investment securities totaling $(457) and $9,841 were recorded, net of $193 and $4,138 in tax liabilities, as accumulated other comprehensive income within stockholders' equity at December 31, 2013 and 2012, respectively. There were no sales of available-for-sale investments during the years ended December 31, 2013 and 2012. There were no transfers of available-for-sale investment securities for the years ended December 31, 2013 and 2012.

(Continued)

(In thousands, except per share amounts)

NOTE 3 – AVAILABLE-FOR-SALE INVESTMENT SECURITIES (Continued)

Available-for-sale investment securities with unrealized losses at December 31, 2013 and 2012 are summarized and classified according to the duration of the loss period as follows:

	2013		2012	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Less than twelve months:				
U.S. Government agencies	$ 183,021	$ (4,469)	$ 39,484	$ (73)
Obligations of states and political subdivisions	23,595	(700)	3,822	(23)
Government guaranteed mortgage backed securities	29,890	(331)	-	-
U.S. Treasury	9,154	(101)	-	-
Other securities	3,928	(71)	-	-
Greater than twelve months:				
U.S. Government agencies	$ 2,893	$ (106)	$ -	$ -
Obligations of states and political subdivisions	965	(43)	-	-
	$ 253,446	$ (5,821)	$ 43,306	$ (96)

U.S. Treasury and U.S. Government Agencies: Management believes that the unrealized losses on the Bank's investment in U.S. Treasuries and Government agencies are caused by the fluctuation in interest rates and are not attributable to changes in credit quality. Management intends to hold these investments until at least a recovery of fair value or until maturity. The Bank does not consider these investments to be other-than-temporarily impaired at December 31, 2013.

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, 2013.

Government Guaranteed Mortgage Backed Securities: Management believes that the unrealized losses on the Bank's investment in government guaranteed mortgage backed securities is caused by the fluctuation in interest rates and is not attributable to changes in credit quality. Management intends to hold these investments until at least a recovery of fair value or until maturity. The Bank does not consider these investments to be other-than-temporarily impaired at December 31, 2013.

Other Securities: Management believes that the unrealized losses on the Bank's investment in other securities is caused by the fluctuation in interest rates and is not attributable to changes in credit quality. Management intends to hold these investments until at least a recovery of fair value or until maturity. The Bank does not consider these investments to be other-than-temporarily impaired at December 31, 2013.

(Continued)

(In thousands, except per share amounts)

NOTE 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, 2013, 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	$ 16,020	$ 16,214
After one year through five years	170,458	172,743
After five years through ten years	199,932	196,023
	386,410	384,980
Investment securities not due at a single maturity date:		
Government sponsored entities mortgage-backed securities	74,421	75,394
	$ 460,831	$ 460,374

The only significant concentration of investment securities (greater than 10% of stockholders' equity) in any individual security issuer at December 31, 2013 is certain U.S. Government sponsored entities mortgage-backed securities such as Federal National Mortgage Association and Federal Home Loan Mortgage Corporation and certain U.S. Government agencies such as Federal Home Loan Bank.

Investment securities with amortized costs of $137,834 and $151,165 and fair values of $141,317 and $158,554 as of December 31, 2013 and 2012, respectively, were pledged to secure public and trust deposits, FHLB borrowing arrangements (see Note 8) and for other purposes required or permitted by law.

NOTE 4 – LOANS AND LEASES

Loans and leases are reported net of deferred loan origination fees and costs of $154 in 2013 and $291 in 2012 and consist of the following at December 31:

	2013	2012
Real estate – commercial	$ 525,131	$ 449,991
Real estate – construction	27,421	57,830
Commercial	245,863	225,459
Lease financing	31,838	31,210
Consumer	300,297	280,379
Total	1,130,550	1,044,869
Less: Allowance for loan and lease losses	(36,946)	(35,631)
	$ 1,093,604	$ 1,009,238

(Continued)

(In thousands, except per share amounts)

NOTE 4 – LOANS AND LEASES (Continued)

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

	2013	2012
Future lease payments receivable	$ 34,603	$ 33,772
Residual interests	146	160
Deferred broker fees	957	824
Unearned income	(3,868)	(3,546)
Net lease financing receivable	$ 31,838	$ 31,210

Future lease payments receivable are as follows:

Year Ending December 31,	
2014	1,728
2015	5,180
2016	8,526
2017	7,185
2018	8,629
Thereafter	3,355
	$ 34,603

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

Activity in the allowance for loan and lease losses for the years ended December 31, 2013 and 2012 was as follows:

	2013	2012
Balance, beginning of year	$ 35,631	$ 31,751
Provision for loan and lease losses	2,500	9,150
Loans charged-off	(3,365)	(7,568)
Recoveries	2,180	2,298
Balance, end of year	$ 36,946	$ 35,631

(In thousands, except per share amounts)

NOTE 4 – LOANS AND LEASES (Continued)

The following tables show the activity of the allowance for loan and lease losses for the year ended December 31, 2013 by portfolio segment, and the allocation of the allowance for loan and lease losses at December 31, 2013 and 2012 by portfolio segment and by impairment methodology:

	December 31, 2013					
	Real Estate – Commercial	Real Estate – Construction	Commercial	Lease Financing	Consumer	Total
Allowance for Credit Losses						
Beginning balance	$ 16,914	$ 4,597	$ 10,887	$ 1,051	$ 2,182	$ 35,631
Provision for loan and lease losses	1,720	2	400	166	212	2,500
Loans charged-off	(2,315)	-	(542)	(223)	(285)	(3,365)
Recoveries	268	596	861	180	275	2,180
Ending balance allocated to portfolio segments	$ 16,587	$ 5,195	$ 11,606	$ 1,174	$ 2,384	$ 36,946
Ending balance: individually evaluated for impairment	$ 2,339	$ 734	$ 2,826	$ 41	$ 1,574	$ 7,514
Ending balance: collectively evaluated for impairment	$ 14,248	$ 4,461	$ 8,780	$ 1,133	$ 810	$ 29,432
Loans						
Ending balance	$ 525,131	$ 27,421	$ 245,863	$ 31,838	$ 300,297	$1,130,550
Ending balance: individually evaluated for impairment	$ 25,720	$ 3,433	$ 13,392	$ 189	$ 8,256	$ 50,990
Ending balance: collectively evaluated for impairment	$ 499,411	$ 23,988	$ 232,471	$ 31,649	$ 292,041	$1,079,560

(Continued)

(In thousands, except per share amounts)

NOTE 4 – LOANS AND LEASES (Continued)

	December 31, 2012					
	Real Estate – Commercial	Real Estate – Construction	Commercial	Lease Financing	Consumer	Total
Allowance for Credit Losses						
Beginning balance	$ 16,165	$ 3,286	$ 9,660	$ 1,042	$ 1,598	$ 31,751
Provision for loan and lease losses	1,767	3,092	2,894	21	1,376	9,150
Loans charged-off	(1,297)	(2,545)	(2,030)	(378)	(1,318)	(7,568)
Recoveries	279	764	363	366	526	2,298
Ending balance allocated to portfolio segments	$ 16,914	$ 4,597	$ 10,887	$ 1,051	$ 2,182	$ 35,631
Ending balance: individually evaluated for impairment	$ 3,331	$ 713	$ 3,102	$ 130	$ 1,319	$ 8,595
Ending balance: collectively evaluated for impairment	$ 13,583	$ 3,884	$ 7,785	$ 921	$ 863	$ 27,036
Loans						
Ending balance	$ 449,991	$ 57,830	$ 225,459	$ 31,210	$ 280,379	$1,044,869
Ending balance: individually evaluated for impairment	$ 20,137	$ 5,411	$ 14,175	$ 566	$ 5,761	$ 46,050
Ending balance: collectively evaluated for impairment	$ 429,854	$ 52,419	$ 211,284	$ 30,644	$ 274,618	$ 998,819

The following tables show the loan portfolio allocated by management's internal risk ratings at December 31, 2013 and 2012:

	December 31, 2013 Commercial Credit Exposure Credit Risk Profile by Internally Assigned Grade				
	Real Estate – Commercial	Real Estate – Construction	Commercial	Lease Financing	Total
Grade:					
Pass	$ 480,880	$ 14,330	$ 221,475	$ 31,506	$ 748,191
Special Mention	8,863	9,600	4,233	92	22,788
Substandard	35,388	3,491	20,155	240	59,274
Total	$ 525,131	$ 27,421	$ 245,863	$ 31,838	$ 830,253

(Continued)

(In thousands, except per share amounts)

NOTE 4 – LOANS AND LEASES (Continued)

	December 31, 2013 Consumer Credit Exposure Credit Risk Profile Based on Payment Activity	
	Consumer	Total
Grade:		
Performing	$ 297,023	$ 297,023
Non-performing	3,274	3,274
Total	$ 300,297	$ 300,297

	December 31, 2012 Commercial Credit Exposure Credit Risk Profile by Internally Assigned Grade				
	Real Estate – Commercial	Real Estate – Construction	Commercial	Lease Financing	Total
Grade:					
Pass	$ 388,045	$ 38,307	$ 194,448	$ 30,169	$ 650,969
Special Mention	28,857	14,018	10,085	416	53,376
Substandard	33,089	5,505	20,926	625	60,145
Total	$ 449,991	$ 57,830	$ 225,459	$ 31,210	$ 764,490

	December 31, 2012 Consumer Credit Exposure Credit Risk Profile Based on Payment Activity	
	Consumer	Total
Grade:		
Performing	$ 278,910	$ 278,910
Non-performing	1,469	1,469
Total	$ 280,379	$ 280,379

The following tables show an aging analysis of the loan portfolio by the time past due at December 31, 2013 and 2012:

	December 31, 2013					
	30-89 Days Past Due	Greater Than 90 Days	Nonaccrual	Total Past Due	Current	Total Loans
Real estate – commercial	$ 1,916	$ -	$ 21,320	$ 23,236	$ 501,895	$ 525,131
Real estate – construction	-	-	3,433	3,433	23,988	27,421
Commercial	41	-	1,521	1,562	244,301	245,863
Lease financing	305	24	133	462	31,376	31,838
Consumer	349	-	3,274	3,623	296,674	300,297
Total	$ 2,611	$ 24	$ 29,681	$ 32,316	$ 1,098,234	$ 1,130,550

(Continued)

(In thousands, except per share amounts)

NOTE 4 – LOANS AND LEASES (Continued)

	December 31, 2012					
	30-89 Days Past Due	Greater Than 90 Days	Nonaccrual	Total Past Due	Current	Total Loans
Real estate – commercial	$ 745	$ -	$ 18,154	$ 18,899	$ 431,092	$ 449,991
Real estate – construction	-	-	5,411	5,411	52,419	57,830
Commercial	758	2	2,163	2,923	222,536	225,459
Lease financing	288	61	152	501	30,709	31,210
Consumer	274	-	1,469	1,743	278,636	280,379
Total	$ 2,065	$ 63	$ 27,349	$ 29,477	$ 1,015,392	$ 1,044,869

The following tables show information related to impaired loans at and for the years ended December 31, 2013 and 2012:

	December 31, 2013				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:	$ -	$ -	$ -	$ -	$ -
With an allowance recorded:					
Real estate – commercial	$ 33,719	$ 35,631	$ 2,339	$ 30,606	$ 1,254
Real estate – construction	$ 7,624	$ 8,226	$ 734	$ 8,652	$ 372
Commercial	$ 6,002	$ 6,344	$ 2,826	$ 6,470	$ 440
Lease financing	$ 349	$ 334	$ 41	$ 617	$ 51
Consumer	$ 12,354	$ 12,850	$ 1,574	$ 10,516	$ 589
Total:					
Real estate – commercial	$ 33,719	$ 35,631	$ 2,339	$ 30,606	$ 1,254
Real estate – construction	$ 7,624	$ 8,226	$ 734	$ 8,652	$ 372
Commercial	$ 6,002	$ 6,344	$ 2,826	$ 6,470	$ 440
Lease financing	$ 349	$ 334	$ 41	$ 617	$ 51
Consumer	$ 12,354	$ 12,850	$ 1,574	$ 10,516	$ 589

(Continued)

(In thousands, except per share amounts)

NOTE 4 – LOANS AND LEASES (Continued)

	December 31, 2012				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:	$ -	$ -	$ -	$ -	$ -
With an allowance recorded:					
Real estate – commercial	$ 27,493	$ 29,158	$ 3,331	$ 27,099	$ 1,715
Real estate – construction	$ 9,680	$ 22,776	$ 713	$ 16,531	$ 391
Commercial	$ 6,938	$ 7,089	$ 3,102	$ 6,326	$ 414
Lease financing	$ 884	$ 845	$ 130	$ 1,186	$ 50
Consumer	$ 8,677	$ 9,011	$ 1,319	$ 9,485	$ 456
Total:					
Real estate – commercial	$ 27,493	$ 29,158	$ 3,331	$ 27,099	$ 1,715
Real estate – construction	$ 9,680	$ 22,776	$ 713	$ 16,531	$ 391
Commercial	$ 6,938	$ 7,089	$ 3,102	$ 6,326	$ 414
Lease financing	$ 884	$ 845	$ 130	$ 1,186	$ 50
Consumer	$ 8,677	$ 9,011	$ 1,319	$ 9,485	$ 456

Included in the tables above are certain impaired loans with small balances that the Bank collectively evaluates for impairment. Non-accrual loans totaled $29,681 and $27,349 at December 31, 2013 and 2012, respectively. Accruing loans that were past due 90 days or more totaled $23 at December 31, 2013, as compared to $63 at December 31, 2012.

Included in the impaired loans above are 99 loans in the amount of $48,307 and 101 loans in the amount of $38,285 that were considered to be troubled debt restructurings at December 31, 2013 and December 31, 2012, respectively.

For the years ended December 31, 2013 and 2012, the average recorded investment in impaired loans was $56,861 and $60,627, respectively. The Bank had $7,514 of specific allowance for loan and lease losses on impaired loans with a recorded investment of $60,048 at December 31, 2013 as compared to $8,595 of specific allowance for loan and lease losses on impaired loans with a recorded investment of $53,672 at December 31, 2012. Interest income on a cash basis was not significant. Foregone interest on non-accrual loans was $1,179 for the year ended December 31, 2013, compared with $1,114 for the year ended December 31, 2012.

Salaries and employee benefits totaling $2,536 and $2,295 have been deferred as loan and lease origination costs for the years ended December 31, 2013 and 2012, respectively.

The Bank has allocated $6,157 and $6,858 of specific reserves to customers whose loan terms have been modified in troubled debt restructurings as of December 31, 2013 and 2012. The Bank has no commitments to lend additional amounts to customers with outstanding loans classified as troubled debt restructurings, as of December 31, 2013. The Bank had committed to lend additional amounts totaling up to $383 on loans classified as troubled debt restructurings as of December 31, 2012.

During the period ending December 31, 2013, the terms of certain loans were modified as troubled debt restructurings. The modification of the terms of such loans included one or a combination of the following: a reduction of the stated interest rate of the loan; an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk; or a permanent reduction of the recorded investment in the loan.

(In thousands, except per share amounts)

NOTE 4 – LOANS AND LEASES (Continued)

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

The following table presents loans by class modified as troubled debt restructurings that occurred during the period ended December 31, 2013:

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled debt restructurings:			
Real estate – commercial	6	$ 9,843	$ 9,295
Real estate – construction	1	1,027	342
Commercial	3	139	139
Lease financing	2	60	48
Consumer	10	5,147	5,147
Total	22	$ 16,216	$ 14,971

The troubled debt restructurings described above increased the allowance for loan losses by $973 and resulted in $1,245 in charge offs during the period ended December 31, 2013.

The following table presents loans by class modified as troubled debt restructurings for which there was a payment default within twelve months following the modification during the period ended December 31, 2013:

	Number of Loans	Recorded Investment
Troubled debt restructurings that subsequently defaulted:		
Lease financing	2	$ 60

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

The troubled debt restructurings that subsequently defaulted described above did not increase the allowance for loan losses and did not result in charge offs during the period ended December 31, 2013.

(Continued)

(In thousands, except per share amounts)

NOTE 4 – LOANS AND LEASES (Continued)

The following table presents loans by class modified as troubled debt restructurings that occurred during the period ended December 31, 2012:

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled debt restructurings:			
Real estate – commercial	7	$ 2,241	$ 2,241
Real estate – construction	-	-	-
Commercial	2	71	71
Lease financing	9	417	417
Consumer	5	578	567
Total	23	$ 3,307	$ 3,296

The troubled debt restructurings described above increased the allowance for loan losses by $1,431 and resulted in $11 in charge offs during the period ended December 31, 2012.

The following table presents loans by class modified as troubled debt restructurings for which there was a payment default within twelve months following the modification during the period ended December 31, 2012:

	Number of Loans	Recorded Investment
Troubled debt restructurings that subsequently defaulted:		
Real estate – commercial	1	$ 87
Consumer	1	73
Total	2	$ 160

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

The troubled debt restructurings that subsequently defaulted described above did not increase the allowance for loan losses and did not result in charge offs during the period ended December 31, 2012.

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

(Continued)

(In thousands, except per share amounts)

NOTE 5 – FEDERAL HOME LOAN BANK STOCK

As a member of the Federal Home Loan Bank of San Francisco (FHLB), the Bank is required to own capital stock in an amount specified by regulation. At December 31, 2013 and 2012, the Bank owned 74,898 and 64,012 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.

NOTE 6 – BANK PREMISES AND EQUIPMENT

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

	2013	2012
Land	$ 2,709	$ 2,709
Buildings	23,600	22,637
Leasehold improvements	6,600	6,588
Equipment	18,511	18,821
Construction in progress	587	753
	52,007	51,508
Less: accumulated depreciation and amortization	(35,936)	(35,023)
	$ 16,071	$ 16,485

Depreciation and amortization expense were $2,020 and $2,357 for the years ended December 31, 2013 and 2012, respectively.

NOTE 7 – INTEREST-BEARING DEPOSITS

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

	2013	2012
Savings	$ 309,198	$ 278,480
Money market	216,286	203,608
NOW accounts	241,056	211,581
Time, $100,000 or more	147,258	146,943
Other time	95,306	102,388
	$ 1,009,104	$ 943,000

The Bank's other time deposits included brokered deposits which totaled $5,085 or .3% and $5,580 or 0.4% of total deposits, respectively, for the years ended December 31, 2013 and 2012. 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, 2013 and 2012.

(Continued)

(In thousands, except per share amounts)

NOTE 7 – INTEREST-BEARING DEPOSITS (Continued)

Aggregate annual maturities of time deposits at December 31, 2013 are as follows:

Year Ending December 31,	
2014	$ 187,017
2015	32,097
2016	17,745
2017	5,027
2018	678
	$ 242,564

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

Federal Home Loan Bank Advances: The Bank may borrow from the Federal Home Loan Bank, on either a short-term or long-term basis, up to 30% of its assets provided that adequate collateral has been pledged. As of December 31, 2013, the Bank has pledged investment securities with a carrying value of $33,131 and loans with a carrying value of $669,069 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, 2013 and 2012:

2013		2012	
Amount	Weighted Average Rate	Amount	Weighted Average Rate
$ 12,000	4.75%	$ 26,000	4.47%

The annual maturities of the advances were as follows:

Year Ending	Amount	Weighted Average Rate
2017	$ 4,000	4.71%
2018	4,000	4.80%
Thereafter	4,000	4.75%
	$ 12,000	4.75%

(Continued)

(In thousands, except per share amounts)

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

Subordinated Debentures: On June 15, 2005, the Bank issued $12,000 of Floating Rate Junior Subordinated Debentures due June 15, 2020. The purpose for issuing this subordinated debt, which qualifies as capital under regulatory risk-based capital standards, was to increase the Bank's Tier 2 capital. The Bank is not considered the primary beneficiary of the trust (variable interest entity); therefore, the trust is not consolidated in the Bank's financial statements, but rather the subordinated debentures are shown as a liability. The interest rate on the debentures is reset quarterly at the 3 Month LIBOR rate plus 1.80%, which was 2.043% at December 31, 2013. Payment on the debentures is interest only, payable quarterly, with all principal due at maturity. On any interest payment date on or after the interest payment date in June 2012, the Bank has the right to redeem all or any part of the debentures in multiples of $1. 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, 2013.

Lines of Credit: The Bank has an unsecured line of credit of $5,000 with its correspondent bank, Pacific Coast Bankers Bank as of December 31, 2013 and 2012.

NOTE 9 – INCOME TAXES

The expense (benefit) from income taxes for the years ended December 31, 2013 and 2012 consisted of the following:

	Federal	State	Total
2013			
Current	$ 4,903	$ 299	$ 5,202
Deferred	859	2,158	3,017
Provision for income taxes	$ 5,762	$ 2,457	$ 8,219
2012			
Current	$ 4,521	$ 365	$ 4,896
Deferred	(298)	1,531	1,233
Provision for income taxes	$ 4,233	$ 1,896	$ 6,129

(In thousands, except per share amounts)

NOTE 9 – INCOME TAXES (Continued)

Deferred tax assets (liabilities) are comprised of the following at December 31, 2013 and 2012:

	2013	2012
Deferred tax assets:		
Allowance for loan losses	$ 14,345	$ 13,457
Deferred compensation	6,161	5,726
Postretirement benefits	1,144	1,420
Restructuring reserve	414	498
Net operating loss	69	1,865
Tax credits	1,991	4,586
Nonaccrual interest	1,409	1,105
OREO property	190	1,128
Bank premises and equipment	905	539
State taxes	56	47
Unrealized losses on available-for-sale investment securities	193	-
Other	322	132
Total deferred tax assets	27,199	30,503
Deferred tax liabilities:		
Deferred loan costs	(1,032)	(875)
Unrealized gains on available-for-sale investment securities	-	(4,138)
Prepaid expenses	(492)	(330)
Pension expenses	(5,270)	(631)
FHLB stock dividends	(387)	(387)
Other	(537)	(573)
Total deferred tax liabilities	(7,718)	(6,934)
Net deferred tax assets	$ 19,481	$ 23,569

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,	
	2013	2012
Federal income tax expense, at statutory rate	35.0%	35.0%
State franchise tax, net of Federal tax effect	6.7	6.7
Tax-exempt interest on obligations of states and political subdivisions	(3.5)	(5.8)
Cash surrender value of life insurance	(4.1)	(2.7)
Tax credits	(1.1)	(1.4)
Other	1.3	1.5
Effective tax rate	34.3%	33.3%

(Continued)

(In thousands, except per share amounts)

NOTE 9 – INCOME TAXES (Continued)

The Bank files income tax returns in the United States jurisdiction and the State of California jurisdiction. The Bank is no longer subject to Federal income tax examinations by tax authorities for years before 2008. The Bank is no longer subject to California income tax examinations by tax authorities for years before 2007.

For the year ended December 31, 2013, the Bank has available for carryover $985 thousand of state net operating losses. The state net operating losses expire in 2030. The Bank also has available for carryover $1,787 of federal minimum tax credits and no federal general business credits. The general business credits expire beginning in 2027. The California minimum tax credits of $309 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, 2013 and 2012, the Bank recognized no interest or penalties.

NOTE 10 – RELATED PARTY TRANSACTIONS

During the normal course of business, the Bank enters into transactions with related parties, including Directors and executive officers. The following is a summary of the aggregate activity involving related party borrowers during 2013:

Balance, January 1, 2013	$ 11,120
Disbursements	3,200
Amounts repaid	(1,645)
Change in relationship	(3,091)
Balance, December 31, 2013	$ 9,584
Undisbursed commitments to related parties, December 31, 2013	$ 1,795

NOTE 11 – COMPREHENSIVE INCOME

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

(Continued)

(In thousands, except per share amounts)

NOTE 11 – COMPREHENSIVE INCOME (Continued)

Components of other comprehensive income and related tax effects for the years ended December 31, 2013 and 2012 are as follows:

	2013	2012
Net Income	$ 15,729	$ 12,262
Other comprehensive income:		
Unrealized gains/losses on securities:		
Unrealized holding gains arising during the period	(10,299)	(539)
Reclassification adjustment for losses (gains)	-	-
Tax effect	4,332	226
Changes in unrealized gain on available-for-sale investment securities, net of tax	(5,967)	(313)
Defined benefit pension plans:		
Net gain arising during the period	12,494	2,979
Reclassification adjustment for amortization of prior service cost and net gain/loss included in net periodic pension cost	15	14
Tax effect	(5,260)	(1,372)
Changes in defined benefit pension plans, net of tax	7,249	1,621
Change in deferred compensation trust liabilities	335	503
Tax effect	(141)	(212)
Changes in deferred compensation trust, net of tax	194	291
Other comprehensive income	1,476	1,599
Total Comprehensive Income	$ 17,205	$ 13,861

(Continued)

(In thousands, except per share amounts)

NOTE 12 – RETIREMENT PLAN

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

	2013	2012
Change in benefit obligation:		
Benefit obligation at beginning of year	$ 46,007	$ 45,846
Service cost	832	859
Interest cost	1,809	1,866
Benefits paid	(2,632)	(4,164)
Actuarial (gain) loss	(4,441)	1,600
Benefit obligation at end of year	$ 41,575	$ 46,007
Change in plan assets:		
Fair value of plan assets at beginning of year	$ 47,507	$ 45,914
Employer contribution	50	-
Benefits paid	(2,632)	(4,164)
Actual return on plan assets	9,183	5,757
Fair value of plan assets at end of year	$ 54,108	$ 47,507
Funded status at end of year	$ 12,533	$ 1,500

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

	2013	2012
Net actuarial loss	$ 3,557	$ 15,022
Prior service cost (credit)	504	589
	$ 4,061	$ 15,611

The accumulated benefit obligation was $41,575 and $46,007 at December 31, 2013 and 2012. The Bank does not expect to contribute to the Plan in 2014.

(Continued)

(In thousands, except per share amounts)

NOTE 12 – RETIREMENT PLAN (Continued)

The following presents the Plan investments, including their fair value and method of fair value determination, as of December 31, 2013 and 2012.

2013	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash and equivalents	$ 702	$ 702	$ -	$ -
Equity securities:				
U.S. large-cap (a)	25,694	25,694	-	-
U.S. small-cap (b)	3,297	3,297	-	-
International large-cap (c)	6,589	6,589	-	-
Fixed income securities:				
U.S. Government agencies (d)	1,547	-	1,547	-
U.S. corporate bond funds (e)	4,668	4,668	-	-
U.S. Total Bond Market fund (f)	11,611	11,611	-	-
Total	$ 54,108	$ 52,561	$ 1,547	$ -

(Continued)

(In thousands, except per share amounts)

NOTE 12 – RETIREMENT PLAN (Continued)

2012	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash and equivalents	$ 764	$ 764	$ -	$ -
Equity securities:				
U.S. large-cap (a)	22,815	22,815	-	-
U.S. small-cap (b)	2,985	2,985	-	-
International large-cap (c)	6,303	6,303	-	-
Fixed income securities:				
U.S. Government agencies (d)	892	-	892	-
U.S. corporate bond funds (e)	3,943	3,943	-	-
U.S. Total Bond Market fund (f)	9,805	9,805	-	-
Total	$ 47,507	$ 46,615	$ 892	$ -

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

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)

NOTE 12 – RETIREMENT PLAN (Continued)

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

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

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

	2013	2012
Asset category:		
Equity	66%	67%
Fixed income	33%	31%
Other	1%	2%
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.

The components of 2013 and 2012 net periodic benefit cost are as follows:

	2013	2012
Service cost	$ 832	$ 859
Interest cost	1,809	1,866
Expected return on plan assets	(3,743)	(3,520)
Amortization of unrecognized prior service cost	85	85
Amortization of unrecognized actuarial loss	1,584	1,972
Total net periodic cost	$ 567	$ 1,262
Net gain	$ (9,882)	$ (637)
Prior service cost		
Amortization of prior service cost	(85)	(85)
Amortization of net gain	(1,583)	(1,972)
Total recognized in other comprehensive income	(11,550)	(2,694)
Total recognized in net periodic benefit cost and other comprehensive income	$ (10,983)	$ (1,432)

(Continued)

(In thousands, except per share amounts)

NOTE 12 – RETIREMENT PLAN (Continued)

The estimated net loss and prior service costs for the defined benefit pension plan that will be amortized from accumulated other comprehensive income into net periodic benefit cost over the next fiscal year are $1,669 and $2,057 as of December 31, 2013 and 2012, respectively.

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

	2013	2012
Discount rate	4.875%	4.00%
Rate of compensation increase	4.00%	4.00%

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

	2013	2012
Discount rate	4.00%	4.25%
Rate of compensation increase	4.00%	4.00%
Expected return of plan assets	8.00%	8.00%

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
2014	$ 1,699
2015	1,881
2016	2,071
2017	2,249
2018	2,361
2019 through 2023	13,295

(Continued)

(In thousands, except per share amounts)

NOTE 13 – POSTRETIREMENT HEALTHCARE PLAN

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

	2013	2012
Change in benefit obligation:		
Benefit obligation at beginning of year	$ 5,336	$ 5,368
Service cost	52	62
Interest cost	205	208
Benefits paid	(383)	(306)
Plan participant contribution	90	76
Actuarial gain	(376)	(72)
Benefit obligation at end of year	$ 4,924	$ 5,336
Change in plan assets:		
Fair value of plan assets at beginning of year	$ 3,960	$ 2,405
Other payments	(89)	(35)
Plan participant contribution	90	76
Benefits paid	(383)	(306)
Employer contribution	-	1,500
Actual return on plan assets	865	320
Fair value of plan assets at end of year	$ 4,443	$ 3,960
Plan assets less benefit obligation at end of year	$ (481)	$ (1,376)

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

	2013	2012
Net actuarial loss	$ 40	$ 1,068
Prior service cost	(347)	(417)
	$ (307)	$ 651

The accumulated benefit obligation was $4,924 and $5,336 at December 31, 2013 and 2012. The Bank does not expect to contribute to the Plan in 2013.

	2013	2012
Components of net periodic benefit cost:		
Service cost	$ 52	$ 62
Interest cost	205	208
Expected return on plan assets	(304)	(183)
Amortization of unrecognized prior service cost	(70)	(70)
Amortization of net actuarial loss	91	161
Total net periodic benefit cost	$ (26)	$ 178

(Continued)

(In thousands, except per share amounts)

NOTE 13 – POSTRETIREMENT HEALTHCARE PLAN (Continued)

	2013	2012
Net (gain) loss	$ (937)	$ (208)
Amortization of net gain	(91)	(161)
Amortization of prior service cost	70	70
Total recognized in other comprehensive income	(958)	(299)
Total recognized in net periodic benefit cost and other comprehensive income	$ (985)	$ (121)

The estimated net loss and prior services costs for the defined benefit pension plan that will be amortized from accumulated other comprehensive income into net periodic benefit cost cover the next fiscal year are $0 and $96 as of December 31, 2013 and 2012, respectively.

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

	2013	2012
Health care trend rate assumed for next year	5.50%	5.50%
Rate to which the cost trend rate is assumed to decline	5.50%	5.50%
Year that the rate reaches the ultimate trend rate	2010	2010

The following presents the Plan investments, including their fair value and method of fair value determination, as of December 31, 2013 and 2012.

2013	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash	$ 92	$ 92	$ -	$ -
Equity securities:				
U.S. large-cap (a)	2,602	2,602	-	-
U.S. small-cap (b)	346	346	-	-
International large-cap (c)	671	671	-	-
Fixed income securities:				
Obligations of states and political subdivisions (d)	732	-	732	-
Total	$ 4,443	$ 3,711	$ 732	$ -

(Continued)

(In thousands, except per share amounts)

NOTE 13 – POSTRETIREMENT HEALTHCARE PLAN (Continued)

2012	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash	$ 202	$ 202	$ -	$ -
Equity securities:				
U.S. large-cap (a)	2,296	2,296	-	-
U.S. small-cap (b)	325	325	-	-
International large-cap (c)	640	640	-	-
Fixed income securities:				
Obligations of states and political subdivisions (d)	497	-	497	-
Total	$ 3,960	$ 3,463	$ 497	$ -

(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.

(Continued)

(In thousands, except per share amounts)

NOTE 13 – POSTRETIREMENT HEALTHCARE PLAN (Continued)

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

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

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

	2013	2012
Asset category:		
Equity	82%	82%
Fixed income	16%	13%
Other	2%	5%
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. For measurement purposes, the healthcare trend rate of 5.5% was used in 2013 and 2012. 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, 2013 or December 31, 2012. In addition, the aggregate of the service and interest components of net periodic postretirement benefit cost would not change as of December 31, 2013 or December 31, 2012.

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, 2013 or 2012. In addition, the aggregate service and interest components of net periodic postretirement benefit cost for the year would not change as of December 31, 2013 or December 31, 2012.

(Continued)

(In thousands, except per share amounts)

NOTE 13 – POSTRETIREMENT HEALTHCARE PLAN (Continued)

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

	2013	2012
Discount rate	4.875%	4.00%
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:

	2013	2012
Discount rate	4.00%	4.00%
Expected return of plan assets	8.00%	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, 2013, 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
2014	$ 336
2015	$ 350
2016	$ 364
2017	$ 369
2018	$ 375
2019 through 2023	$ 1,187

(In thousands, except per share amounts)

NOTE 14 – COMMITMENTS AND CONTINGENCIES

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

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

	2013	2012
Commitments to extend credit	$ 234,237	$ 195,218
Standby letters of credit	21,577	35,107
Total loan commitments	$ 255,814	$ 230,325

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, 2013 and 2012. The Bank recognizes these fees as revenue over the term of the commitment or when the commitment is used.

(Continued)

(In thousands, except per share amounts)

NOTE 14 – 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, 2013, minimum commitments under these noncancellable leases with initial or remaining terms of one year or more are as follows:

Year Ending December 31,	
2014	$ 1,693
2015	1,429
2016	1,127
2017	837
2018	499
Thereafter	939
	$ 6,524

Rent expense under operating leases was $1,629 and $1,597 for the years ended December 31, 2013 and 2012, 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, 2013 and 2012 were $1,120 and $1,091, respectively.

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

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, 2013 and 2012, the Bank had accrued $11,980 and $10,587, 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 $2,035 and $1,747for the years ended December 31, 2013 and 2012, 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, 2013 and 2012, the liability for accrued deferred compensation, including interest earned, totaled $2,985 and $3,295, respectively.

(Continued)

NOTE 14 – COMMITMENTS AND CONTINGENCIES (Continued)

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, 2013 and 2012 in the amount of $2,213 and 2,001, respectively, representing the actuarial present value of the costs to maintain life insurance during the employees' postretirement period.

The cash surrender value of life insurance purchased in connection with these agreements totaled $35,057 and $35,041 as of December 31, 2013 and 2012, 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.

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 $866 and $966 at December 31, 2013 and December 31, 2012, respectively.

NOTE 15 – 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 (the “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 $43,000,000 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 share under the Treasury’s TARP Capital Purchase Program. 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 affect 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.

(Continued)

NOTE 15 – REGULATORY MATTERS (Continued)

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.

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 paripassu with the Series A Preferred Stock or Series B Preferred Stock, or common shares (other than in the case of paripassu 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 paripassu with the Series A Preferred Stock or Series B Preferred Stock, unless full dividends on the Series A Preferred Stock and the Series B Preferred Stock for the latest completed dividend period have been declared and paid in full.

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.

NOTE 15 – REGULATORY MATTERS (Continued)

In 2012, as part of the strategy for winding down its remaining bank investments under the TARP Capital Purchase Program, the Treasury conducted private auctions of securities issued by certain institutions that participated in the program. On July 26, 2012, the Treasury conducted an auction of the Bank's 43,000 share of Series A Preferred Stock and 2,150 shares of Series B Preferred Stock. In the auction, the Bank successfully bid on 20,000 shares of its Series A Preferred Shares, which were retired on the purchase date and are no longer outstanding. The remaining 23,000 shares of Series A Preferred Stock and 2,150 shares of Series B Preferred Stock remain outstanding but are now owned by private investors and are transferable.

On May 3, 2013 the Bank repurchased 10,000 shares of its Series A Preferred Shares, which were retired on the purchase date. On November 4, 2013 the Bank negotiated the private purchase of 2,850 shares of its Series A Preferred Shares which were retired on the purchase date. On December 16, 2013 the Bank redeemed 3,150 shares of its Series A Preferred Shares which were retired on the redemption date. Finally, on January 15, 2014 the Bank provided 30 days' notice to all existing Preferred shareholders that it will redeem all of the remaining outstanding 7,000 shares of its Series A Preferred Shares and all remaining outstanding 2,150 shares of its Series B Preferred Shares on February 14, 2014 at which time all shares will be retired. As of February 14, 2014 there were no remaining Exchange Bank Preferred Shares outstanding.

Several of the Purchase Agreement's covenants relating to the Series A Preferred Stock and the Series B Preferred Stock terminated at the time that Treasury sold the securities to investors. As a result of the Treasury' sale of these securities, the Bank is no longer required to ensure that its benefit plans with respect to its senior executive officers comply with Section 111(b) of the EESA. Neither Treasury nor the new holders of the preferred shares have the right to unilaterally amend the terms of the Purchase Agreement. In addition, the Bank may increase the amount of cash dividend on the common stock without the approval of the Treasury or the current holders of the Series A Preferred Stock and Series B Preferred Stock. Finally the Bank is no longer prohibited from paying dividends on its common stock or repurchasing any equity securities or trust preferred securities, provided that it has declared and paid (or set aside for payment) full dividends on the Series A Preferred Stock and the Series B Preferred Stock for the latest completed dividend period.

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

Regulatory Capital: 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.

(Continued)

(In thousands, except per share amounts)

NOTE 15 – REGULATORY MATTERS (Continued)

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 to which they are subject to as of December 31, 2013 and 2012. In 2012, the Board of Directors of the Bank passed a Board Resolution to maintain a minimum Tier 1 capital to average assets ratio of 8%. At December 31, 2013 and 2012, this ratio was 8.9% and 9.2%, respectively.

	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, 2013						
Total capital (to risk-weighted assets)	$ 185,346	14.4%	$ 102,813	8.0%	$ 128,516	10.0%
Tier 1 capital (to risk-weighted assets)	$ 157,022	12.2%	$ 51,406	4.0%	$ 77.110	6.0%
Tier 1 capital (to average assets)	$ 157,022	8.9%	$ 70,335	4.0%	$ 64.258	5.0%
December 31, 2012						
Total capital (to risk-weighted assets)	$ 180,173	15.0%	$ 96,444	8.0%	$ 120,555	10.0%
Tier 1 capital (to risk-weighted assets)	$ 152,847	12.7%	$ 48,222	4.0%	$ 72,333	6.0%
Tier 1 capital (to average assets)	$ 152,847	9.2%	$ 66,537	4.0%	$ 83,171	5.0%