

CALIFORNIA INDEPENDENT BANCORP
Form 10-K
April 02, 2001

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-K

**/x/ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934 [FEE REQUIRED]
For the fiscal year ended December 31, 2000**

**// TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934 [NO FEE REQUIRED]
For the transition period from _____ to _____**

Commission file number 0-26552

California Independent Bancorp

(Exact name of registrant as specified in its charter)

California
(State or other jurisdiction of
incorporation or organization)

68-0349947
(I.R.S. Employer Identification No.)

**1227 Bridge Street, Suite "C,"
Yuba City, California**
(Address of principal executive offices)

95991
(Zip Code)

Registrant's telephone number, including area code **(530) 674-6025**

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

Title of each class
None

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

Common Stock, No Par Value
(Title of class)

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

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

The aggregate market value of the voting stock held by non-affiliates of California Independent Bancorp at February 28, 2001 was \$37,620,090.

The number of outstanding shares of common stock as of February 28, 2001 was 2,008,966.

DOCUMENTS INCORPORATED BY REFERENCE

Selected portions of the Proxy Statement for 2001 Annual Meeting of Shareholders to be filed pursuant to Regulation 14A are incorporated into Part III.

Selected pages of the Company's 2000 Annual Report to Shareholders are incorporated into Part II and IV.

**THIS REPORT INCLUDES A TOTAL OF 27 PAGES
EXHIBIT INDEX IS ON PAGE 25-27**

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PART I**ITEM 1. BUSINESS**

Certain statements in this Annual Report on Form 10-K (excluding statements of fact or historical financial information) involve forward-looking information within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and are subject to the "safe harbor" created by those sections. These forward-looking statements involve certain risks and uncertainties that could cause actual results to differ materially from those in the forward-looking statements. Such risks and uncertainties include, but are not limited to, the following factors: competitive pressure in the banking industry increases significantly; changes in the interest rate environment that reduce margins; other changes in the interest rate environment; general economic conditions, either nationally or regionally, that are less favorable than expected, resulting in, among other things, a deterioration in credit quality and an increase in the provision for possible loan and lease losses; the loss of key personnel; changes in the regulatory environment; changes in business conditions; volatility of rate sensitive deposits; operational risks including data processing system failures or fraud; asset/liability matching risks and liquidity risks; and changes in the securities markets. In addition, such risks and uncertainties include mortgage banking activities, merchant card processing, concentration of lending activities and the costs and steps necessary to address the residual effects, if any, of the Year 2000 issues. Therefore, the information set forth herein should be carefully considered when evaluating the business prospects of the Company and Bank.

GENERAL

California Independent Bancorp ("Company") is a California corporation and the bank holding company for Feather River State Bank ("Bank"), both located in Yuba City, California. The Company was incorporated on October 28, 1994 and became the bank holding company for the Bank on May 2, 1995, pursuant to the Bank Holding Company Act of 1956, as amended ("BHC Act").

The Bank was incorporated as a California state banking corporation on December 1, 1976 and commenced operations on April 6, 1977. On October 1, 1996, the Bank acquired an equipment leasing company, E.P.I. Leasing Co., Inc. ("EPI"), and operates it as a wholly-owned subsidiary of the Bank. As a part of the Company and Bank's restructuring efforts, it is anticipated that the business affairs of EPI will be dissolved and wound up during the year 2001. On June 25, 1984, the Bank formed Yuba-Sutter Financial Services Corporation ("Yuba-Sutter") as a wholly-owned subsidiary. This subsidiary is inactive.

At December 31, 2000, the Company had two employees, who both serve as executive officers of the Bank. The Bank at December 31, 2000 employed 138 persons, including 18 part-time employees, 6 executive officers and 42 other officers. None of the Company's or Bank's employees is currently represented by a union or covered under a collective bargaining agreement. Management believes that its employee relations are excellent.

The Company itself does not engage in any business activities other than ownership of the Bank. The Company's primary asset is its ownership of the Bank's stock, and the dividends paid by the Bank are the Company's primary source of income. At December 31, 2000, the Company had consolidated assets of \$301,446,561, deposits of \$267,632,227, gross loans and leases of \$179,015,255, and shareholders' equity of \$25,769,609.

GENERAL BANKING SERVICES

The Bank engages in a broad range of financial services activities. Its primary market is located in the northern portion of the Sacramento Valley, with a total of seven branches in Yuba City, Marysville, Colusa, Arbuckle, Wheatland, and Woodland, California, serving Sutter, Yuba, Colusa, and Yolo

Counties. The Bank has received regulatory approval to open a new branch in Lincoln, California, which is located in western Placer County. It is anticipated that the new branch will open during the first half of 2001. All of the Bank's branches are located in areas that are in the periphery of housing for those individuals who work in the growing Sacramento area.

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In addition, the Bank operates one loan production office ("LPO") located in Roseville, California, in Placer County and services customers residing in Placer and Sacramento Counties. This LPO emphasizes commercial real estate, residential construction and commercial lending.

The total population base, in the six counties served by the Bank, is approximately 1.8 million people, the majority of which are in Sacramento County. The economic base of the Bank's primary operating territory is predominantly agricultural in nature. A wide variety of food crops are produced in the area. The leading agricultural commodities produced in the Bank's trade area include peaches, tomatoes, prunes, rice, and almonds. Plentiful water for irrigation and quality soils result in excellent agricultural diversification. In addition to agriculture, western Placer county is one of California's fastest growing regions. Western Placer county is developing into high-tech, light industry and retail center, and Lincoln, in particular, is becoming a large retirement community with developments by Del Webb and U.S. Homes.

The Bank currently has no applications pending to open additional branch offices or LPOs. The Bank may increase the number of its banking facilities in its trade areas when such expansion is appropriate. The Bank's expansion program is dependent on obtaining the necessary governmental approvals, governmental monetary policies, and competition. No assurance can be given that all or any part of the Bank's expansion program can be accomplished without the Bank being required to raise additional capital.

The Bank is engaged in the commercial banking business, including accepting demand, savings and time deposits and making commercial, real estate, agricultural, and consumer loans. The Bank also offers installment note collection, issues cashier's checks and money orders, sells traveler's checks, and provides bank-by-mail, night depository, safe deposit boxes, ATMs, Visa debit cards, and other customary banking services. The Bank offers its customers home banking services, whereby the customers can make transfers between accounts, pay bills, receive balance inquiries and statements via their personal computer or telephone. The Bank does not provide trust or international banking services. Moreover, it does not plan to do so in the near future.

DEPOSITS

Most of the Bank's deposits are obtained from individuals, small and medium-sized businesses, and professionals. The Bank is able to attract and retain these deposits through advertising in the local media and the reputation the Bank has established in the communities it serves. No single depositor or group of related depositors control a significant amount of the Bank's total deposits. The loss of any one depositor or group of related depositors should not have a materially adverse effect on the business of the Bank. The Bank is a member of the Federal Deposit Insurance Corporation ("FDIC"). As a result, deposit accounts held with the Bank are insured in accordance with the FDIC's rules and regulations.

LENDING ACTIVITIES

The Bank engages in a full complement of lending activities, including agricultural, real estate, commercial, and consumer loans.

The Bank makes real estate loans secured by residential, agricultural, and commercial property. Residential loans are made to purchase or refinance one to four family residences or multi-family residential properties and are secured by a first deed of trust on the property, except for loans to

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improve existing properties that are secured by junior liens. The maximum loan-to-value ratio for these loans is 90%. Loans secured by agricultural property include mortgages, loans for farm residences, and other improvement loans. Such agricultural loans are secured by a first lien on real estate. The maximum loan-to-value ratio for farmland is 70%. Commercial real estate loans are made primarily to owner occupied businesses for such purposes as offices, warehouses, professional buildings, retail, and storage facilities. The maximum loan-to-value ratio for commercial properties is 75%. As of December 31, 2000, these types of real estate secured loans totaled \$75,626,555, or 42.2% of the Bank's loan portfolio.

The Bank also makes real estate construction and development loans for acquisition of raw land to be developed into subdivisions for the construction of one to four family and multi-family housing, and for commercial real estate construction. These loans are secured by a first deed of trust and have maximum loan to value ratios ranging from 60% to 90%. As of December 31, 2000, the Bank had construction and development loans of \$35,783,474, representing 20.0% of the Bank's loan portfolio.

The Bank makes a variety of commercial and industrial loans to small-to-medium-sized businesses for working capital, inventory, accounts receivable, equipment, and general improvements. Typically, the Bank obtains a security interest in the collateral being financed or in other available assets of the customer. Loan to value ratios vary but generally do not exceed 75%. As of December 31, 2000, the Bank had loans for these purposes of \$21,042,986, representing 11.8% of the Bank's loan portfolio.

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Additionally, the Bank has made Small Business Administration ("SBA") loans since its inception. The Bank offers both SBA 7(a) and SBA 504 real estate guaranteed loans ranging from amounts of \$50,000 to \$2,000,000. SBA 7(a) loans are for such purposes as working capital, inventory, and other purposes and are guaranteed up to 80%. SBA 504 loans are made to finance commercial real estate.

Furthermore, the Bank offers Business and Industry guaranteed loans through the Rural Development Agency ("RDA"). These loans are designated for businesses that create jobs in rural areas. RDA loans are in amounts up to \$10 million and are 80%-90% guaranteed by the RDA. The Bank generally sells the guaranteed portion of its SBA and RDA loans in the secondary market.

Agricultural loans are primarily made to finance agricultural production expenses generally as non-revolving lines of credit that are drawn upon when crop expenses are incurred and are repaid as crop sale proceeds are received. These loans are typically secured by crops and crop proceeds. The Bank generally requires a repayment margin of 25% for permanent plantings (i.e., tree and vine crops) and 20% for row crops. The Bank participates in the Farm Service Agency ("FSA" an agency of the U.S. Department of Agriculture) guaranteed loan program. The program allows the Bank to obtain loan note guarantees on agricultural loans of up to 90% of the loan amount for eligible farmers. As of December 31, 2000, the Bank had agricultural loans outstanding of \$20,648,335 (of which the FSA guarantees approximately 10%), representing 11.5% of the Bank's total loan and lease portfolio.

Being located in a prime agricultural area, the Bank participates in the Farmer Mac I loan program, pursuant to which it makes and then sells agricultural real estate loans to the Federal Agricultural Mortgage Corporation ("Farmer Mac"), and other institutional investors. In addition, the Bank participates in the Farmer Mac II loan program, pursuant to which it makes FSA guaranteed farm real estate loans and subsequently sells the 90% guaranteed portion of these loans directly to the secondary market and retains the servicing of these loans. The Bank is one of the largest Farmer Mac loan program lenders in the United States.

The Bank also originates mortgage loans on residential and farm properties, which it sells into the secondary market in order to divest itself of the interest rate risk associated with these mostly fixed interest rate products. The purchasers of the loans establish the underwriting criteria for residential and agricultural mortgage loans sold in the secondary market. The Company accounts for these loans in accordance with Statement of Financial Accounting Standards No. 125 "Accounting for Transfers of

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Financial Assets and Extinguishment of Liabilities." These loans are sold without recourse. As of December 31, 2000, 1999, and 1998, total loans serviced by the Bank for third parties were \$92,741,075, \$131,991,682, and \$146,025,594, respectively. For the years ended December 31, 2000, 1999, and 1998, total loans sold by the Bank were \$760,000, \$21,968,279, and \$65,795,347, respectively.

Consumer and installment loans are made for household, family and other personal expenditures. These loans are made on both a secured and unsecured basis. As of December 31, 2000 the Bank had a total of \$4,471,652 in consumer and installment loans representing 2.5% of its loan portfolio.

The Bank maintains commercial and industrial equipment leases which were primarily originated through its subsidiary EPI. Leases were made to a wide variety of businesses including professional, agricultural, industrial, and construction concerns. Total lease financing receivables as of December 31, 2000 were \$19,608,845, or 11.0% of the Bank's portfolio. Although the business affairs of EPI will be wound down during the year 2001, it is anticipated that the Bank may continue to originate or purchase equipment leases.

The Bank also makes other miscellaneous loans that totaled \$1,833,408 or 1.0% of the Bank's portfolio.

INVESTMENT POLICY

The Bank's investment policy is to provide the Bank with the maximum return on its investment securities consistent with safety and liquidity.

In accordance with this policy and state laws regarding permissible investments, the Bank invests primarily in U. S. Treasury and Agency securities with a maturity of 10 years or less, tax-free municipal bonds rated "A" or better by Standard and Poors or Moody's with a maturity not to exceed 13 years and corporate bonds rated "A" or better by Moody's or Standard and Poors with a maturity not to exceed 7 years. The Bank also invests in federal funds.

The Bank's investment securities may also be used as collateral for public deposits and for other borrowings.

OTHER SERVICES

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The Bank offers other financial products and services including annuities, mutual funds, mutual fund advisory service, IRAs, brokerage and custodial services, 401(k) plans, estate plans, asset management, asset consulting, charitable remainder trusts, fiduciary services, pension plans, non-qualified deferred compensation, and retirement plans. All these investments and/or financial services are offered by a registered investment representative through the Bank's affiliation with London Pacific Securities, Inc., a registered broker/dealer and a member of the National Association of Securities Dealers ("NASD") and the Securities Investor Protection Corporation ("SIPC").

COMPETITION

The Bank's primary service area consists of Colusa, Sutter, Yolo, and Yuba Counties. It is estimated that this service area contains 70 competitive banking and savings and loan offices, of which fifteen (15) offices are owned by other independent banks. Based upon total bank deposits as of June 30, 2000 (the last period for which data is available), the Bank is second in market share in Sutter County, second in Colusa County, third in Yuba County, and tenth in Yolo County.

The banking business in California and, specifically, in the Bank's primary service area is highly competitive with respect to both loans and deposits. The business is dominated by a relatively small number of major banks with many offices operating over a wide geographic area. Among the advantages such major banks have over the Bank are their ability to finance wide-ranging advertising

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campaigns and to allocate their investment assets to regions of highest yield and demand. Such institutions offer certain services such as trust services and international banking which are not offered directly by the Bank, and, by virtue of their greater total capitalization, they have substantially higher lending limits than does the Bank. Other entities, both governmental and in private industry, seeking to raise capital through the issuance and sale of debt or equity securities also provide competition for the Bank in the acquisition of deposits. The Bank also competes with money-market funds for deposits.

In order to compete with major financial institutions and other competitors, the Bank relies upon the experience of its executive and senior officers in serving businesses and individuals and upon its specialized service, local promotional activities, and the personal contacts made by its officers, directors, and employees. For customers whose loan demands exceed the Bank's legal lending limit (15% of its capital and allowance for loan losses for unsecured loans and 25% of its capital and allowance for loan losses for secured loans), the Bank may arrange to extend such loans on a participation basis with other financial institutions or institutional lenders. In this manner, the Bank is able to close the loan while selling a portion of the credit to a participant.

SUPERVISION AND REGULATION

Bank holding companies and their subsidiary banks are extensively regulated under applicable federal and/or state laws and regulations. Statutes, regulations, and policies affecting the banking industry are frequently being reviewed, added to, or changed by Congress, the state legislature, or the federal or state supervisory agencies responsible for the industry's oversight. Changes in the laws, regulations, or policies that impact the Company and Bank cannot always be predicted and may have a material impact on earnings and the manner with which they conduct business.

As a result of the Company's and Bank's 1999 financial performance, the final results of the FDIC and California Department of Financial Institutions' ("DFI") February of 2000 examination of the Bank, and continued concerns regarding the quality of the Bank's loan portfolio, the Bank's Board of Directors passed a resolution to address the concerns. The resolution requires the Bank to: (1) maintain management acceptable to the FDIC and DFI, (2) to seek approval of the agencies prior to appointing any individual as a director or senior officer, (3) continue with the diligent implementation of a previously adopted plan to reduce the level of nonperforming and problem loans and leases, (4) maintain an adequate reserve for loan and lease losses, (5) seek prior approval of the FDIC and DFI before the payment of any cash dividends, and (6) maintain a Tier 1 Leverage ratio of at least 7.5%.

Given Management's expectation for continuing improvement in the Bank's financial condition in 2001, Management intends to recommend to the Bank's Board of Directors to eliminate the resolution's management approval requirement, dividend approval requirement, and capital limitations. Management does not believe that complying with the resolution's limitations will have a material adverse impact on the Bank's operations.

Furthermore, the FDIC and Federal Reserve Bank ("FRB") have notified the Bank and Company, respectively, that the condition of the Bank and Company are such that prior approval of the regulatory agency is necessary before adding or replacing any member of the boards of directors, employing any person as a senior executive officer, or changing the responsibilities of any senior executive officer so that the individual would be assuming a different senior executive officer position. Finally, due to the Bank's condition, the FDIC is also restricting the Company's and Bank's ability to enter into any contracts to pay or make any golden parachute and indemnification payments to

institution-affiliated parties. Given Management's expectation for continuing improvements in the Company's financial condition in 2001, Management believes that the FDIC and FRB will rescind their limitations on the Bank and the Company.

Discussed below are brief summaries of certain laws, regulations, or policies that apply to the operation of bank holding companies and to the banks they own or control. The summaries are qualified in their entirety by reference to the full text of the applicable law, regulation, or policy.

Regulation of the Company

The Company is a registered bank holding company within the meaning of the BHC Act and is subject to the supervision of the FRB. The FRB requires the Company to file quarterly and annual reports and may conduct examinations of the Company and its subsidiaries.

The FRB can require the Company to terminate an activity of, control of, liquidation of, or divestiture of certain subsidiaries or affiliates when the FRB believes that the activity or the control of the subsidiary or affiliate constitutes a significant risk to the financial safety, soundness, or stability of any of its banking subsidiaries. The FRB also has the authority to regulate provisions of certain bank holding company debt, including authority to impose interest ceilings and reserve requirements on such debt. Under certain circumstances, the Company must file a written notice and obtain approval from the FRB prior to the purchase or redemption of its own common stock.

Under the BHC Act, a company generally must obtain the prior approval of the FRB before it exercises a controlling influence over, or acquires directly or indirectly, more than 5% of the voting shares or substantially all of the assets of any bank or bank holding company. The Company is required to obtain the FRB's prior approval before it acquires, merges, or consolidates with any bank or bank holding company. Additionally, any company seeking to acquire, merge, or consolidate with the Company would also be required to obtain the FRB's approval.

The BHC Act generally prohibits the Company from acquiring ownership or control of more than 5% of the voting shares of any company that is not a bank or bank holding company and from engaging directly or indirectly in activities other than banking, managing banks, or providing services to affiliates of the holding company. A bank holding company, with the approval of the FRB, may engage, or acquire the voting shares of companies engaged, in activities that the FRB has determined to be so closely related to banking, managing, or controlling banks as to be a proper incident thereto. A bank holding company must demonstrate that the benefits to the public of the proposed activity will outweigh the possible adverse effects associated with such activity.

Transactions between the Company, the Bank, and any future subsidiaries of the Company are subject to a number of other restrictions. FRB policies forbid the payment by bank subsidiaries of management fees that are unreasonable in amount or exceed the fair market value of the services rendered (or, if no market exists, actual costs plus a reasonable profit). Additionally, a bank holding company and its subsidiaries are prohibited from engaging in certain tie-in arrangements in connection with the extension of credit, sale or lease of property or furnishing of services. Subject to certain limitations, depository institution subsidiaries of bank holding companies may extend credit to, invest in the securities of, purchase assets from, or issue a guarantee, acceptance, or letter of credit on behalf of, an affiliate, provided that the aggregate of such transactions with affiliates may not exceed 10% of the capital stock and surplus of the institution, and the aggregate of such transactions with all affiliates may not exceed 20% of the capital stock and surplus of such institution. The Company may borrow only from depository institution subsidiaries if the loan is secured by marketable obligations with a value of a designated amount in excess of the loan. Further, the Company may not sell a low-quality asset to a depository institution subsidiary.

The FRB requires the Company to maintain certain levels of capital. (See "Capital Standards.") The FRB also has the authority to take enforcement action against any bank holding company that commits any unsafe or unsound practice or violates certain laws, regulations, or conditions imposed in writing by the FRB. (See "Prompt Corrective Action and Other Enforcement Mechanisms.")

Pursuant to FRB regulations, a bank holding company is required to serve as a source of financial and managerial strength to its subsidiary banks and may not conduct its operations in an unsafe or unsound manner. In addition, the FRB has issued a policy that in order to serve as a source of strength to its subsidiary banks, a bank holding company should stand ready to use available resources to provide adequate capital funds to its subsidiary banks during periods of financial stress or adversity and should maintain the financial flexibility and capital-raising capacity to obtain additional resources for assisting its subsidiary banks. A bank holding company's failure to meet its obligations to serve as a source of strength to its subsidiary banks will generally be considered by the FRB to be an unsafe and unsound banking practice or a violation of the FRB's regulations, or both.

The Company is also a bank holding company within the meaning of California Financial Code section 3700. As a result, the Company and its subsidiaries are subject to examination by, and may be required to file reports with, the DFI.

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The Company's securities are registered with the Securities and Exchange Commission under the Securities Exchange Act of 1934 ("the 1934 Act"). As such, the Company is subject to the information, proxy solicitation, insider trading, and other requirements and restrictions of the 1934 Act.

Regulation of the Bank

As a California state chartered bank, the Bank is subject to primary supervision, periodic examination, and regulation by the DFI and the FDIC. Additionally, the Bank is subject to certain regulations promulgated by the FRB.

If the FDIC should determine, as a result of an examination of the Bank, that the Bank's financial condition, capital resources, asset quality, earnings prospects, management, liquidity, or other aspects of the Bank's operations are unsatisfactory or that the Bank or its management is violating, or has violated, any law or regulation, various actions are available to the FDIC to remedy the situation. Such remedies include the power to enjoin "unsafe or unsound" practices, to require affirmative action to correct any conditions resulting from any violation or practice, to issue an administrative order that can be judicially enforced, to direct an increase in capital, to restrict the growth of the Bank, to assess civil monetary penalties, to remove officers and directors and ultimately to terminate the Bank's deposit insurance, which would result in a revocation of the Bank's California charter. The DFI also has many of the same remedial powers.

Various other requirements and restrictions under the laws of California and the United States affect the Bank's operations. State and federal statutes and regulations which relate to many aspects of the Bank's operations include: reserve requirements against deposits, ownership of deposit accounts, interest rates payable on deposits, loans, investments, mergers and acquisitions, borrowings, dividends, locations of branch offices, and capital requirements. Furthermore, the Bank is required to maintain certain levels of capital. (See "Capital Standards.")

Capital Standards

The FRB, FDIC, and other federal banking agencies have risk-based capital adequacy guidelines intended to provide a measure of capital adequacy that reflects the degree of risk associated with a banking organization's operations for both transactions reported on the balance sheet as assets, and transactions, such as letters of credit, unused commitments, and recourse arrangements, which are reported as off balance sheet items. Under these guidelines, nominal dollar amounts of assets and credit equivalent amounts of off balance sheet items are multiplied by one of several risk adjustment percentages, which range from 0% for assets with low credit risk, such as certain U.S. government securities, to 100% for assets with relatively higher credit risk, such as business loans.

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A banking organization's risk-based capital ratios are obtained by dividing its qualifying capital by its total risk-adjusted assets and off balance sheet items. The regulators measure risk-adjusted assets and off balance sheet items against both total qualifying capital (the sum of Tier 1 capital and limited amounts of Tier 2 capital) and Tier 1 capital. Tier 1 capital consists of common stock, retained earnings, noncumulative perpetual preferred stock, and minority interests in certain subsidiaries, less most other intangible assets. Tier 2 capital may consist of a limited amount of the allowance for possible loan and lease losses and certain other instruments with some characteristics of equity. The inclusion of elements of Tier 2 capital are subject to certain other requirements and limitations of the federal banking agencies. Since December 31, 1992, the federal banking agencies have required a minimum ratio of qualifying total capital to risk-adjusted assets and off balance sheet items of 8%, and a minimum ratio of Tier 1 capital to risk-adjusted assets and off balance sheet items of 4%.

In addition to the risk-based guidelines, federal banking regulators require banking organizations to maintain a minimum amount of Tier 1 capital to total average assets, referred to as the leverage ratio. For a banking organization rated in the highest of the five categories used by regulators to rate banking organizations, the minimum leverage ratio of Tier 1 capital to total assets is 3%. It is improbable, however, that an institution with a 3% leverage ratio would receive the highest rating by the regulators since a strong capital position is a significant part of the regulators' rating. For all banking organizations not rated in the highest category, the minimum leverage ratio is at least 100 to 200 basis points above the 3% minimum. Thus, the effective minimum leverage ratio, for all practical purposes, is at least 4% or 5%. In addition to these uniform risk-based capital guidelines and leverage ratios that apply across the industry, the regulators have the discretion to set individual minimum capital requirements for specific institutions at rates significantly above the minimum guidelines and ratios.

The following tables present the capital ratios for the Company and the Bank as of December 31, 2000:

Company		Bank	
Amount	Ratio	Amount	Ratio

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Company

Bank

(Dollars in thousands)

Risk Based Capital Ratios As of December 31, 2000

Tier 1 Capital	\$ 25,683	11.51%	\$ 25,534	11.45%
Tier 1 Capital Minimum Requirement	8,928	4.00%	8,918	4.00%
Excess	\$ 16,755	7.51%	\$ 16,616	7.45%
Total Capital	\$ 28,509	12.77%	\$ 28,357	12.72%
Total Capital Minimum Requirement	17,856	8.00%	17,835	8.00%
Excess	\$ 10,653	4.77%	\$ 10,522	4.72%
Risk-Adjusted Assets	\$ 223,196	\$ 222,939		

Leverage Capital Ratio

Tier 1 Capital to Quarterly Average Total Assets	\$ 25,683	8.49%	\$ 25,534	8.45%
Minimum Leverage Requirement	12,093	4.00%	12,090	4.00%
Excess	\$ 13,590	4.49%	\$ 13,444	4.45%
Total Quarterly Average Assets	\$ 302,336		\$ 302,239	

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Prompt Corrective Action and Other Enforcement Mechanisms

Federal banking agencies possess broad powers to take corrective or other supervisory action to resolve an insured depository institution's problems. Problems that may be addressed through such actions include, but are not limited to, institutions that fall below one or more prescribed minimum capital ratios. Each federal banking agency has promulgated regulations defining the following five categories in which an insured depository institution will be placed, based on its capital ratios: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. At December 31, 2000, the Bank and the Company exceeded all the required ratios for classification as "well capitalized."

An institution that, based upon its capital levels, is classified as well capitalized, adequately capitalized, or undercapitalized may be treated as though it were in the next lower capital category if the appropriate federal banking agency, after notice and opportunity for hearing, determines that an unsafe or unsound condition or an unsafe or unsound practice warrants such treatment. At each successive lower capital category, an insured depository institution is subject to more restrictions. The federal banking agencies, however, may not treat a significantly undercapitalized institution as critically undercapitalized unless its capital ratio actually warrants such treatment.

A bank may fall into the critically undercapitalized category if its "tangible equity" does not exceed 2% of the bank's total assets. Federal guidelines generally define "tangible equity" as a bank's tangible assets less liabilities. Federal regulators may, among other alternatives, require the appointment of a conservator or a receiver for a critically undercapitalized bank. In California, the Commissioner may require the appointment of a conservator or receiver for a state-chartered bank if its tangible equity does not exceed 3% of the bank's total assets, or \$1 million.

In addition to measures taken under the prompt corrective action provisions, banks may be subject to potential enforcement actions by the federal or state regulators for unsafe or unsound practices in conducting their businesses or for violations of any law, rule, regulation, or any condition imposed in writing by the agency or any written agreement with the agency.

Safety and Soundness Standards

The Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA") implemented certain specific restrictions on transactions and required the regulators to adopt overall safety and soundness standards for depository institutions related to internal control, loan underwriting and documentation, and asset growth. Among other things, FDICIA limited the interest rates paid on deposits by undercapitalized institutions, the use of brokered deposits, and the aggregate extension of credit by a depository institution to an executive officer, director, principal stockholder, or related interest, and reduces deposit insurance coverage for deposits offered by undercapitalized institutions for deposits by certain employee benefits accounts.

The federal financial institution agencies published a final rule effective August 9, 1995, implementing safety and soundness standards. The FDICIA added a new section 39 to the Federal Deposit Insurance Act, which required the agencies to establish safety and soundness standards for insured financial institutions covering: (1) internal controls, information systems, and internal audit systems; (2) loan documentation; (3) credit underwriting; (4) interest rate exposure; (5) asset growth; (6) compensation, fees, and benefits; (7) asset quality, earnings, and stock valuation; and (8) excessive compensation for executive officers, directors, or principal shareholders which could lead to material financial loss. The agencies issued the final rules in the form of guidelines that set forth operational and managerial standards relating to: (i) internal controls, information systems, and internal audit systems; (ii) loan documentation; (iii) credit underwriting; (iv) asset growth; (v) earnings; and (vi) compensation, fees, and benefits.

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In addition, the federal banking agencies have also adopted safety and soundness guidelines with respect to asset quality and earnings standards. These guidelines provide six standards for establishing and maintaining a system to identify problem assets and prevent those assets from deteriorating. Under these standards, an insured depository institution should: (i) conduct periodic asset quality reviews to identify problem assets; (ii) estimate the inherent losses in problem assets and establish reserves that are sufficient to absorb estimated losses; (iii) compare problem asset totals to capital; (iv) take appropriate corrective action to resolve problem assets; (v) consider the size and potential risks of material asset concentrations; and (vi) provide periodic asset quality reports with adequate information for management and the board of directors to assess the level of asset risk. These guidelines also set forth standards for evaluating and monitoring earnings and for ensuring that earnings are sufficient for the maintenance of adequate capital and reserves.

If an agency determines that an institution fails to meet any standard established by the guidelines, the agency may require the financial institution to submit to the agency an acceptable plan to achieve compliance with the standard. Should the agency require submission of a compliance plan and the institution fails to timely submit an acceptable plan, within 30 days of a request to do so, or to implement an accepted plan, the agency must require the institution to correct the deficiency. The agencies may elect to initiate enforcement action in certain cases rather than rely on an existing plan, particularly where failure to meet one or more of the standards could threaten the safe and sound operation of the institution.

Restrictions on Dividends and Other Distributions

The power of the board of directors of an insured depository institution to declare a cash dividend or other distribution with respect to capital is subject to statutory and regulatory restrictions that limit the amount available for such distribution depending upon the earnings, financial condition, and cash needs of the institution, as well as general business conditions. FDICIA prohibits insured depository institutions from paying management fees to any controlling persons or, with certain limited exceptions, making capital distributions, including dividends, if, after such transaction, the institution would be undercapitalized.

The FRB has issued a policy statement that a bank holding company should not declare or pay a cash dividend to its stockholders if the dividend would place undue pressure on the capital of its subsidiary banks or if the dividend could be funded only through additional borrowings or other arrangements that might adversely affect the financial position of the bank holding company. Specifically, a bank holding company should not continue its existing rate of cash dividends on its common stock unless its net income is sufficient to fully fund each consistent with its capital needs, asset quality, and overall financial condition. Further, as previously stated, the Company is expected to act as a source of financial strength for each of its subsidiary banks and to commit resources to support each subsidiary bank in circumstances when it might not do so absent such policy.

The Company's ability to pay dividends depends in large part on the ability of the Bank to pay management fees and dividends to the Company. The ability of its subsidiary bank to pay dividends will be subject to restrictions set forth in California banking law and the regulations of the FDIC. As previously stated, due to the Bank's 1999 financial performance and continued concerns regarding the quality of the Bank's loan portfolio, the Bank's Board of Directors passed a resolution which requires the Bank to seek the prior approval of the FDIC and DFI before the payment of any cash dividends. Furthermore, as previously discussed, given Management's expectation for continuing improvement in the Bank's financial condition in 2001, Management intends to recommend to the Bank's Board of Directors to eliminate the resolution's dividend approval requirement.

Under California Financial Code section 642, funds available for cash dividend payments by a bank are restricted to the lesser of: (i) retained earnings; or (ii) the bank's net income for its three fiscal

years (less any distributions to stockholders made during such period). However, with the prior approval of the California Superintendent of Banks, California Financial Code section 643 provides that a bank may pay cash dividends in an amount not to exceed the greater of: (1) the retained earnings of the bank; (2) the net income of the bank for its last fiscal year; or (3) the net income of the bank for its current fiscal year. However, if the Superintendent finds that the stockholders' equity of the bank is not adequate or that the payment of a dividend would be unsafe or unsound, the Superintendent may order such bank not to pay a dividend to stockholders.

Additionally, under FDICIA a bank may not make any capital distribution, including the payment of dividends, if, after making such distribution, the bank would be in any of the "under-capitalized" categories under the FDIC's Prompt Corrective Action regulations.

Also, under the Financial Institution's Supervisory Act, the FDIC has the authority to prohibit a bank from engaging in business practices that the FDIC considers unsafe or unsound. It is possible, depending upon the financial condition of a bank and other factors, that the FDIC could assert that the payment of dividends or other payments in some circumstances might be such an unsafe or unsound practice and thereby prohibit such payment.

Finally, the Bank is subject to certain restrictions imposed by federal law on any extensions of credit to, or the issuance of a guarantee or letter of credit on behalf of, the Company or other affiliates, the purchase of, or investments in, stock or other securities thereof, the taking of such securities as collateral for loans, and the purchase of assets of the Company or other affiliates. Such restrictions prevent the Company and such other affiliates from borrowing from the Bank unless the loans are secured by marketable obligations of designated amounts. Further, such secured loans and investments by the Bank to or in the Company or to or in any other affiliate are limited, individually, to 10% of the Bank's capital and surplus (as defined by federal regulations), and such secured loans and investments are limited, in the aggregate, to 20% of the Bank's capital and surplus (as defined by federal regulations). California law also imposes certain restrictions with respect to transactions involving the Company and other controlling persons of the Bank. Additional restrictions on transactions with affiliates may be imposed on the Bank under the prompt corrective action provisions of federal law.

Interstate Banking and Branching

On September 29, 1994, the Reigle/Neal Interstate Banking and Branching Efficiency Act of 1994 (the "Interstate Act") was signed into law, effectively permitting nationwide banking. The Interstate Act provides that adequately capitalized and adequately managed bank holding companies may acquire banks in any state, even in those jurisdictions that currently bar acquisition by out-of-state institutions, subject to deposit concentration limits. The deposit concentration limits provide that regulatory approval by the FRB may not be granted for a proposed interstate acquisition if, after the acquisition, the acquirer on a consolidated basis would control more than 10% of the total deposits nationwide or would control more than 30% of deposits in the state where the acquiring institution is located. The deposit concentration state limit does not apply for initial acquisitions in a state and, in every case, may be waived by the state regulatory authority. Interstate acquisitions are subject to compliance with the Community Reinvestment Act (the "CRA"). States are permitted to impose age requirements not to exceed five years on target banks for interstate acquisitions.

Branching between states may be accomplished either by merging separate banks located in different states into one legal entity, or by establishing new branches in another state. Interstate branching is also subject to a 30% statewide deposit concentration limit on a consolidated basis and a 10% nationwide deposit concentration limit. The laws of the host state regarding community reinvestment, fair lending, consumer protection (including usury limits), and establishment of branches shall apply to the interstate branches.

The opening of a new branch by an out-of-state bank is not permitted unless the host state expressly permits such an opening. The establishment of an initial new branch in a state is subject to the same conditions as apply to initial acquisition of a bank in the host state, other than the deposit concentration limits.

The Interstate Act permits bank subsidiaries of a bank holding company to act as agents for affiliated depository institutions in receiving deposits, renewing time deposits, closing loans, servicing loans, and receiving payments on loans and other obligations. When acting as agent for an affiliate, a bank shall not be considered a branch of the affiliate. Any agency relationship between affiliates must be on terms that are consistent with safe and sound banking practices. The authority for an agency relationship for receiving deposits includes the taking of deposits for an existing account, but is not meant to include the opening or origination of new deposit accounts. Subject to certain conditions, insured

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savings associations that were affiliated with banks as of June 1, 1994 may act as agents for such banks. An affiliate bank or savings association may not conduct any activity as an agent which it is prohibited from conducting as a principal.

If an interstate bank decides to close a branch located in a low or moderate income area, it must comply with additional branch closing notice requirements. The appropriate regulatory agency is authorized to consult with community organizations to explore options to maintain banking services in the affected community where the branch is to be closed.

To ensure that interstate branching does not result in taking deposits without regard to a community's credit needs, the regulatory agencies have implemented regulations prohibiting interstate branches from being used as "deposit production offices." The regulations include a provision to the effect that if loans made by an interstate branch are less than 50% of the average of all depository institutions in the state, then the regulator must review the loan portfolio of the branch. If the regulator determines that the branch is not meeting the credit needs of the community, it has the authority to close the branch and to prohibit the bank from opening new branches in the state.

The Caldera, Weggeland and Killea California Interstate Banking and Branching Act of 1995 (the "Caldera Act"), effective October 2, 1995, amends the California Financial Code to, among other matters, regulate the operations of state banks to eliminate conflicts with and to implement the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 discussed above. The Caldera Act includes: (1) an election to permit early interstate merger transactions; (2) a prohibition against interstate branching through the acquisition of a branch business unit located in California without acquisition of the whole business unit of the California bank; and (3) a prohibition against interstate branching through de novo establishment of California branch offices. The Caldera Act mandates that initial entry into California by an out-of-state institution be accomplished by acquisition of or merger with an existing whole bank that has been in existence for at least five years.

Community Reinvestment Act

The Bank is subject to the fair lending requirements and reporting obligations involving home mortgage lending operations and CRA activities. The CRA generally requires the federal banking agencies to evaluate the record of a financial institution in meeting the credit needs of its local communities, including low and moderate income neighborhoods. A bank may be subject to substantial penalties and corrective measures for a violation of certain fair lending laws. The federal banking agencies may take compliance with such laws and CRA obligations into account when regulating and supervising other activities.

A Bank's compliance with its CRA obligations is based on a performance- based evaluation system, which bases CRA ratings on the institution's lending service and investment performance. When a bank holding company applies for approval to acquire a bank or other bank holding company, the FRB will review the assessment of each subsidiary bank of the applicant bank holding company, and such records

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may be the basis for denying the application. Based on an examination conducted in the first quarter of 1999, the Bank was rated satisfactory in complying with its CRA obligations.

Deposit Insurance Premiums

The Bank's deposit accounts are insured by the FDIC's Bank Insurance Fund ("BIF") to the maximum permitted by law. This deposit insurance may be terminated by the FDIC upon a finding that the institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, rule, order, or condition imposed by the FDIC or the institution's primary regulator.

The FDIC charges an annual assessment for the insurance of deposits. As of December 31, 2000, the assessment ranged from 0 to 27 basis points per \$100 of insured deposits, based on the risk a particular institution poses to its deposit insurance fund. The risk classification is based on an institution's capital group and supervisory subgroup assignment.

Pursuant to the Economic Growth and Paperwork Reduction Act of 1996 ("EGPRA"), at January 1, 1997, the Bank began paying, in addition to its normal deposit insurance premium as a member of the BIF, an amount equal to approximately 1.2 basis points per \$100 of insured deposits toward the retirement of the Financing Corporation Bonds ("FICO Bonds") issued in the 1980s to assist in the recovery of the savings and loan industry. Members of the Savings Association Insurance Fund ("SAIF"), by contrast, pay, in addition to their normal deposit insurance premium, approximately 5.8 basis points. Under the EGPRA, the FDIC is not permitted to establish SAIF assessment rates that are lower than comparable BIF assessment rates. Beginning no later than January 1, 2000, the rate paid to retire the FICO Bonds will be equal for members of the BIF and the SAIF.

Asset Conservation, Lender Liability, and Deposit Insurance Protection Act of 1996

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Environmental Protection Agency regulations excluding financial institutions from liability for the clean up of toxic materials on property held as collateral for loans were overturned by the federal courts. Due to concerns expressed by interested parties (owners, realtors, and lenders), Congress passed amendments to the Comprehensive Environmental Response, Compensation and Liability Act of 1980 ("CERCLA") to reinstate certain safeguards for fiduciaries and lenders. A bank or other party acting as a fiduciary may hold property in such capacity and shall have no liability for the release or threatened release of a hazardous substance in excess of the value of the property held in a fiduciary capacity. For example, a bank acting as trustee under the terms of a written trust agreement will not have any liability in excess of the actual value of the assets in that particular trust. The assets of the Bank will not be at risk for a release occurring on property belonging to the trust. This amendment does not limit the liability of the fiduciary to private parties that may have a cause of action outside the scope of CERCLA. "Fiduciary," as used in CERCLA, includes trustees, executors, administrators, custodians, guardians, receivers, conservators, and personal representatives.

The amendments to CERCLA include changes in the definitions contained in 42 U.S.C. section 9601(20), entitled "Definitions." A major change in the definition of "Owner" or "Operator" has the effect of limiting the liability of a financial institution that does not participate in management of an environmentally impaired property. Section 9607 of CERCLA states that owners and operators of a vessel or facility are liable for damages arising out of discharge of a hazardous substance on property. The amendment specifically states that a financial institution holding a deed of trust on real property that does not participate in the management of the operations carried out on the property is not an owner or an operator under the statute. The amendments further state that a financial institution that forecloses on such property does not incur liability simply by the act of foreclosing on the property or through the subsequent sale of the property to a third party.

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Financial Modernization Act

President Clinton signed into law the Gramm-Leach-Bliley Act of 1999 (the "Financial Modernization Act") on November 12, 1999. The Financial Modernization Act generally accomplishes the following:

- (1) Facilitates the affiliation of commercial banks with security firms, insurance companies and other financial service providers by: repealing restrictions on affiliation contained in the Glass-Steagall Act; expressly preempting any state law restrictions on affiliation; and by eliminating the BHC Act's prohibition on insurance underwriting activities.
- (2) Substantially modifies and expands the BHC Act to permit bank holding companies to engage in a full range of "financial activities" through a new entity known as a "Financial Holding Company". "Financial activities" is broadly defined to include not only banking, insurance, and securities activities, but also merchant banking, real estate development and additional activities that the Federal Reserve, in consultation with the Secretary of the Treasury, determines to be financial in nature, incidental to financial activities, or complementary activities that do not pose a substantial risk to the safety and soundness of depository institutions or the financial system.
- (3) Sets forth a systematic structure for the functional regulation of banks, savings institutions, holding companies and their activities.
- (4) Provides enhanced protections for the privacy rights of consumer information.
- (5) Adopts provisions to modernize the Federal Home Loan Bank system including provisions relating to the capitalization, membership and corporate governance.
- (6) Revises the laws that implement CRA.
- (7) Amends the Federal Deposit Insurance Act regarding the governance of subsidiaries of state banks that engage in "activities as principal that would only be permissible" for a national bank to conduct in a financial subsidiary. The amendment expressly preserves a state bank's ability to retain all existing subsidiaries. And;
- (8) Addresses a wide range of other legal and regulatory issues affecting financial institutions operations and activities.

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The Company has not determined whether it will seek an election to become a Financial Holding Company. The Board and Management are evaluating the benefits to determine whether the Company desires to utilize any of the Financial Modernization Act's expanded powers. Since California permits state chartered commercial banks to engage in any activity permissible for national banks, the Bank should be allowed to form subsidiaries to engage in the activities authorized by the Financial Modernization Act, to the same extent as a national bank.

The Company does not believe that the Financial Modernization Act will have a material adverse effect on its operations in the near future. However, some commentators have projected that in the long term the Financial Modernization Act's enactment may result in further consolidation of and increased competition in the financial services industry.

Proposed Legislation

Periodically, legislation is enacted and regulations are promulgated which have the effect of increasing the cost of doing business, limiting or expanding permissible activities, or affecting the competitive balance between banks and other financial services providers. It is likely that additional legislation will be introduced in Congress or in state legislatures in the future which may impact the Company's business. It cannot be predicted whether or in what form any of these proposals will be

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taken or adopted, or the extent to which the present or future business of the Company or the Bank may be affected.

IMPACT OF MONETARY POLICIES

Banking is a business that depends on interest rate differentials. In general, the difference between the interest paid by a bank on its deposits and other borrowings and the interest rate earned by a bank on loans, securities, and other interest-earning assets comprises the major source of a bank's earnings. Thus, the earnings and growth of banks are subject to the influence of economic conditions generally, both domestic and foreign, and also to the monetary and fiscal policies of the United States and its agencies, particularly the FRB. The FRB implements national monetary policy, such as seeking to curb inflation and combat recession, by its open-market dealings in United States government securities, by adjusting the required level of reserves for financial institutions subject to reserve requirements and through adjustments to the discount rate applicable to borrowings by banks that are members of the FRB. The actions of the FRB in these areas influence the growth of bank loans, investments, and deposits and also affect interest rates. The nature and timing of any future changes in such policies and their impact on the Bank cannot be predicted. In addition, adverse economic conditions could make a higher provision for loan losses a prudent course and could cause higher loan loss charge-offs, thus adversely affecting a bank's net earnings.

ACCOUNTING PRONOUNCEMENTS

SFAS No. 131 "Disclosures About Segments of an Enterprise and Related Information"

SFAS No. 131 establishes standards for public business enterprises' reporting of information about operating segments in annual financial statements. The Statement requires that the enterprises report selected information concerning operating segments in interim financial reports issued to shareholders. Additionally, the Statement establishes requirements for related disclosures about products, services, geographic areas, and major customers.

SFAS No. 131 requires public business enterprises to report a measure of segment profit or loss, certain specific revenue and expense items, and segment assets. The Statement further requires reconciliation of total segment revenues, total segment profit or loss, total segment assets, and other amounts disclosed for segments to corresponding amounts in the enterprise's general purpose financial statements. It requires that all public business enterprises report information about the revenues derived from the enterprise's products or services (or groups of similar products and services), about the countries in which the enterprise earns revenues and holds assets, and about major customers regardless of whether that information is used in making operating decisions. However, SFAS No. 131 does not require an enterprise to report information that is not prepared for internal use if reporting it would be impracticable. SFAS No. 131 is effective for financial statements for periods beginning after December 15, 1997.

The Company has adopted SFAS No. 131. The adoption of the applicable provisions did not have a material effect on the Company, as Management believes that it operates only in one segment the commercial banking segment.

SFAS No. 133 "Accounting for Derivative Instruments and Hedging Activities"

In June 1998, the FASB issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 133 establishes accounting and reporting standards for derivative instruments and for hedging activities. It requires recognition of all derivatives as either assets

or liabilities in the statement of financial condition and the measurement of those instruments at fair value. Recognition of changes in fair value will be recognized into income or as a component of other comprehensive income depending upon the type of the derivative and its related hedge, if any. As issued, SFAS No. 133 was to

be effective for the Company beginning January 1, 2000. However, in July 1999, the FASB issued Statement No. 137, "Accounting for Derivative Instruments and Hedging Activities-Deferral of the Effective Date of FASB Statement No. 133," extending the effective date to fiscal years beginning after June 15, 2000. In June 2000, the FASB issued SFAS No. 138 "Accounting for Certain Derivative Instruments and Certain Hedging Activities", to provide guidance in the implementation of certain issues related to SFAS No. 133. The Company does not expect that the implementation of these Statements will have a material impact on its financials statements.

SFAS No. 140 "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities "

In September of 2000, the FASB issued SFAS No. 140 "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, a replacement of FASB Statement No. 125" ("SFAS No. 140"). This statement replaces SFAS No. 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." SFAS No. 140 revises the standard for accounting for securitizations and other transfers of financial assets and collateral and requires certain disclosures, but it carries over most of SFAS's No. 125's provisions without reconsideration. The Company has adopted the disclosure provisions related to the securitization of financial assets. All transactions entered into after the first quarter of 2001 will be accounted for in accordance with SFAS No. 140. This adoption is not expected to have a material impact on the Company.

End to Pooling-of-Interests Accounting for Business Combinations

In April 1999, FASB announced its tentative decision to no longer deem the pooling-of-interests method of accounting as an acceptable method to account for business combinations between independent parties. The FASB has published a proposed Statement and expects a final Statement will be issued by the end of June 2001. A portion of the Company's business strategy may involve the pursuit of appropriate acquisition opportunities so as to expand its market presence. A change in the accounting for business combinations could have a negative impact on the Company's ability to realize those business strategies.

YEAR 2000 COMPLIANCE

The Company's systems responded successfully to the century date change. The Company will continue to monitor its systems and those of its vendors and suppliers over the coming months. (For a further discussion of the Company's and the Bank's efforts regarding "Year 2000" compliance, see "ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS AND RESULTS OF OPERATIONS.")

OTHER INFORMATION

There has been no material effect upon the Bank's capital expenditures, earnings, or competitive position as a result of federal, state, or local provisions regarding the discharge of materials into the environment.

ITEM 2. PROPERTIES

The Bank currently conducts its banking operations from an administrative office, seven branch offices, and one loan production office ("LPO"). On July 21, 2000, the Bank received approval from the FDIC to establish a branch in Lincoln, California. Approval was also granted by the DFI on July 3, 2000. It is anticipated that the new branch will open during the first half of 2001. On October 18, 2000, the Bank entered into an agreement to lease a 1,200 square foot office space located at 435 South Highway 65, Suite A in Lincoln, California. The term of this lease is five years with rent payments of \$2,340 per month for the first twenty-four (24) months. Thereafter monthly lease payments are subject to annual adjustments pursuant to the lease agreement that is attached as exhibit 10.28.

The Bank's principal branch office in Yuba City, California, is located at 777 Colusa Avenue in a modern, single-story, shopping center end building, which has drive-up windows and off-street parking for its customers. This office was opened in 1982 and has a total square footage of 9,122.

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In 1991, the Bank purchased a 3,694 square foot building located at 1005 Stafford Way, Yuba City, California, located directly behind its main branch. This building housed the Bank's note department until March 2000. This vacant building is currently in escrow and scheduled to close at the end of the first quarter of 2001.

The Bank purchased land for the Bank's office at 1221 Bridge Street, Yuba City, California, in 1978. In 1991, the Bank purchased a combined 14,972 square foot retail and office building with parking located at 1227 Bridge Street, adjacent to the Bank's Bridge Street branch. Currently, the Company's headquarters, the Bank's Data Center, and the Bank's administrative and financial consulting service offices are located in this building.

The Bank's Marysville office is located at 700 "E" Street in Marysville, California. The Bank purchased this 3,702 square foot building, which was a branch of another bank, in September 1995.

The Bank's Colusa branch office is located at 655 Fremont Street in a 2,819 square foot office building that was converted to banking quarters. The Bank owns the land and premises for the branch.

In 1985, the Bank purchased a 5,306 square foot premises for its Arbuckle office located at the corner of Amanda and Sixth Streets. The Bank moved its Arbuckle office to this location in June 1986. The Bank leases 1,800 square feet plus a common area of these premises to an unaffiliated party.

In 1993, the Bank purchased a 4,427 square foot building that is now the location of its Woodland, California, branch office located at 203 Main Street. This was formerly the site of a branch of another bank.

The Bank leased the land and a module on the property located at 114 "D" Street, Wheatland, California, from March 1997 until April 1998 for its Wheatland branch office. In April 1998, the Bank entered a new lease for the same site together with a new freestanding building. The 2,831 square foot building was completed on September 21, 1998, at which time the Bank relocated from the previously leased module. The term of the lease is 10 years with the option to extend the original term of this lease for two periods of five years each. The monthly lease payment is \$2,797 and is subject to annual adjustments on the anniversary of the lease commencement date.

The Bank moved its Citrus Heights LPO to a new office in Roseville in December 2000. The Bank entered into an agreement on July 26, 2000, to lease 3,816 square feet of office space at 1552 Eureka Road in Roseville. The term of this lease is sixty-two (62) months. Commencing on October 1, 2000, lease payments of \$6,296 per month are required continuing through the twenty sixth (26) month. Between months twenty-six (26) and fifty (50), rent will be \$6,678 per month. Thereafter, the monthly payment rises to \$7,060 through the end of the lease term.

On December 2, 1996, the Bank purchased a former bank branch located at 995 Tharp Road in Yuba City, California. The Bank's Note Department and Special Assets Department are located at this facility.

Rental expense for all premises leased by the Company totaled \$53,004 for the year ended December 31, 2000. It is estimated that rental expense for leased premises will be approximately \$111,742 for 2001.

ITEM 3. LEGAL PROCEEDINGS

Other than routine litigation incidental to the ordinary course of the Company and Bank's business, neither entity is a party to any material legal proceedings nor is any of their property the subject of any such proceeding. The Company believes that the ultimate disposition of all currently pending matters will not have a material adverse affect on the Company's financial condition or the results of its operations.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON STOCK AND RELATED STOCKHOLDER MATTERS

The Company's common stock is trading on the NASDAQ Stock Market under the trading symbol "CIBN." The Company's common stock began trading on the NASDAQ Stock Market on July 31, 1996. Prior to that time, the Company's common stock was listed on the NASDAQ Bulletin Board and was the subject of limited trading.

The following table presents the high and low closing sale prices of the Company's common stock for each quarterly period for the last two years as reported by the NASDAQ Stock Market:

RANGE OF STOCK PRICES

2000 Quarters	High	Low
4 th	\$ 21.63	\$ 19.00
3 rd	\$ 22.02	\$ 17.86
2 nd	\$ 24.05	\$ 15.24
1 st	\$ 17.14	\$ 12.02
1999 Quarters	High	Low
4 th	\$ 17.86	\$ 15.24
3 rd	\$ 21.32	\$ 16.07
2 nd	\$ 19.05	\$ 17.69
1 st	\$ 21.32	\$ 16.33

Cash dividends paid on the Company's common stock were \$0.44 per share for the year ending December 31, 2000, and \$0.42 per share for the year ending December 31, 1999.

It is currently the intention of the Board of Directors of the Company to pay cash dividends on a quarterly basis. However, there is no assurance that cash dividends will be paid in the future as the Company's ability to pay dividends is dependent upon the earnings, financial condition, and capital requirements of the Company and the Bank, as well as legal and regulatory requirements.

Federal and State banking and corporate laws could limit the Bank's ability to pay dividends to the Company. The Bank has issued a policy statement that a bank holding company should not declare or pay a cash dividend to its shareholders if the dividend would place undue pressure on the capital of its subsidiary banks or if the dividend could be funded only through additional borrowings or other arrangements that may adversely affect the financial position of the Company. In addition, a bank holding company may not continue its existing rate of cash dividends on its common stock unless its net income is sufficient to fully fund each dividend, and its prospective rate of earnings retention is

sufficient to fully fund each dividend and appears consistent with its capital needs, asset quality, and overall financial condition.

Due to the Bank's 1999 financial performance and continued concerns regarding the quality of the Bank's loan portfolio, the Bank's Board of Directors passed a resolution which requires the Bank to seek the prior approval of the FDIC and DFI before the payment of any cash dividends. As previously discussed, given Management's expectation for continuing improvement in the Bank's financial condition in 2001, Management intends to recommend to the Bank's Board of Directors to eliminate the resolution's dividend approval requirement.

As of February 28, 2001, there were 1,683 holders of record of the Company's common stock.

ITEM 6. SELECTED FINANCIAL DATA

For the "Selected Financial Data," see page 3 of the Company's 2000 Annual Report to the Shareholders, which is incorporated herein by reference.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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For the "Management's Discussion and Analysis of Financial Condition and Results of Operations," see pages 9-28 of the Company's 2000 Annual Report to Shareholders, which is incorporated herein by reference.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

For the discussion of "Quantitative and Qualitative Disclosures About Market Risk," see section titled "Interest Rate Sensitivity" at pages 24-26 of the Company's 2000 Annual Report to the Shareholders, which is incorporated herein by reference.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

For "Financial Statements and Supplemental Data," see pages 29-51 of the Company's 2000 Annual Report to the Shareholders, which is incorporated herein by reference.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

For information concerning directors and executive officers of the Company, see "ELECTION OF DIRECTORS" and "Compliance with Section 16(a) of the Securities Exchange Act of 1934" in the definitive Proxy Statement for the Company's 2001 Annual Meeting of Shareholders to be filed pursuant to Regulation 14A (the "Proxy Statement"), which is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION

For information concerning executive compensation, see "EXECUTIVE COMPENSATION" in the Proxy Statement, which is incorporated herein by reference.

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ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

For information concerning security ownership of certain beneficial owners and management, see "Security Ownership of Certain Beneficial Owners and Management" and "Election of Directors" in the Proxy Statement, which is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

For information concerning certain relationships and related transactions, see "Indebtedness of Management and Other Transactions" in the Proxy Statement, which is incorporated herein by reference.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

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Signature	Title	Date
/s/ WILLIAM H. GILBERT	Director	March 20, 2001
WILLIAM H. GILBERT		
/s/ LARRY D. HARTWIG	President, Chief Executive Officer and Director	March 20, 2001
LARRY D. HARTWIG		
/s/ JOHN I. JELAVICH	Director	March 20, 2001
JOHN I. JELAVICH		
/s/ DONALD H. LIVINGSTONE	Director	March 20, 2001
DONALD H. LIVINGSTONE		
	23	
/s/ ALFRED G. MONTNA	Director	March 20, 2001
ALFRED G. MONTNA		
/s/ DAVID A. OFFUTT	Chairman of the Board of Directors, and Director	March 20, 2001
DAVID A. OFFUTT		
/s/ WILLIAM K. RETZER	Director	March 20, 2001
WILLIAM K. RETZER		
/s/ MICHAEL C. WHEELER	Director	March 20, 2001
MICHAEL C. WHEELER		
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INDEX TO EXHIBITS

Exhibit No.

- 2.1 Plan of Reorganization and Merger Agreement dated January 30, 1995 by and between Feather River State Bank, FRSB Merger Company and California Independent Bancorp. Filed as Exhibit 2.1 to the Company's General Form for Registration of Securities on Form 10 (File No. 0-26552).*
- 3.1 Secretary's Compiled, Amended and Restated Articles of Incorporation for California Independent Bancorp as of April 26, 1999. Filed as Exhibit 3.1 to the Company's Quarterly Report filed on Form 10Q for the period ended March 31, 1999.*
- 3.2 Secretary's Compiled, Amended and Restated Bylaws of California Independent Bancorp as of September 30, 1999. Filed as Exhibit 3.2 to the Company's Quarterly Report filed on Form 10Q for the period ended September 30, 1999.*

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Exhibit No.

- 10.1 Salary Continuation Agreement dated April 28, 1993 with Annette Dier Bertolini. Filed as Exhibit 10.1 to the Company's General Form for Registration of Securities on Form 10 (File No. 0-26552).*
- 10.2 Consolidated Agreement dated April 30, 1993 with Unisys Corporation. Filed as Exhibit 10.3 to the Company's General Form for Registration of Securities on Form 10 (File No. 0-26552).*
- 10.3 Agreements with Information Technologies, Inc. Filed as Exhibit 10.4 to the Company's General Form for Registration of Securities on Form 10 (File No. 0-26552).*
- 10.4 Deferred Compensation Agreement dated July 19, 1994 with William H. Gilbert. Filed as Exhibit 10.6 to the Company's General Form for Registration of Securities on Form 10 (File No. 0-26552).*
- 10.5 Feather River State Bank Employee Ownership Plan. Filed as Exhibit 10.7 to the Company's General Form for Registration of Securities on Form 10 (File No. 0-26552).*
- 10.6 Bank Affiliate Agreement between Feather River State Bank and London Pacific Securities, Inc., formerly know as Select Advisors, Inc. Filed as Exhibit 10.8 to the Company's General Form for Registration of Securities on Form 10 (File No. 0-26552).*
- 10.7 California Independent Bancorp 1989 Amended and Restated Stock Option Plan including related Incentive and Non Statutory Stock Option Agreements. Filed as Exhibit 4 to Amendment No. 1 to the Company's Registration Statement on Form S-8/SEC Registration No. 333-09813 dated November 26, 1996.*
- 10.8 California Independent Bancorp 1996 Stock Option Plan and related Incentive Stock Option and Nonstatutory Stock Option Agreements. Filed as Exhibit to Amendment No. 1 to the Company's Form S-8/SEC Registration No. 333-09823 dated November 26, 1996.*
- 10.9 Lease by and between Raj J. Sharma and Feather River State Bank for 114 D Street, Wheatland, California. Filed as Exhibit 10.16 to the Company's Form 10-K for December 31, 1998.*
- 10.10 Severance Agreement between California Independent Bancorp, Feather River State Bank and Robert J. Mulder dated May 25, 1999. Filed as Exhibit 10.19 to the Company's Form 10-Q for June 30, 1999.*

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- 10.11 Director Deferred Fee Agreement between Feather River State Bank and David A. Offutt dated April 1, 1999. Filed as Exhibit 10.20 to the Company's Form 10-Q for September 30, 1999.*
- 10.12 Employment Agreement between California Independent Bancorp, Feather River State Bank and Larry D. Hartwig dated July 19, 1999. Filed as Exhibit 10.21 to the Company's Form 10-Q for September 30, 1999.*
- 10.13 Nonqualified Stock Option Agreement between California Independent Bancorp and Larry D. Hartwig dated July 19, 1999. Filed as Exhibit 10.22 to the Company's Form 10-Q for September 30, 1999.*
- 10.14 Executive Salary Continuation Agreement between Feather River State Bank and Blaine C. Lauhon dated May 7, 1999. Filed as Exhibit 10.23 to the Company's Form 10-Q for September 30, 1999.*
- 10.15 Executive Salary Continuation Agreement between Feather River State Bank and Larry D. Hartwig dated October 27, 1999. Filed as Exhibit 10.19 to the Company's Form 10-K for December 31, 1999.*
- 10.16 Promissory Note, Loan Agreement and Annual Contribution Agreement dated May 11, 2000, by and between Feather River State Bank Employee Stock Ownership Plan and Trust and United ComServe. Filed as Exhibit 10.21 to the Company's Form 10-Q for June 30, 2000.*
- 10.17 California Independent Bancorp Revised 2000 Equity Incentive Plan. Filed as Exhibit 10.22 to the Company's Form 10-Q for September 30, 2000.*

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- 10.18 California Independent Bancorp 2000 Equity Incentive Plan Form Nonqualifying Stock Option Agreement. Filed as Exhibit 10.23 to the Company's Form 10-Q for September 30, 2000.*
- 10.19 California Independent Bancorp 2000 Equity Incentive Plan Form Nonqualifying Stock Option Exercise Agreement. Filed as Exhibit 10.24 to the Company's Form 10-Q for September 30, 2000.*
- 10.20 California Independent Bancorp 2000 Equity Incentive Plan Form Incentive Stock Option Agreement. Filed as Exhibit 10.25 to the Company's Form 10-Q for September 30, 2000.*
- 10.21 California Independent Bancorp 2000 Equity Incentive Plan Form Incentive Stock Option Exercise Agreement. Filed as Exhibit 10.26 to the Company's Form 10-Q for September 30, 2000.*
- 10.22 Severance Agreement and Release of Claims dated August 11, 2000 between Feather River State Bank and Annette Bertolini. Filed as Exhibit 10.27 to the Company's Form 10-Q for September 30, 2000.*
- 10.23 Consulting Agreement dated July 5, 2000 between Feather River State Bank and Annette Bertolini. Filed as Exhibit 10.28 to the Company's Form 10-Q for September 30, 2000.*
- 10.24 Lease by and between Eureka Corporate Plaza, Ltd., L.P. and Feather River State Bank, for the premises at 1552 Eureka Road, Roseville, California. Filed as Exhibit 10.29 to the Company's Form 10-Q for September 30, 2000.*

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- 10.25 Pursuant to the 2000 Equity Incentive Plan as referenced in Exhibit 10.22, to the Company's Form 10-Q for September 30, 2000, Nonqualifying Stock Options amounting to 825 shares at \$20.75 per share were granted to non-employee directors on September 19, 2000. The options vest 20% after twelve months and 20% each year thereafter. Such options terminate September 19, 2010. The following Directors were granted shares under these terms: John Dowdell, Harold Eastridge, William Gilbert, John Jelavich, Don Livingstone, Alfred Montna, David Offutt, William Retzer, Ross Scott and Michael Wheeler. Each Director has entered into Nonqualifying Stock Option Agreements with the Company in the form attached as Exhibit 10.23 to the Company's Form 10-Q for September 30, 2000.*
- 10.26 Pursuant to the 2000 Equity Incentive Plan as referenced in Exhibit 10.22, to the Company's Form 10-Q for September 30, 2000, Nonqualifying Stock Options amounting to 10,000 shares were granted at \$22.62 per share on July 18, 2000, to Robert Lampert, Executive Vice President/Chief Operating Officer of the Bank. The options vest 20% after twelve months and 20% each year thereafter. Such options terminate July 18, 2010. Mr. Lampert has entered into a Nonqualifying Stock Option Agreement with the Company in the form attached as Exhibit 10.23 to the Company's Form 10-Q for September 30, 2000, to the Company's Form 10-Q for September 30, 2000.*
- 10.27 Pursuant to the 2000 Equity Incentive Plan as referenced in Exhibit 10.25, to the Company's Form 10-Q for September 30, 2000, Incentive Stock Options were granted to the following executive and senior officers of the Bank. The options were granted on September 19, 2000 at \$20.75 per share. The options vest 20% after twelve months and 20% each year thereafter. Such options terminate September 19, 2010. Each officer has entered into an Incentive Stock Option Agreement with the Company in the form attached as Exhibit 10.25 to the Company's Form 10-Q for September 30, 2000.*
- | | |
|---|---------------|
| Larry Hartwig, President/CEO | 15,000 shares |
| Robert Lampert, Chief Operating Officer | 5,000 shares |
| Blaine Lauhon, Chief Lending Officer | 4,000 shares |
| Kenneth Anderson, Marketing & Branch Services Officer | 4,000 shares |
| Douglas Marr, Chief Credit Officer | 5,000 shares |
| Don McDonel, Senior Loan Officer | 5,000 shares |
- 10.28 Lease for a branch office at 435 South Highway 65, Suite A, Lincoln, California, entered into between Lincoln Town Center, LLC and Feather River State Bank on December 1, 2000.
- 10.29 Lease Servicing Agreement dated May 26, 2000, by and among Bancorp Financial Services, Inc., as the Servicer, and EPI Leasing Company Inc., a subsidiary of Feather River State Bank as the Originator.
- 13 California Independent Bancorp's 2000 Annual Report to Shareholders. (Deemed filed only with respect to those sections which have been incorporated into this Form 10-K by reference.)
- 21 Feather River State Bank, a California banking corporation, is the only subsidiary of Registrant.

*

Document incorporated herein by reference.

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QuickLinks

DOCUMENTS INCORPORATED BY REFERENCE

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PART IV

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SIGNATURES

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