

California Independent Bankers

20th Annual Community Bank Conference

September 21, 2010

**William S. Haraf, Commissioner
Department of Financial Institutions**

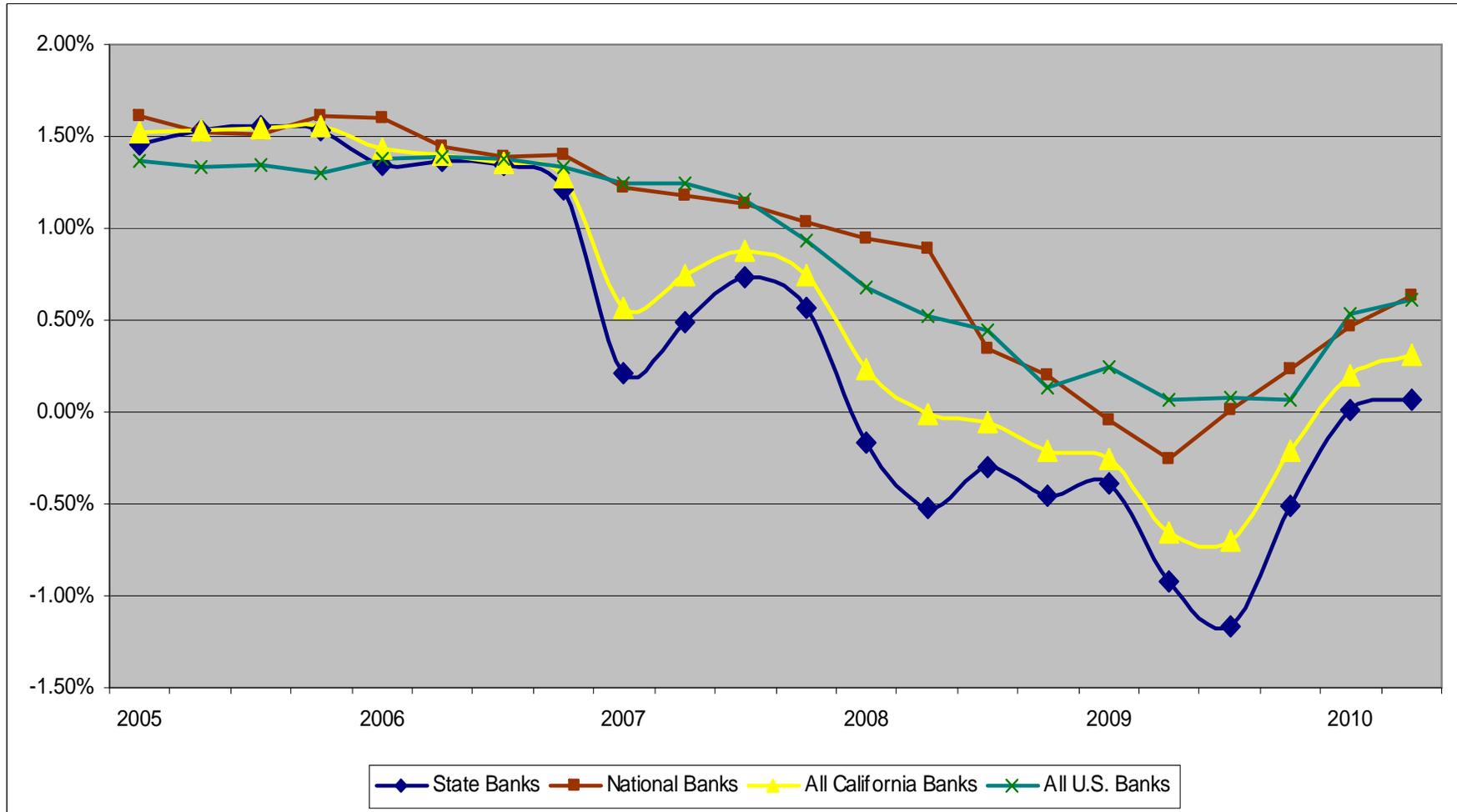
Topics for Discussion

- Update on Condition of the Industry
- Observations on the Outlook for the Economy & Community Banking
- A Lesson Learned about Bank Supervision

State / National Bank Comparison

Return on Assets

Annualized



Return on Assets by Quintile*

State Chartered Commercial and Industrial Banks

Annualized year-to-date through June 30, 2010

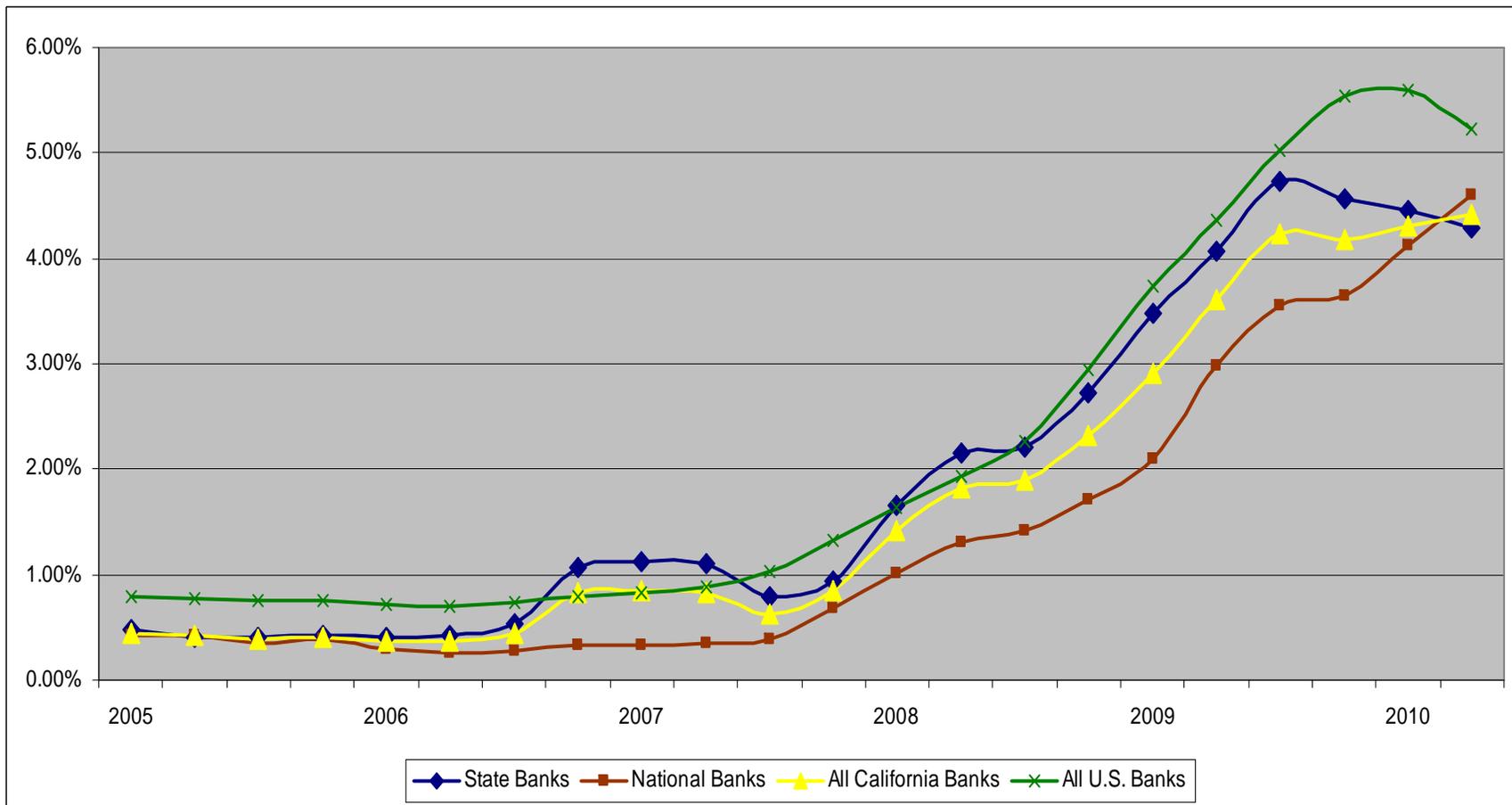
Asset Size	Less than \$100MM	\$100 to \$500MM	\$500MM to \$2 Billion	\$2 Billion and More**	Total
Number of Banks	32	119	39	18	208
First Quintile	1.0	1.0	1.1	1.0	1.1
Second Quintile	0.3	0.5	0.7	0.6	0.5
Third Quintile	-0.8	0.2	0.3	0.2	0.2
Fourth Quintile	-1.4	-0.7	0.1	-0.9	-0.6
Fifth Quintile	-3.1	-2.6	-0.9		-3.1
Total	-0.9	-0.2	-0.3	0.2	0.1

* Quintiles of equal sizes are created by dropping off first the highest then the lowest ratio in each group until the number of institutions is divisible by 5.

** Due to the small population in this category, it was divided into four equal sized groups.

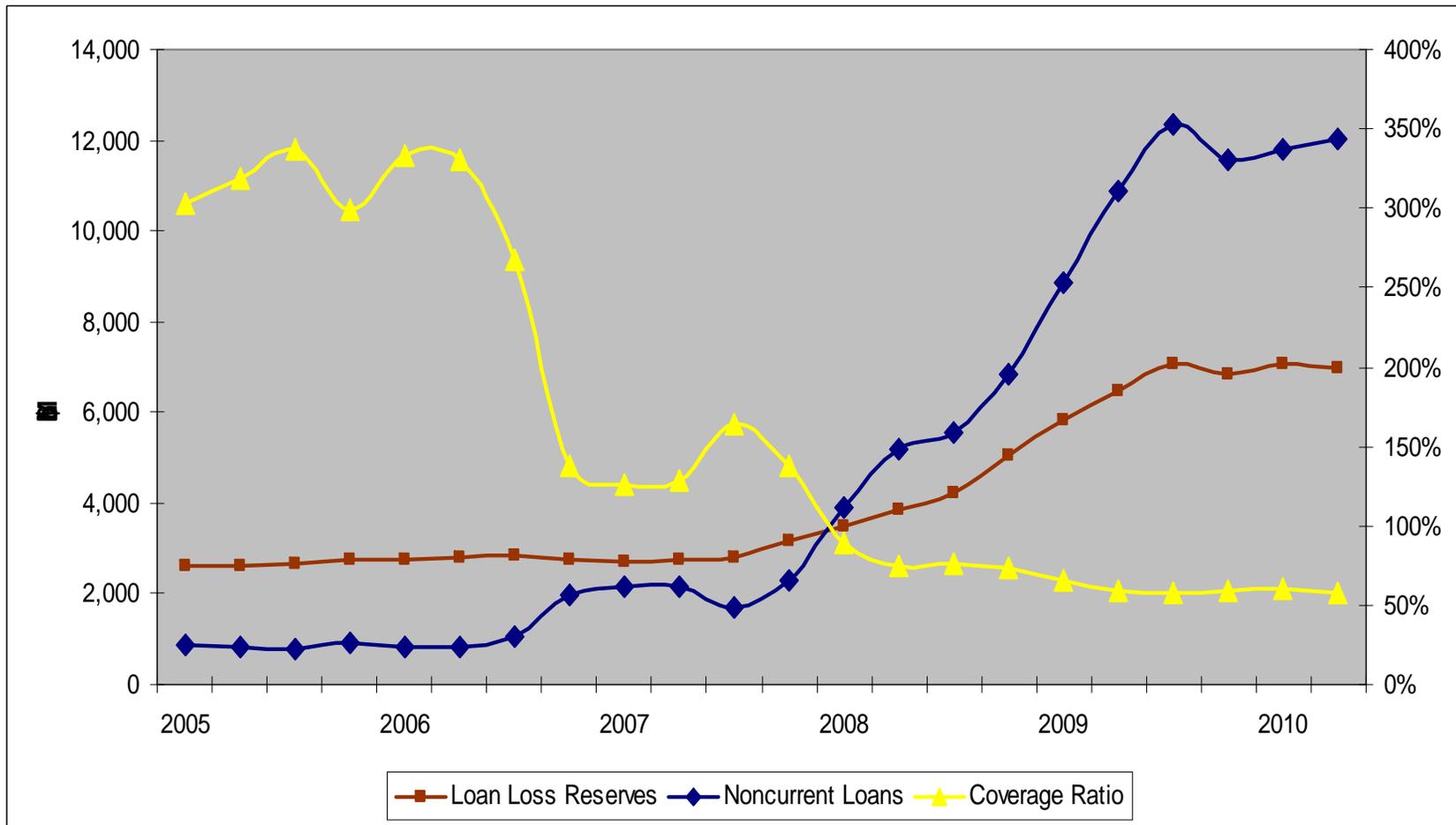
State / National Bank Comparison

Noncurrent Loans and Leases to Total Loans and Leases



Loan Loss Reserves vs. Noncurrent Loans and Leases

All California Banks



Reserves for Loans / Noncurrent Loans & Leases by Quintile*

State Chartered Commercial and Industrial Banks

As of June 30, 2010

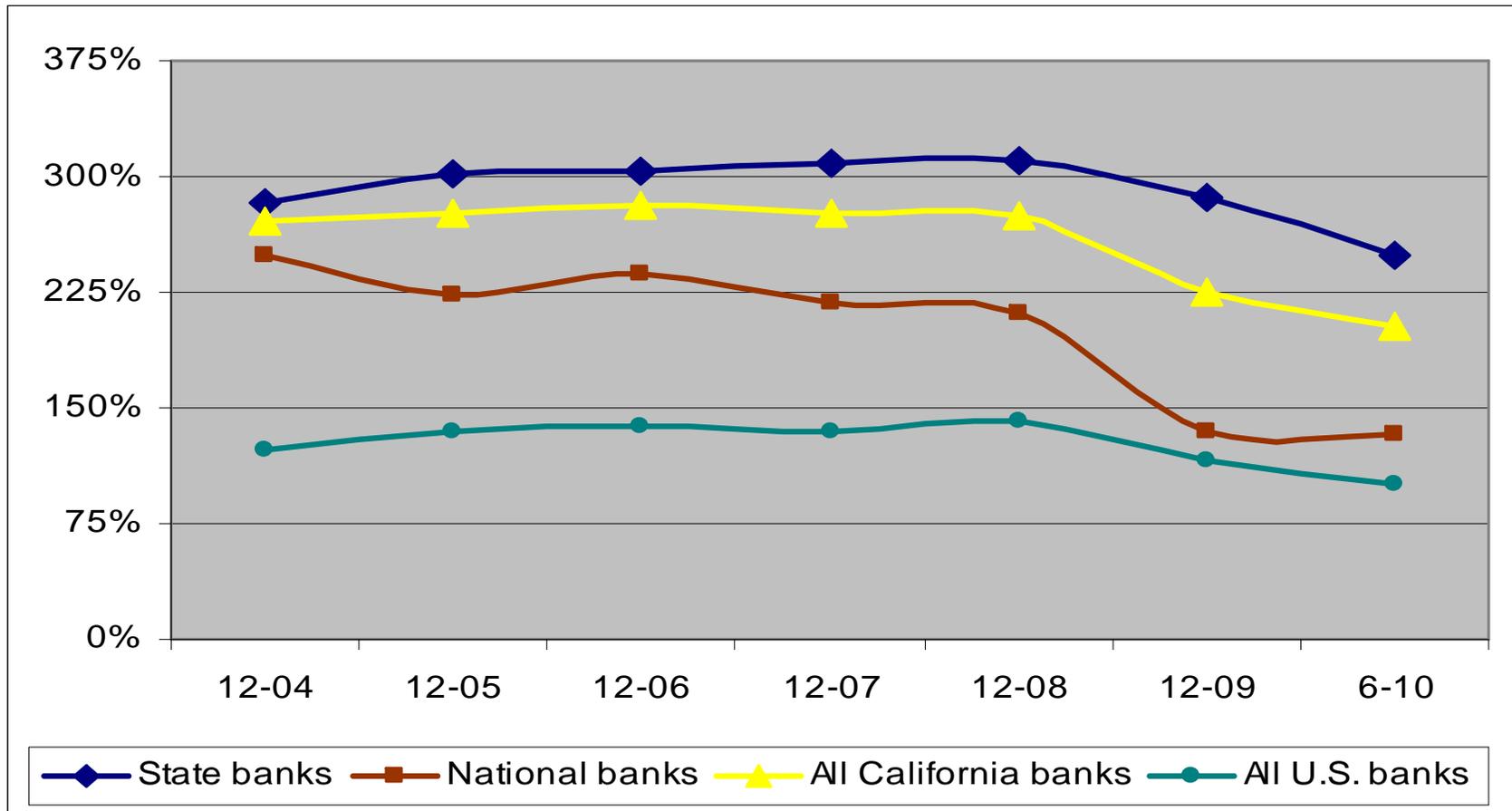
Asset Size	Less than \$100MM	\$100 to \$500MM	\$500MM to \$2 Billion	\$2 Billion and More**	Total
Number of Banks	32	119	39	18	208
First Quintile	∞	∞	612.1	81.1	∞
Second Quintile	∞	164.7	97.8	73.2	170.3
Third Quintile	237.3	87.2	66.2	56.2	81.1
Fourth Quintile	88.2	57.3	48.5	45.5	54.8
Fifth Quintile	47.0	37.6	37.6		36.6
Total	101.3	63.7	81.3	61.7	65.0

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State / National Bank Comparison

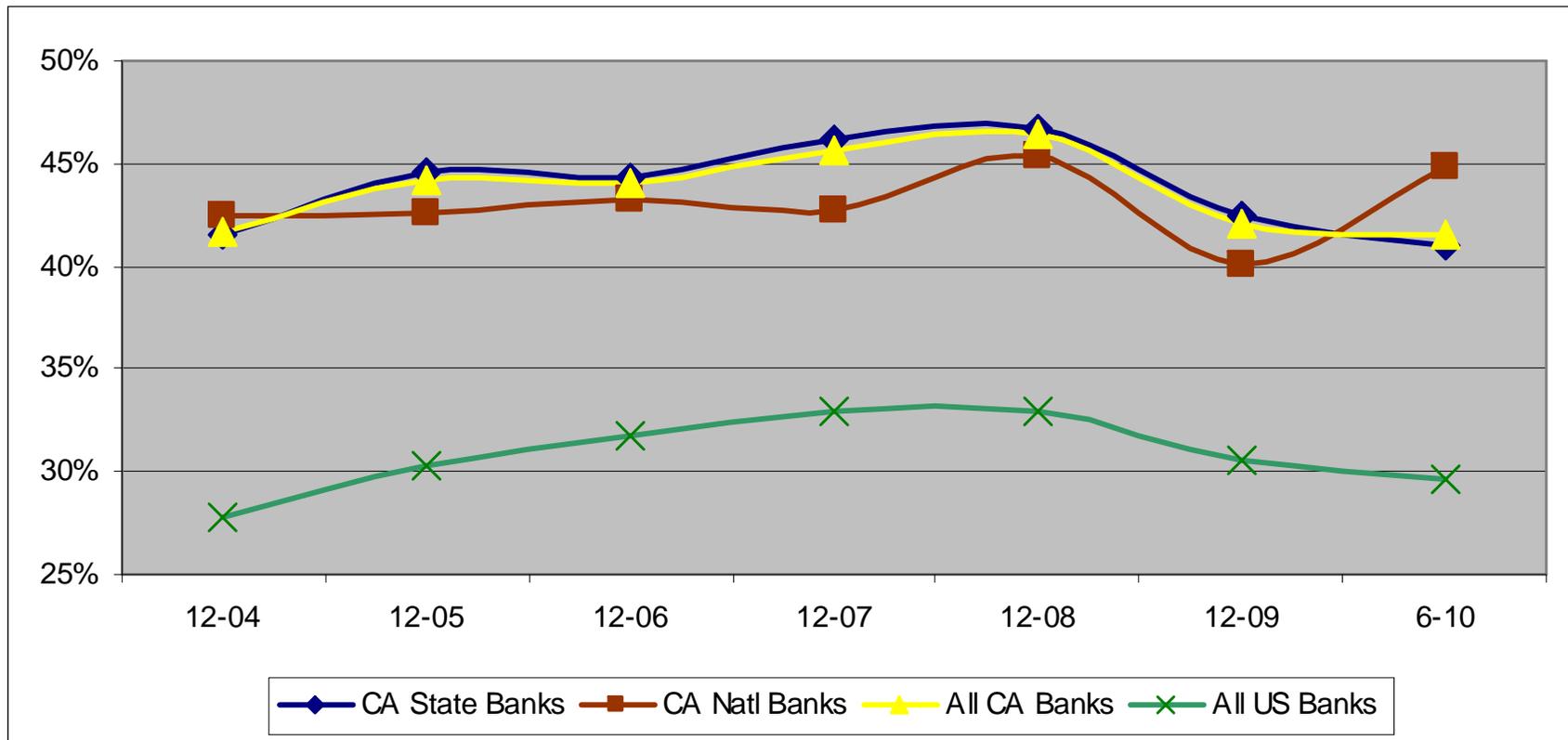
Commercial Real Estate Loans to Total Equity Capital



State / National Bank Comparison

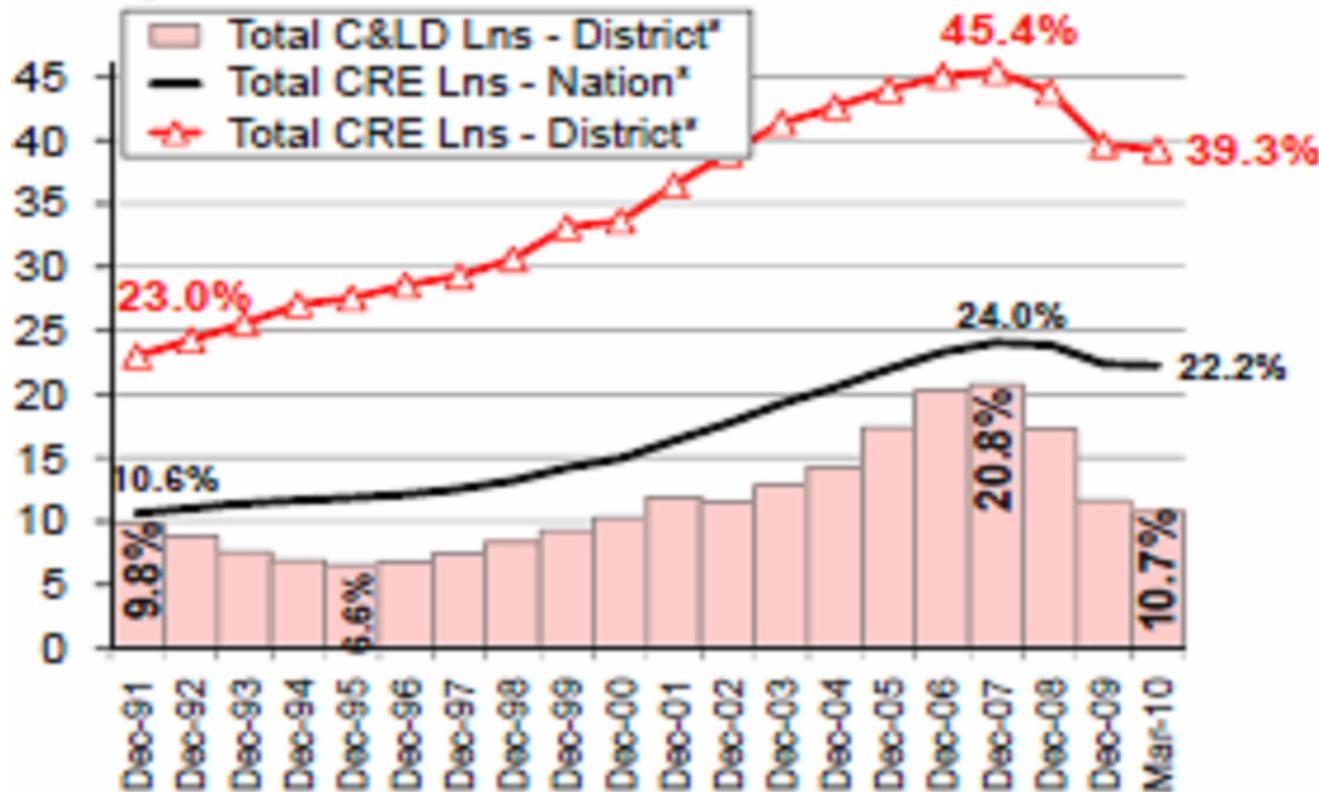
CRE to Total Assets

Banks with Assets of < \$2 Billion



District Avg. Total CRE Loan Concentrations Have Declined But are Still Well Above the Nation

Average Loan Concentrations as a Pct of Total Loans – %



CRE Lns / Tot. Lns excl. owner occupied NFNR		
U.S. Rank	State	State Avg
1	NV	46%
2	CA	42%
5	AZ	38%
6	WA	38%
7	OR	37%
10	HI	34%
11	UT	34%
16	AK	31%
17	ID	30%
12 th District		38%
Nation		22%

FRB-SF

First Glance 12L - May 2010

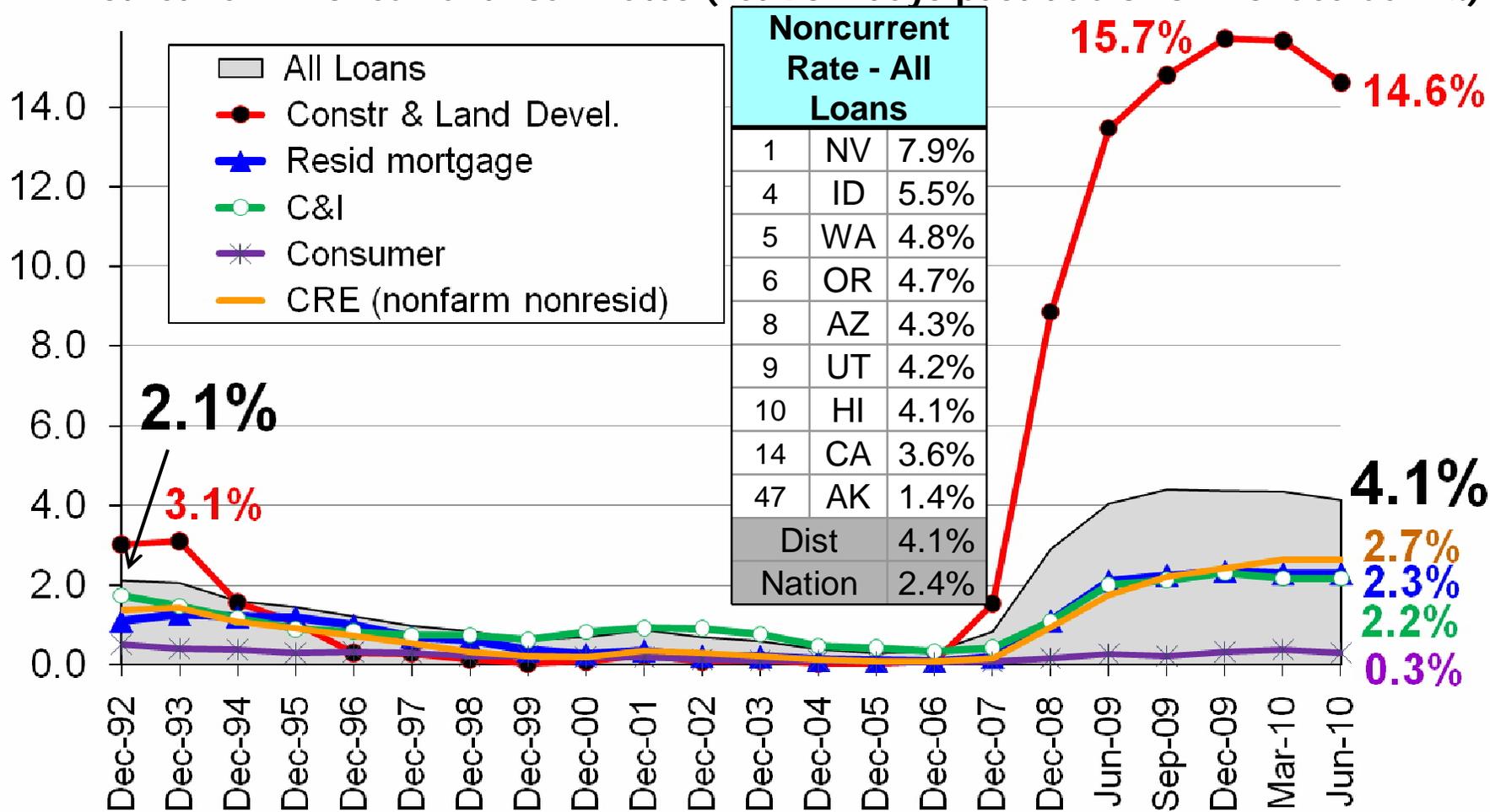
Commercial banks only (excludes industrials); trimmed means; * Total CRE loans include C&LD loans, and exclude owner-occupied nonfarm nonresidential secured loans, as estimated prior to 2008, preliminary 2/2010 data.

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Noncurrent Loan Rates Edged Downward, Due Largely to C&LD Loan Charge-offs

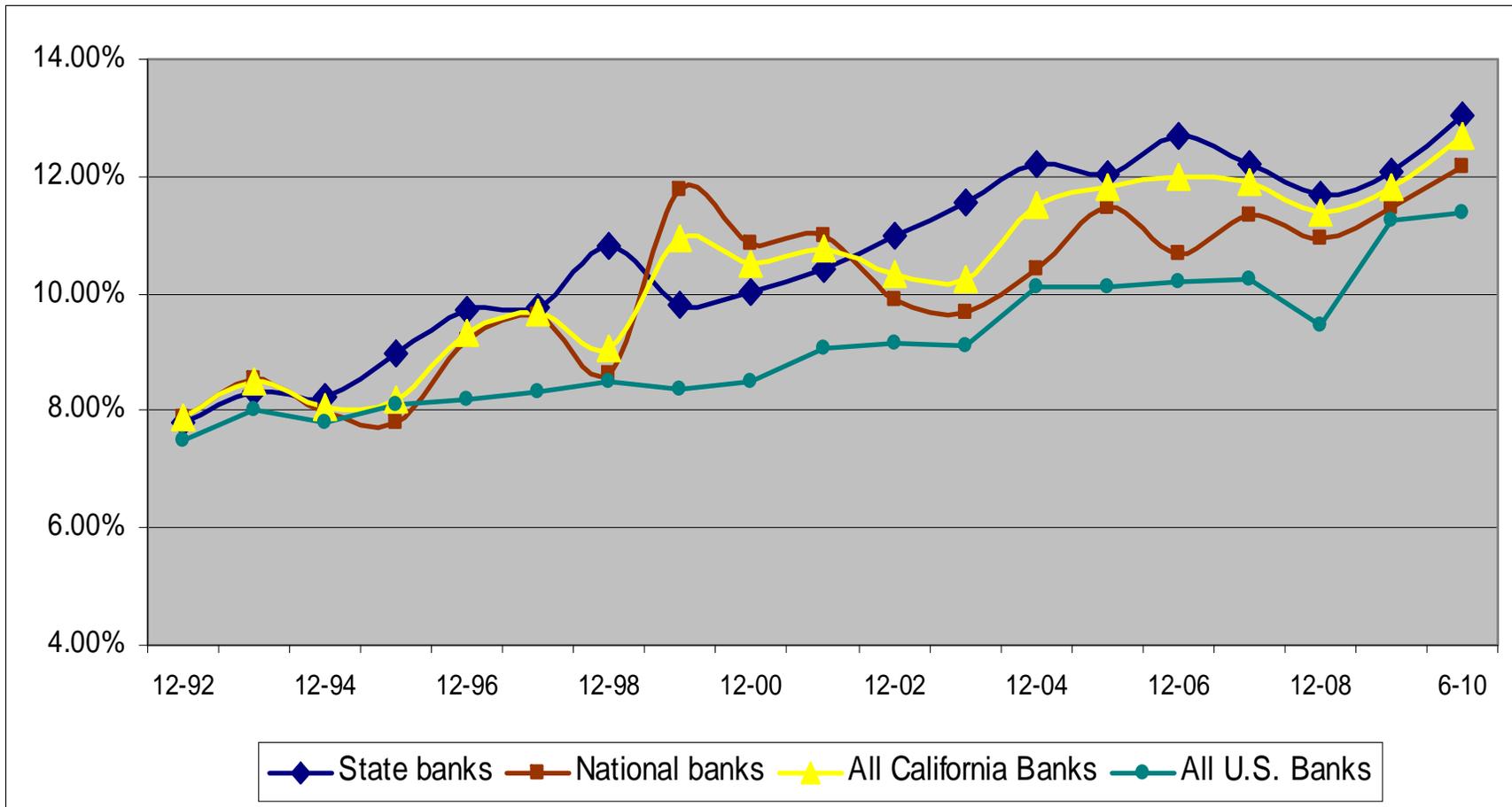
CRE Income Property Noncurrent Rates Continue to Rise in 1H10

12th District Bank Noncurrent Loan Rates (Pct 90+ days past due or on nonaccrual -%)



State / National Bank Comparison

Total Bank Equity / Total Assets



Equity Capital / Assets by Quintile*

State Chartered Commercial and Industrial Banks

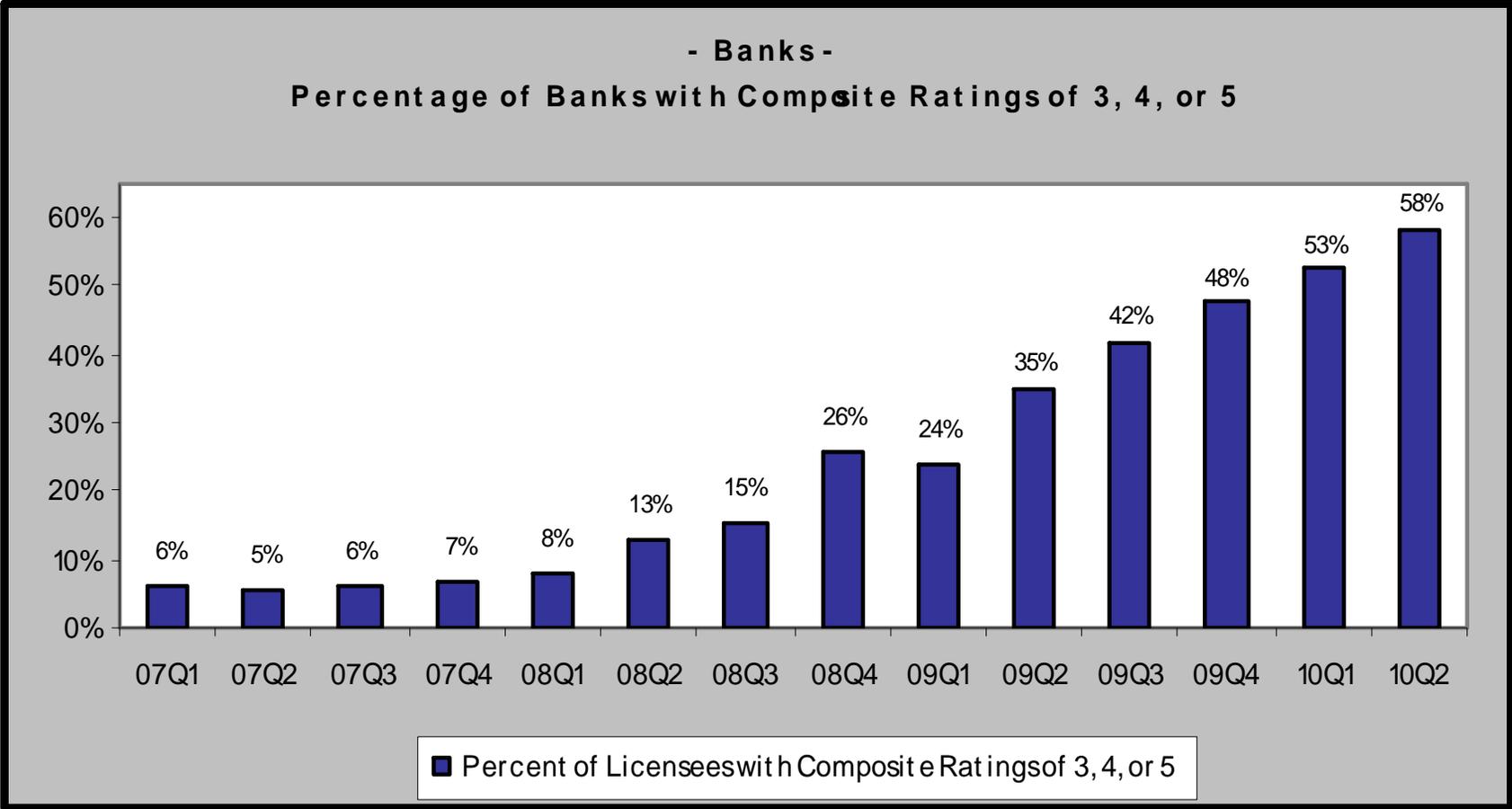
As of June 30, 2010

Asset Size	Less than \$100MM	\$100 to \$500MM	\$500MM to \$2 Billion	\$2 Billion and More**	Total
Number of Banks	32	119	39	18	208
First Quintile	35.2	17.0	15.3	13.9	21.1
Second Quintile	17.9	12.6	12.6	11.9	13.0
Third Quintile	13.1	11.0	11.0	10.8	11.2
Fourth Quintile	10.7	9.8	10.3	8.7	10.0
Fifth Quintile	8.4	7.7	9.3		7.7
Total	18.1	12.3	12.1	13.3	13.0

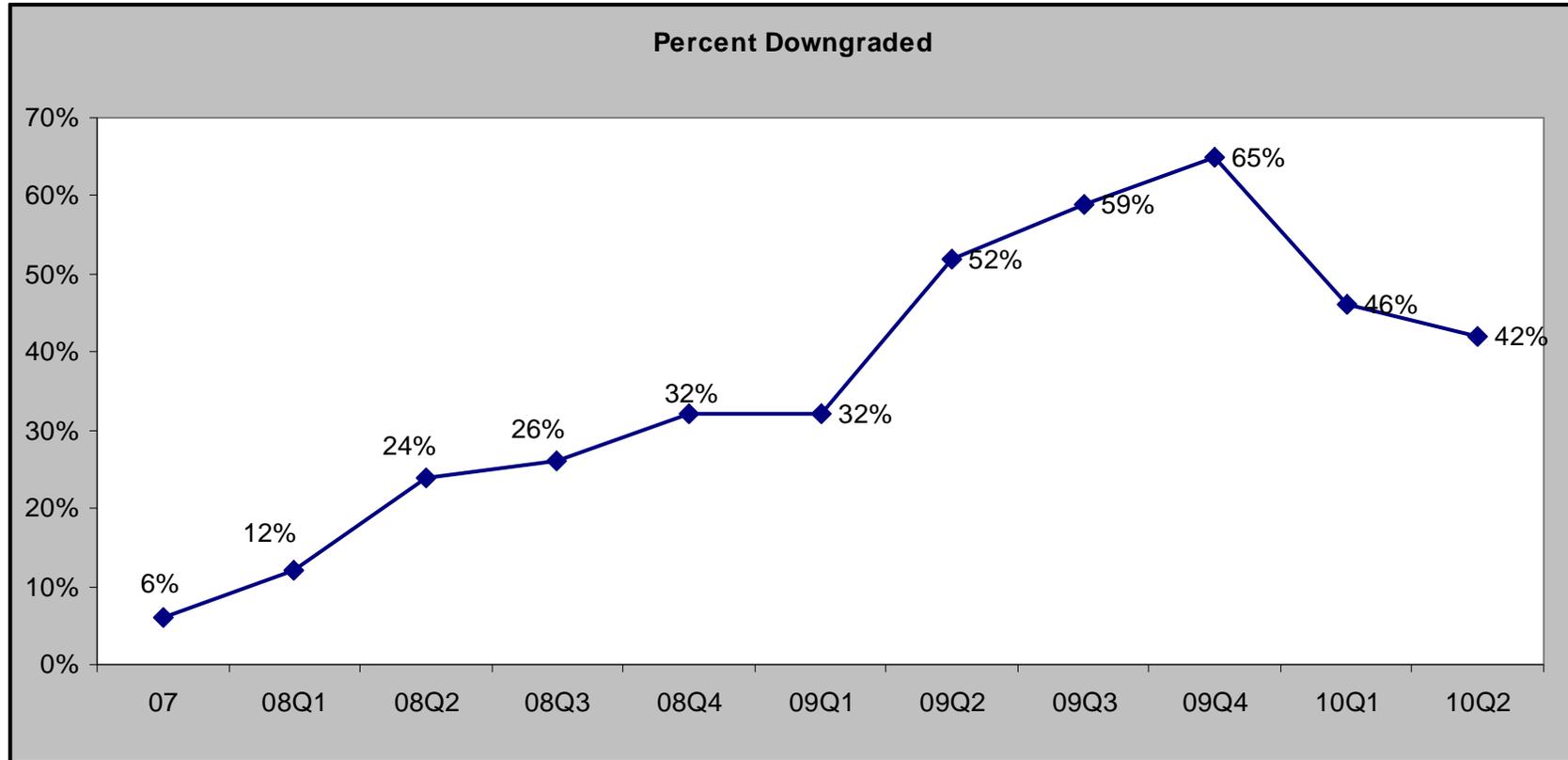
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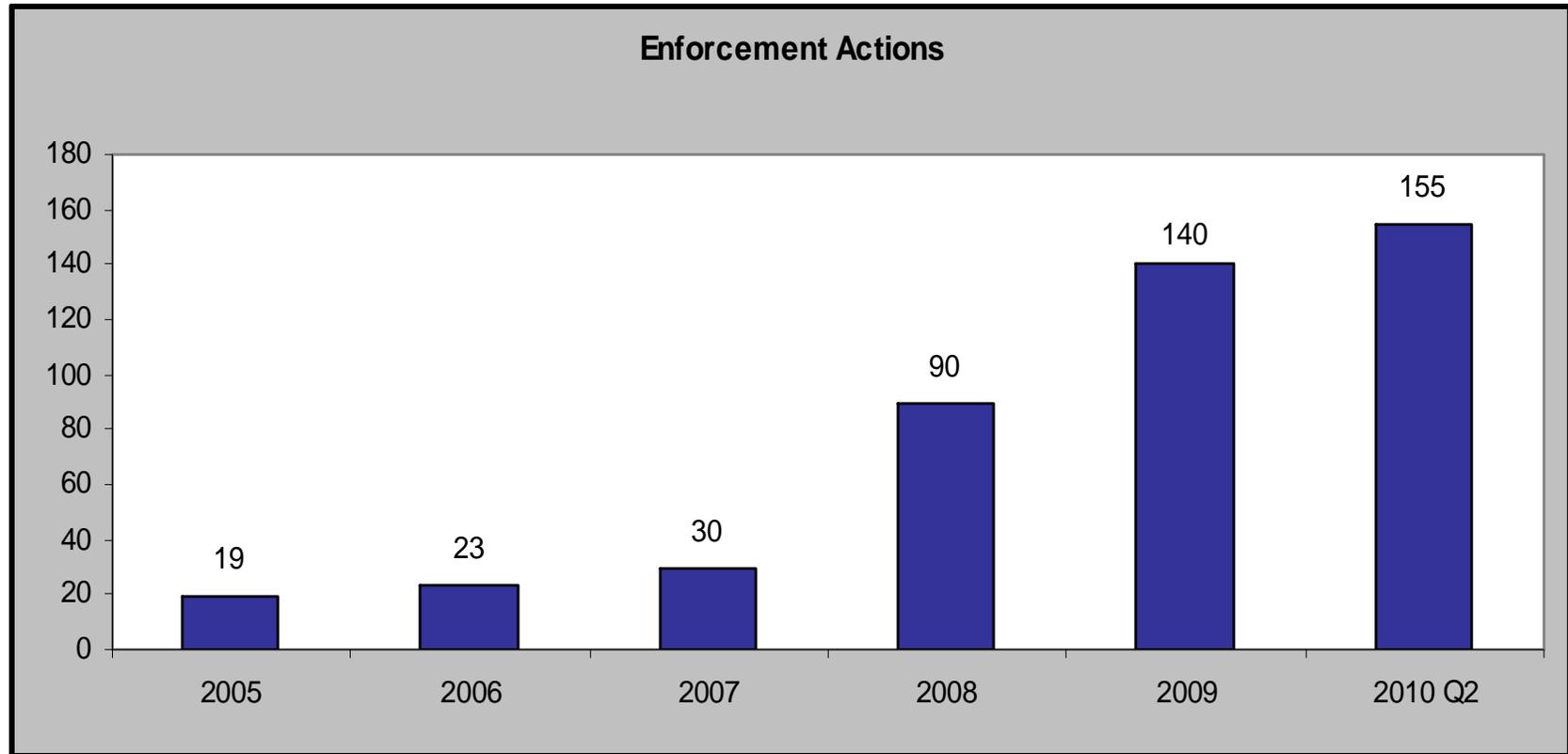
Increase in Problem Banks



Downgrades Decelerating



Enforcement Actions are UP



California Bank and Thrift Failures 2009 – Present

<u>Name</u>	<u>Type</u>	<u>City</u>	<u>Total Assets (000)*</u>	<u>Date Closed</u>
1st Centennial Bank	State	Redlands	797,959	1/23/09
Alliance Bank	State	Culver City	1,113,361	2/6/09
County Bank	State	Merced	1,711,552	2/6/09
IndyMac Federal Bank, F.S.B.	FSB	Pasadena	23,477,908	3/19/09
First Bank of Beverly Hills	State	Calabasas	1,260,354	4/24/09
MetroPacific Bank	State	Irvine	75,316	6/26/09
Mirae Bank	State	Los Angeles	480,619	6/26/09
Temecula Valley Bank	State	Temecula	1,396,622	7/17/09
Vineyard Bank, National Association	National	Rancho Cucamonga	1,638,378	7/17/09
Affinity Bank	State	Ventura	1,211,431	8/28/09
San Joaquin Bank	State	Bakersfield	766,359	10/16/09
California National Bank	National	Los Angeles	7,781,100	10/30/09
Pacific National Bank	National	San Francisco	2,319,263	10/30/09
San Diego National Bank	National	San Diego	3,594,544	10/30/09

* Total assets are as of quarter-end prior to failure.

California Bank and Thrift Failures 2009 – Present (Continued)

<u>Name</u>	<u>Type</u>	<u>City</u>	<u>Total Assets (000)*</u>	<u>Date Closed</u>
United Commercial Bank	State	San Francisco	10,895,336	11/6/09
Pacific Coast National Bank	National	San Clemente	131,418	11/13/09
First Federal Bank of California	FSB	Santa Monica	6,143,903	12/18/09
Imperial Capital Bank	State	La Jolla	4,046,888	12/18/09
First Regional Bank	State	Los Angeles	2,082,684	1/29/10
La Jolla Bank, FSB	FSB	La Jolla	3,646,071	2/19/10
Innovative Bank	State	Oakland	268,891	4/16/10
Tamalpais Bank	State	San Rafael	628,903	4/16/10
1st Pacific Bank of California	State	San Diego	335,798	5/7/10
Granite Community Bank, N.A.	National	Granite Bay	102,913	5/28/10
Butte Community Bank	State	Chico	498,751	8/20/10
Los Padres Bank	FSB	Solvang	901,516	8/20/10
Pacific State Bank	State	Stockton	312,077	8/20/10
Sonoma Valley Bank	State	Sonoma	337,113	8/20/10

* Total assets are as of quarter-end prior to failure.

California Chartered Institutions

Completed Capital Offerings

2009 – Present

<u>Name</u>	<u>Location</u>	<u>Date</u>	<u>Funding Type</u>	<u>Offering Amount (\$000)</u>
PacWest Bancorp	San Diego	1/14/09	Common Stock	100,000
Preferred Bank	Los Angeles	2/11/09	Senior Debt	26,000
Pacific Valley Bank	Salinas	2/19/09	Common Stock	1,502
Bank of the West	San Francisco	3/23/09	Senior Debt	1,000,000
East West Bancorp, Inc.	Pasadena	7/14/09	Common Stock	27,500
East West Bancorp, Inc.	Pasadena	7/20/09	Common Stock	69,850
CVB Financial Corp.	Ontario	7/21/09	Common Stock	115,245
PacWest Bancorp	San Diego	8/25/09	Common Stock	50,000
Sierra Bancorp	Porterville	8/28/09	Common Stock	21,285
Hanmi Financial Corporation	Los Angeles	9/4/09	Common Stock	6,946
Preferred Bank	Los Angeles	9/9/09	Common Stock	17,029
Cathay General Bancorp	El Monte	9/30/09	Common Stock	32,379
Pacific Valley Bank	Salinas	9/30/09	Common Stock	1,900

California Chartered Institutions

Completed Capital Offerings

2009 – Present (Continued)

<u>Name</u>	<u>Location</u>	<u>Date</u>	<u>Funding Type</u>	<u>Offering Amount (\$000)</u>
Cathay General Bancorp	El Monte	10/13/09	Common Stock	70,435
Nara Bancorp, Inc.	Los Angeles	10/21/09	Common Stock	75,000
Pacific Premier Bancorp, Inc.	Costa Mesa	11/4/09	Common Stock	15,000
East West Bancorp, Inc.	Pasadena	11/6/09	Preferred Stock	335,047
East West Bancorp, Inc.	Pasadena	11/6/09	Common Stock	164,953
SVB Financial Group	Santa Clara	11/18/09	Common Stock	300,300
Center Financial Corporation	Los Angeles	11/30/09	Common Stock	1,510
Center Financial Corporation	Los Angeles	11/30/09	Common Stock	11,271
Pacific Mercantile Bancorp	Costa Mesa	12/3/09	Preferred Stock	1,650
American River Bankshares	Rancho Cordova	12/7/09	Common Stock	22,000
Pacific Mercantile Bancorp	Costa Mesa	12/9/09	Preferred Stock	5,250
Pacific Mercantile Bancorp	Costa Mesa	12/18/09	Preferred Stock	950
Pacific Mercantile Bancorp	Costa Mesa	12/21/09	Preferred Stock	200

California Chartered Institutions

Completed Capital Offerings 2009 – Present (Continued)

<u>Name</u>	<u>Location</u>	<u>Date</u>	<u>Funding Type</u>	<u>Offering Amount (\$000)</u>
Central Valley Community Bancorp	Fresno	12/23/09	Common Stock	6,641
Central Valley Community Bancorp	Fresno	12/23/09	Preferred Stock	1,359
Cathay General Bancorp	El Monte	12/24/09	Common Stock	12,550
Citizens Bancorp	Nevada City	12/28/2009	Common Stock	1,576
Sierra Vista Bank	Folsom	12/30/09	Common Stock	1,232
Center Financial Corporation	Los Angeles	12/31/09	Preferred Stock	73,500
Mission Valley Bancorp	Sun Valley	12/31/09	Preferred Stock	4,580
Pacific Valley Bank	Salinas	12/31/09	Common Stock	500
Cathay General Bancorp	El Monte	2/1/10	Common Stock	115,000
Pacific Mercantile Bancorp	Costa Mesa	2/26/10	Preferred Stock	500
Pacific Valley Bank	Salinas	3/1/10	Common Stock	3,000
Saehan Bancorp	Los Angeles	3/9/10	Common Stock	60,600
Heritage Oaks Bancorp	Paso Robles	3/12/10	Preferred Stock	52,088

California Chartered Institutions

Completed Capital Offerings

2009 – Present (Continued)

<u>Name</u>	<u>Location</u>	<u>Date</u>	<u>Funding Type</u>	<u>Offering Amount (\$000)</u>
Heritage Oaks Bancorp	Paso Robles	3/12/10	Preferred Stock	3,866
First California Financial Group, Inc.	Westlake Village	3/18/10	Common Stock	36,000
Bank of Commerce Holdings	Redding	3/23/10	Common Stock	30,600
Pacific Mercantile Bancorp	Costa Mesa	3/31/10	Preferred Stock	300
Seacoast Commerce Bank	Chula Vista	3/31/10	Common Stock	3,200
Community Bank of the Bay	Oakland	4/5/10	Common Stock	5,000
North Valley Bancorp	Redding	4/20/10	Preferred Stock	40,000
Mission Community Bancorp	San Luis Obispo	4/27/10	Common Stock	10,000
Citizens Bancorp	Nevada City	4/30/10	Common Stock	100
Pacific Mercantile Bancorp	Costa Mesa	5/7/10	Preferred Stock	805
Ventura County Business Bank	Oxnard	5/19/10	Common Stock	9,359
Heritage Oaks Bancorp	Paso Robles	6/8/10	Preferred Stock	4,072
Mission Community Bancorp	San Luis Obispo	6/15/10	Common Stock	15,000

California Chartered Institutions

Completed Capital Offerings 2009 – Present (Continued)

<u>Name</u>	<u>Location</u>	<u>Date</u>	<u>Funding Type</u>	<u>Offering Amount (\$000)</u>
First Republic Bank	San Francisco	6/18/10	Common Stock	1,862,004
Heritage Commerce Corp	San Jose	6/21/10	Preferred Stock	53,996
Heritage Commerce Corp	San Jose	6/21/10	Preferred Stock	21,004
Preferred Bank	Los Angeles	6/21/10	Preferred Stock	77,000
Pacific Mercantile Bancorp	Costa Mesa	6/30/10	Preferred Stock	1,250
Seacoast Commerce Bank	Chula Vista	6/30/10	Common Stock	1,800
Community Bank of the Bay	Oakland	7/19/10	Common Stock	7,700
Plaza Bank	Irvine	7/22/10	Common Stock	15,000
Hanmi Financial Corporation	Los Angeles	7/27/10	Common Stock	47,282
Hanmi Financial Corporation	Los Angeles	7/27/10	Common Stock	72,718
Bay Commercial Bank	Walnut Creek	8/5/10	Common Stock	18,000
Pacific Mercantile Bancorp	Costa Mesa	8/12/10	Preferred Stock	1,750
SVB Financial Group	Santa Clara	9/15/10	Senior Debt	350,000
Security California Bancorp	Riverside	9/16/10	Common Stock	20,000
Total				\$5,514,134

Equity Offerings by California State Chartered Banks Since 2009

- 30 state-chartered banks in California or their BHCs completed 63 equity offerings that raised \$4.1 billion
- Number of completed offerings by CAMELS rating at the time of the offering:

<u>CAMELS</u>	<u>Rating at Offering Date</u>
1	0
2	14
3	21
4	24
5	3
<u>Unrated</u>	<u>1</u>
Total	63

Capital Purchase Program - All California Banks

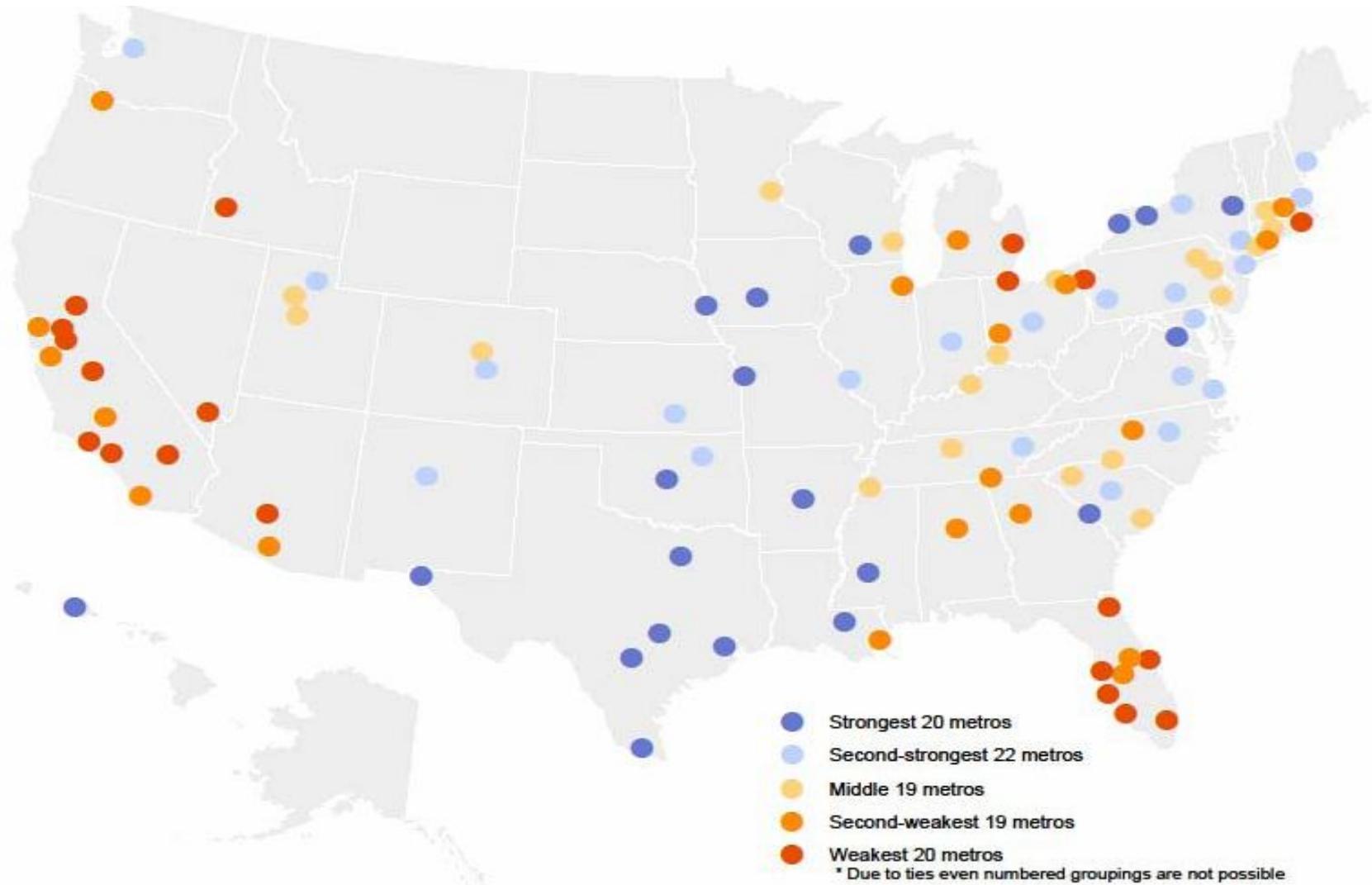
Period Ending 8/11/10 (in million \$s)

<u>Type of Bank</u>	<u>#</u>	<u>Total Purchase Amount</u>	<u>Total Capital Repayment Amount</u>	<u>Total Treasury CPP Investment Amount</u>
State Banks	53	\$1,948.8	\$476.7	\$1,472.1
National Banks	14	672.3	402.6	269.7
Federal Savings Banks	4	46.5	4.9	41.6
Total	71	\$2,667.6	\$884.2	\$1,783.4

Observations on the Outlook

- Economic Conditions
- Credit Outlook
- Revenue Prospects
- Impact of Regulatory Reform

Economic Performance by SMA



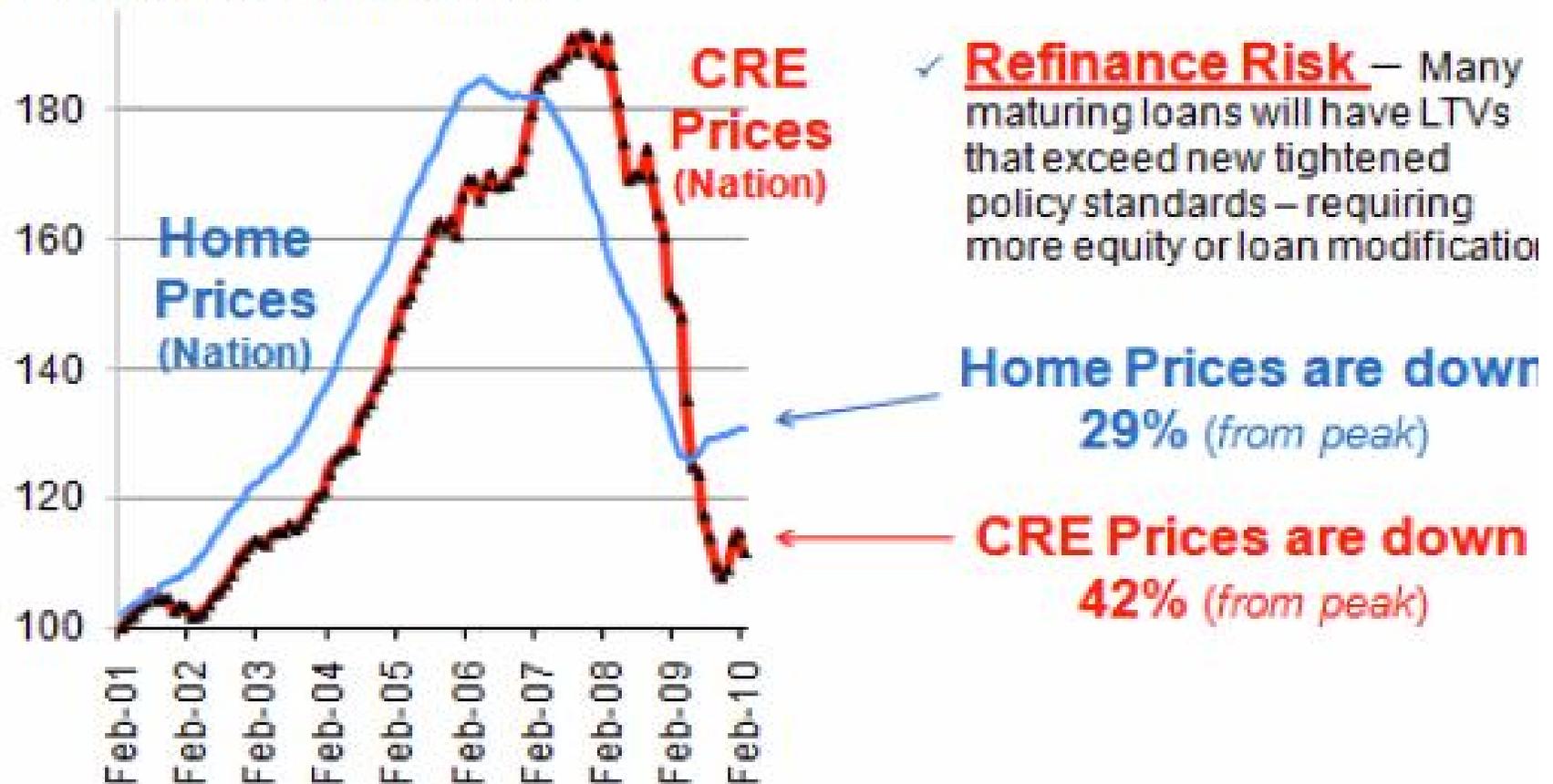
Best/Worst Metro Areas

The 20 strongest-performing metro areas		The 20 weakest-performing metro areas	
Albany, NY	Jackson, MS	Boise City, ID	Oxnard, CA
Augusta, GA-SC	Kansas City, MO-KS	Cape Coral, FL	Palm Bay, FL
Austin, TX	Little Rock, AR	Detroit, MI	Phoenix, AZ
Baton Rouge, LA	Madison, WI	Fresno, CA	Providence, RI-MA
Buffalo, NY	McAllen, TX	Jacksonville, FL	Riverside, CA
Dallas, TX	Oklahoma City, OK	Las Vegas, NV	Sacramento, CA
Des Moines, IA	Omaha, NE-IA	Los Angeles, CA	Stockton, CA
El Paso, TX	Rochester, NY	Miami, FL	Tampa, FL
Honolulu, HI	San Antonio, TX	Modesto, CA	Toledo, OH
Houston, TX	Washington, DC-VA-MD-WV	North Port, FL	Youngstown, OH-PA

5) CRE Property Values Down Even More Than Housing

Maturing CRE Loans Increasingly to Require Extensions & Restructuring

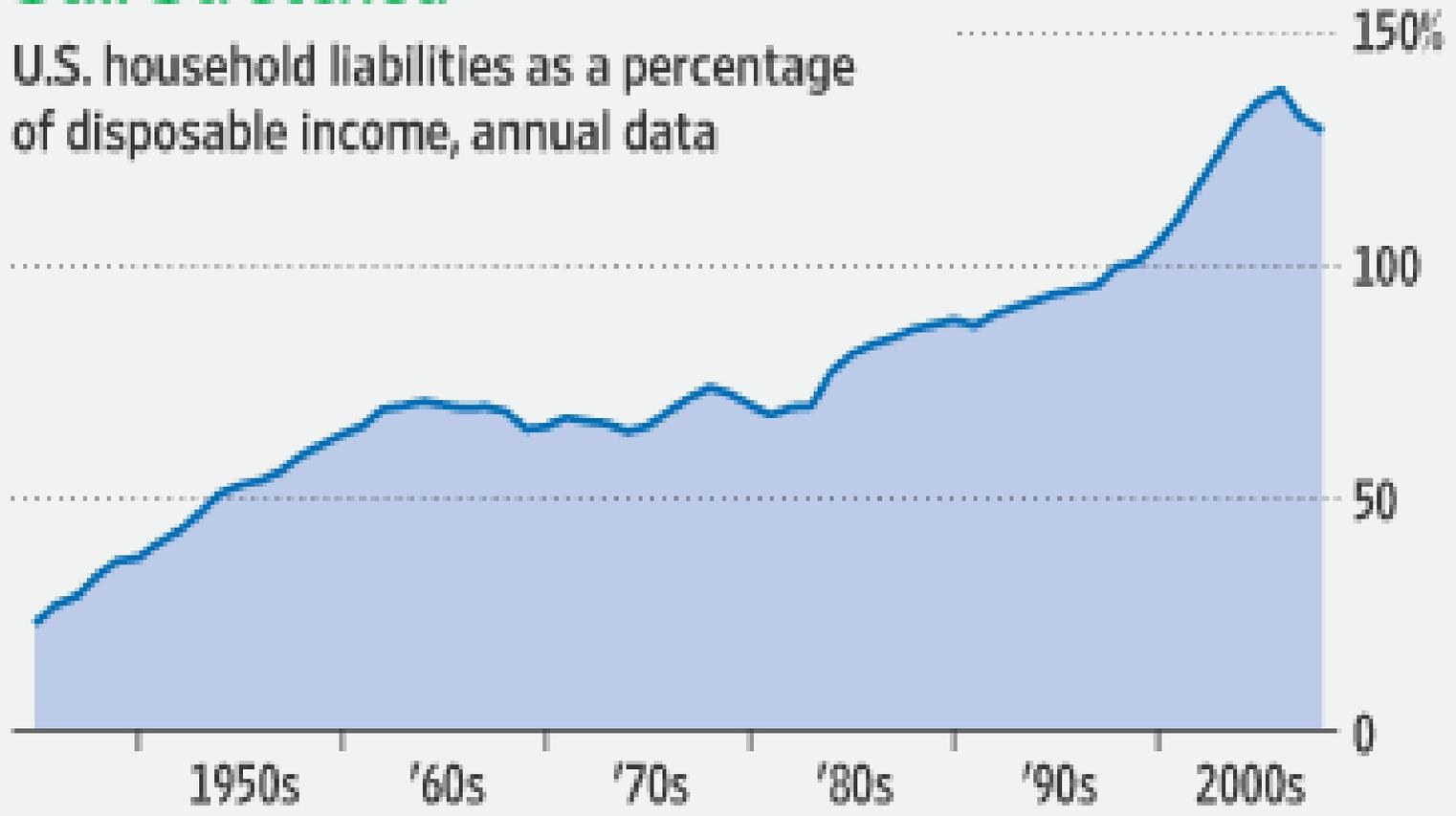
Home and CRE Price Indices



Sources: Moody's/REAL Commercial Property Index; S&P Case-Shiller Home Price Composite 20 Index, SA; Haver Analytics; re-indexed to 100 at Dec 2000. Note: the CRE index is based on very few transactions -- the value decline may be overstated

Still Stretched

U.S. household liabilities as a percentage of disposable income, annual data



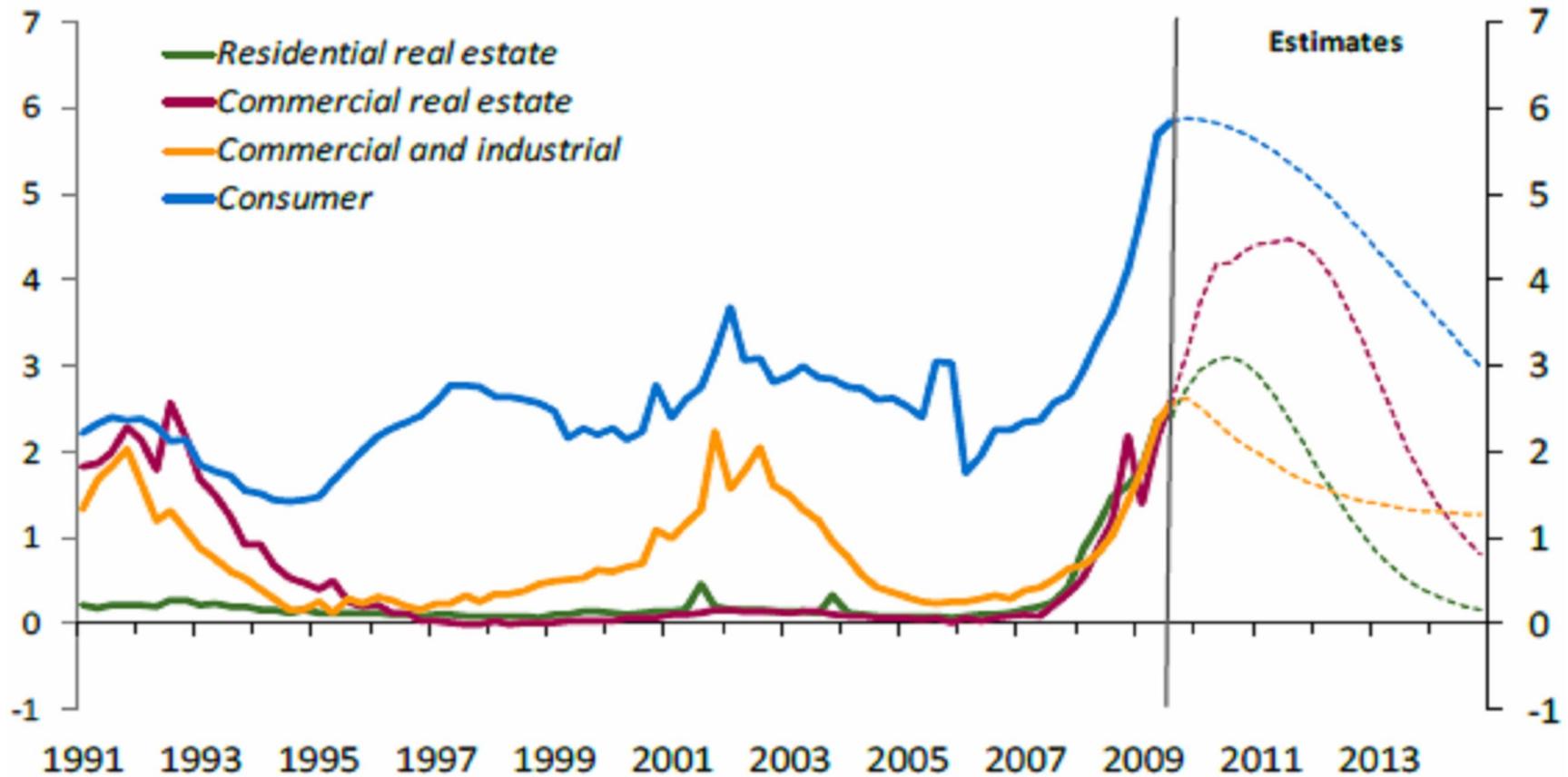
Notes: Includes nonprofit organizations; 2009 figure is for the second quarter
Source: U.S. Federal Reserve

Characteristics of Post-crisis Economies

- These are not normal cyclical events. Postwar U.S. experience with recessions and recoveries is not a good guide.
- Balance sheet damage from a collapse in valuations produces a slow, protracted recovery.
- Normal tools of monetary and fiscal policy less effective or unavailable.
- “Sovereign” risk and crises are part of the landscape.
- =>Prepare for a Slow, Potentially Bumpy Recovery

U.S. Loan Charge-Off Rates (Including IMF Forecasts)

(In percent of total loans)



Sources: Federal Reserve; and IMF staff estimates.

Back to the Future?

California Banking in the 1930s

Excerpts from the reports of
California State Bank Superintendants

Superintendent Will C. Wood, 1930

- *The people of California have reason to be proud of the fine way in which our banking institutions have handled financial problems growing out of the rather drastic deflation of the stock markets last fall. Not one bank failure can be attributed directly or indirectly to the market crisis of 1929...*

Superintendent Edward M. Rainey, 1932

- *In view of the unprecedented demands made upon banks everywhere during the past three years, the current statement of the California State banks are indeed reassuring.*
- *While failures are at all times to be regretted, it would be unfair not to mention the very enviable record maintained by banks in California during this depression period...Generally speaking, California is a distinctly bright spot on the National map of bank failures.*

Superintendent Friend William Richardson, 1934

- *the combined statements submitted herewith give a factual demonstration of the urgent problem faced uniformly by all banks--earning assets in the form of good loans are not available in sufficient amounts to take up the increase in deposits. The only outlet is government bonds at extremely low rates--in fact lower than the prevailing rates on time deposits... Even the acquisition of government bonds on a low yield basis may cause future embarrassment should prevailing rates increase due either to declining public confidence in government issues or to the flotation of more attractive private issues.*

Dodd-Frank

- Dodd-Frank will touch every corner of the financial system, but its biggest impact will be on largest financial institutions.
- Direct and indirect impacts on community and regional banks are difficult to assess at this time.
 - Key provisions: increase in deposit insurance coverage now permanent, interest payable on DDA, Fed to regulate interchange fees
- CFPB creates major new uncertainties.
- Roll-back of OCC's preemption authority invites new state-level consumer financial legislation.
- Basle III initiative could be at least as significant as Dodd-Frank and should be watched closely.

A Lesson Learned from the Crisis

Taking the “M” in CAMELS Seriously
The Management Component Rating

A California Lament from 20 Years Ago

- *“Our present management rating system is deficient in many areas...*
- *the reluctance of the examiners to make a decision on the competence of management and the board left us with actually no rating...*
- *the criticisms lodged in the confidential section of the report are hardly ever carried forward to the page one because it is probably felt that they don't have enough 'feel' for what management and the board is supposed to do. Most of management is rated average whether good or bad.”*

Memorandum from Chief Bank Examiner Harold Doyle
to Superintendent of Banks James E. Gilleran
July 27, 1990

The Traditional Emphasis

- *A bank's performance with respect to asset quality and diversification, capital adequacy, earnings performance and trends, liquidity and funds management, and sensitivity to fluctuations in market interest rates is, to a very significant extent, a result of decisions made by the bank's directors and officers. Consequently, findings and conclusions in regard to the other five elements of the CAMELS rating system are often major determinants of the management rating.*

Uniform Financial Institutions Ratings System

Revised 1996

A Better Emphasis

1. Does the bank have effective board oversight and corporate governance practices, policies and procedures?
2. Does the bank have an effective framework for risk management consistent with its size, complexity, structure and risk profile?
3. How well do the board, management and control functions execute against this framework?

1. Evaluate Corporate Governance

- Corporate governance involves the manner in which the business and affairs of a bank are governed by its board and management:
 - Setting strategy and objectives;
 - Determining risk tolerances;
 - Protecting the interests of depositors, other recognized stakeholders while meeting shareholder obligations;
 - Operating the bank in a safe and sound manner, with integrity and in compliance with applicable laws and regulations.

Key Elements of Effective Governance

- Board members and management have the expertise and integrity to fulfill their roles.
- Board and management have effective processes and committee structures to set objectives and achieve them.
- Information presented to the board is complete, accurate and presented in an understandable manner.
- Board has established processes to properly oversee and evaluate management and control functions and assess its own effectiveness.
- Internal audit function conducts independent, risk-based and effective audits.
- Board has knowledge of and controls over all potential conflicts of interest at board and management levels.

Common Governance Weaknesses

- Board lacks experienced, capable financial professionals with knowledge of regulations/guidance.
- Board is dysfunction (e.g., factional, distrustful, dominated by an individual or small group, unengaged, unprepared, etc.)
- Board is too trusting of the CEO & management. Dominant CEO controls the bank.
- Lack of formalized processes for management evaluations – both management structures and executive competencies. Board relies excessively on regulatory assessments of management.
- Lack of independence of the risk management functions.
- Weak or inactive risk committee structures at board and management levels.

2. Evaluate Risk Management Framework

- How effectively does the bank:
 - Identifying key risks;
 - Measure exposures to these risks;
 - Monitor risk exposures on an ongoing basis;
 - Control or mitigate risk exposures through effective processes that work as intended and through capital and liquidity resources that are appropriate for the risks; and
 - Report to the board on these items.

Key Elements of Effective Risk Management

- Independent risk management function with adequate stature, authority, board access and resources.
- MIS and analytical capabilities to perform stress tests/scenario analyses for all key exposures.
- Risk mitigation strategies, contingency plans and adequate capital and liquidity resources that are informed by such analyses.
- Capability to understand and effectively adapt to changes in the economic, financial and competitive environment.
- Compensation systems that are effectively aligned with prudent risk taking.

Common Weakness in the Risk Framework

- Emphasis is on ROE without adequate consideration of risk factors. Board does not articulate risk appetite or set risk limits in a meaningful/measurable way.
- Comp plans that incent growth or short-run returns.
- Risk management function lacks leadership or support from the Board/CEO and/or lacks independence from revenue generating officers and units.
- Inadequate resources. Poor MIS. Inadequate analytical capabilities for stress testing/scenario analysis.
- Failure to recognize and control interrelated risks.
- Audit functions not independent of management.

3. Evaluate Execution Against Risk Framework

- Are all risk factors appropriately identified, assessed and controlled?
- Are credit concentrations properly identified and mitigated?
- Are underwriting principles sound and sensitive to market conditions?
- Is there a realistic liquidity plan for dealing with a range of potential disruptions to normal liquidity sources?
- Has the board provided proper oversight of management?
- Are internal audit, compliance and control functions effective?

Common Weaknesses in Risk Management Execution

- Failure to stay within prescribed policy limits. Exceptions to risk limits granted to meet competition.
- Inadequate communication flows.
- Ineffective oversight and controls.
- Inadequate credit underwriting standards/credit administration function.
- Excessive reliance on third parties' risk assessments (e.g., credit rating agencies, lead bank for loan participations).
- Failure to implement audit recommendations.
- Lack of accountability.

Overcoming the Hurdles to a More Effective “M” Rating Process

- Qualitative assessments are inherently less defensible, making the “M” rating more contentious.
- Is this why regulators have gravitated toward assessing M based on a bank’s condition?
- A clearly articulated methodology is essential.
- Examiner guidance in need of an update.
- “Key Elements” and “Common Weaknesses” are a good place to start.
- This is not rocket science!

