WESTAMERICA BANCORPORATION
Form 10-K
February 28, 2013

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

# FORM 10-K

(Mark one)

þ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2012

or

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____________ to_____________.

Commission File Number: 001-9383
WESTAMERICA BANCORPORATION
(Exact name of the registrant as specified in its charter)

| CALIFORNIA | 94-2156203 |
|---|---|
| (State or Other Jurisdiction of Incorporation or Organization) | (I.R.S. Employer Identification Number) |

1108 FIFTH AVENUE, SAN RAFAEL, CALIFORNIA 94901
(Address of principal executive offices) (zip code)

Registrant’s telephone number, including area code: (707) 863-6000

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

| Title of class: | Name of each exchange on which registered: |
|---|---|
| Common Stock, no par value | The NASDAQ Stock Market LLC |

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YESþ NO o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES o NO þ

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 þ NO o

Indicate by check mark if whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (section 232.405 of this chapter during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files.) YES þ NO o

Indicate by check mark if disclosure of delinquent filers pursuant to item 405 of Regulation S-K (section 229.405) is not contained herein, and will not be contained, to the best of the 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. o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

| Large accelerated filer þ | Accelerated filer o | Non-accelerated filer o | Smaller reporting company o |
|---|---|---|---|
| | | (Do not check if a smaller reporting company) | |

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
YES o NO þ

The aggregate market value of the Common Stock held by non-affiliates of the registrant as of June 30, 2012 as reported on the NASDAQ Global Select Market, was $1,248,315,696.22. Shares of Common Stock held by each executive officer and director and by each person who owns 5% or more of the outstanding Common Stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

Number of shares outstanding of each of the registrant's classes of common stock, as of the close of business on February 19, 2013
27,165,929 Shares

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement relating to registrant's Annual Meeting of Shareholders, to be held on April 25, 2013, are incorporated by reference in Items 10, 11, 12, 13 and 14 of Part III to the extent described therein.

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FORWARD-LOOKING STATEMENTS

This report on Form 10-K contains forward-looking statements about Westamerica Bancorporation for which it claims the protection of the safe harbor provisions contained in the Private Securities Litigation Reform Act of 1995. Examples of forward-looking statements include, but are not limited to: (i) projections of revenues, expenses, income or loss, earnings or loss per share, the payment or nonpayment of dividends, capital structure and other financial items; (ii) statements of plans, objectives and expectations of the Company or its management or board of directors, including those relating to products or services; (iii) statements of future economic performance; and (iv) statements of assumptions underlying such statements. Words such as "believes", "anticipates", "expects", "intends", "targeted", "projected", "continue", "remain", "will", "should", "may" and other similar expressions are intended to identify forward-looking statements but are not the exclusive means of identifying such statements.

These forward-looking statements are based on Management’s current knowledge and belief and include information concerning the Company’s possible or assumed future financial condition and results of operations. A number of factors, some of which are beyond the Company’s ability to predict or control, could cause future results to differ materially from those contemplated. These factors include but are not limited to (1) the length and severity of current and potential future difficulties in the global, national and California economies and the effects of government efforts to address those difficulties; (2) liquidity levels in capital markets; (3) fluctuations in asset prices including, but not limited to stocks, bonds, real estate, and commodities; (4) the effect of acquisitions and integration of acquired businesses; (5) economic uncertainty created by terrorist threats and attacks on the United States, the actions taken in response, and the uncertain effect of these events on the national and regional economies; (6) changes in the interest rate environment; (7) changes in the regulatory environment; (8) competitive pressure in the banking industry; (9) operational risks including data processing system failures or fraud; (10) volatility of interest rate sensitive loans, deposits and investments; (11) asset/liability management risks and liquidity risks; (12) the effect of natural disasters, including earthquakes, fire, flood, drought, and other disasters, on the uninsured value of loan collateral, the financial condition of debtors and issuers of investment securities, the economic conditions affecting the Company’s market place, and commodities and asset values, and (13) changes in the securities markets. The Company undertakes no obligation to update any forward-looking statements in this report. See also “Risk Factors” in Item 1A and other risk factors discussed elsewhere in this Report.

PART I

ITEM 1. BUSINESS

Westamerica Bancorporation (the “Company”) is a bank holding company registered under the Bank Holding Company Act of 1956, as amended (“BHCA”). Its legal headquarters are located at 1108 Fifth Avenue, San Rafael, California 94901. Principal administrative offices are located at 4550 Mangels Boulevard, Fairfield, California 94534 and its telephone number is (707) 863-6000. The Company provides a full range of banking services to individual and corporate customers in Northern and Central California through its subsidiary bank, Westamerica Bank (“WAB” or the “Bank”). The principal communities served are located in Northern and Central California, from Mendocino, Lake and Nevada Counties in the north to Kern County in the south. The Company’s strategic focus is on the banking needs of small businesses. In addition, the Bank owns 100% of the capital stock of Community Banker Services Corporation (“CBSC”), a company engaged in providing the Company and its subsidiaries with data processing services and other support functions.

The Company was incorporated under the laws of the State of California in 1972 as “Independent Bankshares Corporation” pursuant to a plan of reorganization among three previously unaffiliated Northern California banks. The Company operated as a multi-bank holding company until mid-1983, at which time the then six subsidiary banks were merged into a single bank named Westamerica Bank and the name of the holding company was changed to Westamerica Bancorporation.

The Company acquired five banks within its immediate market area during the early to mid 1990's. In April 1997, the Company acquired ValliCorp Holdings, Inc., parent company of ValliWide Bank, the largest independent bank holding company headquartered in Central California. Under the terms of all of the merger agreements, the Company issued shares of its common stock in exchange for all of the outstanding shares of the acquired institutions. The subsidiary banks acquired were merged with and into WAB. These six aforementioned business combinations were accounted for as poolings-of-interests.

In August, 2000, the Company acquired First Counties Bank. In June of 2002 the Company acquired Kerman State Bank. On March 1, 2005, the Company acquired Redwood Empire Bancorp, the parent company of National Bank of the Redwoods (NBR). These acquisitions were accounted for using the purchase accounting method.

On February 6, 2009, Westamerica Bank acquired the banking operations of County Bank ("County") from the Federal Deposit Insurance Corporation ("FDIC"). The Bank and the FDIC entered loss-sharing agreements regarding future losses incurred on acquired loans and foreclosed loan collateral. Under the terms of the loss-sharing agreements, the FDIC absorbs 80 percent of losses and is entitled to 80 percent of loss recoveries on the first $269 million of losses, and absorbs 95 percent of losses and is entitled to 95 percent of loss recoveries on losses exceeding $269 million. The term for loss-sharing on residential real estate loans is ten years, while the term for loss-sharing on non-residential real estate loans is five years in respect to losses and eight years in respect to loss recoveries.On August 20, 2010, Westamerica Bank acquired assets and assumed liabilities of the former Sonoma Valley Bank ("Sonoma") from the FDIC. The County and Sonoma acquired assets and assumed liabilities were measured at estimated fair values, as required by FASB ASC 805, Business Combinations.

Management made significant estimates and exercised significant judgment in accounting for these 2009 and 2010 acquisitions. Management judgmentally measured loan fair values based on loan file reviews (including borrower financial statements and tax returns), appraised collateral values, expected cash flows, and historical loss factors. Repossessed loan collateral was primarily valued based upon appraised collateral values. The Bank also recorded identifiable intangible assets representing the value of the core deposit customer bases based on Management's evaluation of the cost of such deposits relative to alternative funding sources. In determining the value of the identifiable intangible assets, Management used significant estimates including average lives of deposit accounts, future interest rate levels, the cost of servicing various depository products, and other significant estimates. Management used quoted market prices to determine the fair value of investment securities, FHLB advances and other borrowings which were purchased and assumed. See Note 2 of the Notes to Consolidated Financial Statements for additional information regarding the Sonoma acquisition.

At December 31, 2012, the Company had consolidated assets of approximately $5.0 billion, deposits of approximately $4.2 billion and shareholders' equity of approximately $560.1 million. The Company and its subsidiaries employed 935 full-time equivalent staff as of December 31, 2012.

The Company's annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any amendments to those reports as well as beneficial ownership reports on Forms 3, 4 and 5 are available through the SEC's website (http://www.sec.gov). Such documents are also available free of charge from the Company, as well as the Company's director, officer and employee Code of Conduct and Ethics, by request to:

Westamerica Bancorporation
Corporate Secretary A-2M
Post Office Box 1200
Suisun City, California 94585-1200

Supervision and Regulation

The following is not intended to be an exhaustive description of the statutes and regulations applicable to the Company's or the Bank's business. The description of statutory and regulatory provisions is qualified in its entirety by reference to the particular statutory or regulatory provisions. Moreover, major new legislation and other regulatory changes affecting the Company, the Bank, and the financial services industry in general have occurred in the last several years and can be expected to occur in the future. The nature, timing and impact of new and amended laws and regulations cannot be accurately predicted.

Regulation and Supervision of Bank Holding Companies

The Company is a bank holding company subject to the BHCA. The Company reports to, is registered with, and may be examined by, the Board of Governors of the Federal Reserve System ("FRB"). The FRB also has the authority to examine the Company's subsidiaries. The Company is a bank holding company within the meaning of Section 3700 of the California Financial Code. As such, the Company and the Bank are subject to examination by, and may be required to file reports with, the California Commissioner of Financial Institutions (the "Commissioner").

The FRB has significant supervisory and regulatory authority over the Company and its affiliates. 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. Under the BHCA, the Company is required to obtain the prior approval of the FRB before it acquires, merges or consolidates with any bank or bank holding company. Any company seeking to acquire, merge or consolidate with the Company also would be required to obtain the prior approval of the FRB.

The Company is generally prohibited under the BHCA from acquiring ownership or control of more than 5% of any class of 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. However, 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 closely related to banking or managing or controlling banks. 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.

The FRB generally prohibits a bank holding company from declaring or paying a cash dividend that would impose undue pressure on the capital of subsidiary banks or would be funded only through borrowing or other arrangements which might adversely affect a bank holding company's financial position. Under the FRB policy, 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 dividend and its prospective rate of earnings retention appears consistent with its capital needs, asset quality and overall financial condition. See the section entitled "Restrictions on Dividends and Other Distributions" for additional restrictions on the ability of the Company and the Bank to pay dividends.

Transactions between the Company and the Bank are restricted under Regulation W. The regulation codifies prior interpretations of the FRB and its staff under Sections 23A and 23B of the Federal Reserve Act. In general, subject to certain specified exemptions, a bank or its subsidiaries are limited in their ability to engage in "covered transactions" with affiliates: (a) to an amount equal to 10% of the bank's capital and surplus, in the case of covered transactions with any one affiliate; and (b) to an amount equal to 20% of the bank's capital and surplus, in the case of covered transactions with all affiliates. The Company is considered to be an affiliate of the Bank. A "covered transaction" includes, among other things, a loan or extension of credit to an affiliate; a purchase of securities issued by an affiliate; a purchase of assets from an affiliate, with some exceptions; and the issuance of a guarantee, acceptance or letter of credit on behalf of an affiliate.

Federal regulations governing bank holding companies and change in bank control (Regulation Y) provide for a streamlined and expedited review process for bank acquisition proposals submitted by well-run bank holding companies. These provisions of Regulation Y are subject to numerous qualifications, limitations and restrictions. In order for a bank holding company to qualify as "well-run," both it and the insured depository institutions which it controls must meet the "well capitalized" and "well managed" criteria set forth in Regulation Y.

The Gramm-Leach-Bliley Act (the "GLBA"), or the Financial Services Act of 1999, repealed provisions of the Glass-Steagall Act, which had prohibited commercial banks and securities firms from affiliating with each other and engaging in each other's businesses. Thus, many of the barriers prohibiting affiliations between commercial banks and securities firms have been eliminated.

The BHCA was also amended by the GLBA to allow new "financial holding companies" ("FHCs") to offer banking, insurance, securities and other financial products to consumers. Specifically, the GLBA amended section 4 of the BHCA in order to provide for a framework for the engagement in new financial activities. A bank holding company ("BHC") may elect to become an FHC if all its subsidiary depository institutions are well capitalized and well managed. If these requirements are met, a BHC may file a certification to that effect with the FRB and declare that it elects to become an FHC. After the certification and declaration is filed, the FHC may engage either de novo or through an acquisition in any activity that has been determined by the FRB to be financial in nature or incidental to such financial activity. BHCs may engage in financial activities without prior notice to the FRB if those activities qualify under the list of permissible activities in section 4(k) of the BHCA. However, notice must be given to the FRB within 30 days after an FHC has commenced one or more of the financial activities. The Company has not elected to become an FHC.

Regulation and Supervision of Banks

The Bank is a California state-chartered Federal Reserve member bank and its deposits are insured by the FDIC. The Bank is subject to regulation, supervision and regular examination by the California Department of Financial Institutions ("DFI"), and the Federal Reserve. The regulations of these agencies affect most aspects of the Bank's business and prescribe permissible types of loans and investments, the amount of required reserves, requirements for branch offices, the permissible scope of its activities and various other requirements.

In addition to federal banking law, the Bank is also subject to applicable provisions of California law. Under California law, the Bank is subject to various restrictions on, and requirements regarding, its operations and administration including the maintenance

of branch offices and automated teller machines, capital requirements, deposits and borrowings, shareholder rights and duties, and investment and lending activities.

California law permits a state-chartered bank to invest in the stock and securities of other corporations, subject to a state-chartered bank receiving either general authorization or, depending on the amount of the proposed investment, specific authorization from the Commissioner. In addition, the Federal Deposit Insurance Corporation Improvement Act ("FDICIA") imposes limitations on the activities and equity investments of state chartered, federally insured banks. FDICIA also prohibits a state bank from making an investment or engaging in any activity as a principal that is not permissible for a national bank, unless the Bank is adequately capitalized and the FDIC approves the investment or activity after determining that such investment or activity does not pose a significant risk to the deposit insurance fund.

On July 21, 2010, financial regulatory reform legislation entitled the "Dodd-Frank Wall Street Reform and Consumer Protection Act" (the "Dodd-Frank Act") was signed into law. The Dodd-Frank Act implements far-reaching changes across the financial regulatory landscape, including provisions that, among other things, will:

- Centralize responsibility for consumer financial protection by creating a new agency, the Consumer Financial Protection Bureau, responsible for implementing, examining and enforcing compliance with federal consumer financial laws.
- Restrict the preemption of state law by federal law and disallow subsidiaries and affiliates of national banks from availing themselves of such preemption.
- Apply the same leverage and risk-based capital requirements that apply to insured depository institutions to most bank holding companies.
- Require bank regulatory agencies to seek to make their capital requirements for banks countercyclical so that capital requirements increase in times of economic expansion and decrease in times of economic contraction.
- Change the assessment base for federal deposit insurance from the amount of insured deposits to consolidated assets less tangible capital, eliminate the ceiling on the size of the Deposit Insurance Fund ("DIF") and increase the floor of the size of the DIF.
- Impose comprehensive regulation of the over-the-counter derivatives market, which would include certain provisions that would effectively prohibit insured depository institutions from conducting certain derivatives businesses in the institution itself.
- Require large, publicly traded bank holding companies to create a risk committee responsible for the oversight of enterprise risk management.
- Implement corporate governance revisions, including with regard to executive compensation and proxy access by shareholders, that apply to all public companies, not just financial institutions.
- Make permanent the $250 thousand limit for federal deposit insurance and provide unlimited federal deposit insurance until December 31, 2012 for non-interest bearing demand transaction accounts at all insured depository institutions.
- Repeal the federal prohibitions on the payment of interest on demand deposits, thereby permitting depository institutions to pay interest on business transaction and other accounts.
- Amend the Electronic Fund Transfer Act ("EFTA") to, among other things, give the FRB the authority to establish rules regarding interchange fees charged for electronic debit transactions by payment card issuers having assets over $10 billion and to enforce a new statutory requirement that such fees be reasonable and proportional to the actual cost of a transaction to the issuer. While the Company's assets are currently less than $10 billion, interchange fees charged by larger institutions may dictate the level of fees smaller institutions will be able to charge to remain competitive.

Many aspects of the Dodd-Frank Act are subject to rulemaking and will take effect over several years, making it difficult to anticipate the overall financial impact on the Company, its customers or the financial industry more generally. Provisions in the legislation that affect the payment of interest on demand deposits and interchange fees

may increase the costs associated with deposits as well as place limitations on certain revenues those deposits may generate.

Capital Standards

The 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 resulting in assets being recognized on the balance sheet as assets, and the extension of credit facilities such as letters of credit and recourse arrangements, which are recorded 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 certain loans. 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 federal banking agencies take into consideration concentrations of credit risk and risks from nontraditional activities, as well as an institution's ability to manage those risks, when determining the adequacy of an institution's capital. This evaluation is made as a part of the institution's regular safety and soundness examination. The federal banking agencies also consider interest rate risk (related to the interest rate sensitivity of an institution's assets and liabilities, and its off balance sheet financial instruments) in the evaluation of a bank's capital adequacy.

As of December 31, 2012, the Company's and the Bank's respective ratios exceeded applicable regulatory requirements. See Note 10 to the consolidated financial statements for capital ratios of the Company and the Bank, compared to the standards for well capitalized depository institutions and for minimum capital requirements.

On June 7, 2012, the Federal Reserve Board invited comment on three proposed rules intended to improve the quality and increase the quantity of capital in the banking industry. Under the proposals, any bank subject to the rules which is unable to maintain a prescribed "capital conservation buffer" will be restricted in the payment of shareholder distributions and in the payment of discretionary executive compensation. The proposals have phase-in schedules for the various provisions; the higher minimum capital requirements are fully phased-in by January 1, 2015 and the "capital conservation buffer" and changed risk-weightings are fully phased-in by January 1, 2019. These proposals do not supersede the Federal Deposit Insurance Corporation Improvement Act (FDICIA) requiring federal banking agencies to take prompt corrective action (PCA) to resolve problems of insured depository institutions. The proposals would revise the PCA thresholds to incorporate the proposed regulatory capital minimums, including the newly proposed "common equity tier 1" ratios. As of December 31, 2012, the Federal Reserve Board had not issued final rules.

Prompt Corrective Action and Other Enforcement Mechanisms

FDICIA requires each federal banking agency to take prompt corrective action to resolve the problems of insured depository institutions, including but not limited to those that fall below one or more prescribed minimum capital ratios.

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. In addition to measures taken under the prompt corrective action provisions, commercial banking organizations may be subject to potential enforcement actions by the federal banking agencies 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 Company's ability to pay dividends to its shareholders is subject to the restrictions set forth in the California General Corporation Law ("CGCL"). The CGCL provides that a corporation may make a distribution to its shareholders if (i) the corporation's retained earnings equal or exceed the amount of the proposed distribution plus unpaid accrued dividends, (if any) on securities with a dividend preference, or (ii) immediately after the dividend, the corporation's total assets equal or exceed total liabilities plus unpaid accrued dividends (if any) on securities with a dividend preference.

FDICIA also implemented certain specific restrictions on transactions and required federal banking 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 limits the interest rates paid on deposits by undercapitalized institutions, restricts the use of brokered deposits, limits the aggregate extensions of credit by a depository institution to an executive officer, director, principal shareholder or related interest, and reduces deposit

insurance coverage for deposits offered by undercapitalized institutions for deposits by certain employee benefits accounts. The federal banking agencies may require an institution to submit an acceptable compliance plan as well as have the flexibility to pursue other more appropriate or effective courses of action given the specific circumstances and severity of an institution's noncompliance with one or more standards.

Federal banking agencies require banks to maintain adequate valuation allowances for potential credit losses. The Company has an internal staff that continually reviews loan quality and reports to the Board of Directors. This analysis includes a detailed review of the classification and categorization of problem loans, assessment of the overall quality and collectability of the loan portfolio, consideration of loan loss experience, trends in problem loans, concentration of credit risk, and current economic conditions, particularly in the Bank's market areas. Based on this analysis, Management, with the review and approval of the Board, determines the adequate level of allowance required. The allowance is allocated to different segments of the loan portfolio, but the entire allowance is available for the loan portfolio in its entirety.

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 which 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.

In addition to the restrictions imposed under federal law, banks chartered under California law generally may only pay cash dividends to the extent such payments do not exceed the lesser of retained earnings of the bank or the bank’s net income for its last three fiscal years (less any distributions to shareholders during this period). In the event a bank desires to pay cash dividends in excess of such amount, the bank may pay a cash dividend with the prior approval of the Commissioner in an amount not exceeding the greatest of the bank’s retained earnings, the bank’s net income for its last fiscal year or the bank’s net income for its current fiscal year.

The federal banking agencies also have the authority to prohibit a depository institution from engaging in business practices which are considered to be unsafe or unsound, possibly including payment of dividends or other payments under certain circumstances even if such payments are not expressly prohibited by statute.

Premiums for Deposit Insurance

Substantially all of the deposits of the Bank are insured up to applicable limits by the Deposit Insurance Fund ("DIF") of the FDIC and are subject to deposit insurance assessments to maintain the DIF. The FDIC utilizes a risk-based assessment system that imposes insurance premiums based upon a risk matrix that takes into account a bank's capital level and supervisory rating ("CAMELS rating").

In November 2009, the FDIC issued a rule that required all insured depository institutions, with limited exceptions, to prepay their estimated quarterly risk-based assessments for the fourth quarter of 2009 and for all of 2010, 2011 and 2012.

In October 2010, the FDIC adopted a new DIF restoration plan to ensure that the DIF reserve ratio reaches 1.35% by September 30, 2020, as required by the Dodd-Frank Act. At least semi-annually, the FDIC will update its loss and income projections for the fund and, if needed, will increase or decrease assessment rates, following notice-and-comment rulemaking if required.

In November 2010, the FDIC issued a final rule to implement provisions of the Dodd-Frank Act that provide for temporary unlimited coverage for noninterest-bearing transaction accounts. The separate coverage for non-interest-bearing transaction accounts became effective on December 31, 2010 and terminated on December 31, 2012.

In February 2011, the FDIC issued a final rule changing the deposit insurance assessment base from total domestic deposits to average total assets minus average tangible equity, as required by the Dodd-Frank Act, effective April 1, 2011. The FDIC also issued a final rule revising the deposit insurance assessment system for “large” institutions having more than $10 billion in assets and another for "highly complex" institutions that have over $50 billion in assets and are fully owned by a parent with over $500 billion in assets. The Bank is neither a “large” nor “highly complex” institution. Under the new assessment rules, the initial base assessment rates range from 5 to 35 basis points, and after potential adjustments for unsecured debt and brokered deposits, assessment rates range from 2.5 to 45 basis points.

The Company cannot provide any assurance as to the effect of any future changes in its deposit insurance premium rates.

Community Reinvestment Act and Fair Lending Developments

The Bank is subject to certain fair lending requirements and reporting obligations involving home mortgage lending operations and Community Reinvestment Act ("CRA") activities. The CRA generally requires the federal banking agencies to evaluate the record of financial institutions in meeting the credit needs of their local communities, including low and moderate income neighborhoods. In addition to substantive penalties and corrective measures that may be required for a violation of certain fair lending laws, the federal banking agencies may take compliance with such laws and CRA into account when regulating and supervising other activities.

Financial Privacy Legislation and Customer Information Security

The GLBA, in addition to the previously described changes in permissible nonbanking activities permitted to banks, BHCs and FHCs, also required the federal banking agencies, among other federal regulatory agencies, to adopt regulations governing the privacy of consumer financial information. The Bank is subject to the FRB's regulations in this area. The federal bank regulatory agencies have established standards for safeguarding nonpublic personal information about customers that implement provisions of the GLBA (the "Guidelines"). Among other things, the Guidelines require each financial institution, under the supervision and ongoing oversight of its Board of Directors or an appropriate committee thereof, to develop, implement and maintain a comprehensive written information security program designed to ensure the security and confidentiality of customer information, to protect against any anticipated threats or hazards to the security or integrity of such information, and to protect against unauthorized access to or use of such information that could result in substantial harm or inconvenience to any customer.

U.S.A. PATRIOT Act

Title III of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 ("USA Patriot Act") is the International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001. It includes numerous provisions for fighting international money laundering and blocking terrorist access to the U.S. financial system. The goal of Title III is to prevent the U.S. financial system and the U.S. clearing mechanisms from being used by parties suspected of terrorism, terrorist financing and money laundering. The provisions of Title III of the USA Patriot Act which affect the Bank are generally set forth as amendments to the Bank Secrecy Act. These provisions relate principally to U.S. banking organizations' relationships with foreign banks and with persons who are resident outside the United States. The USA Patriot Act does not impose any filing or reporting obligations for banking organizations, but does require certain additional due diligence and recordkeeping practices.

Sarbanes-Oxley Act of 2002

The stated goals of the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley") are to increase corporate responsibility, to provide for enhanced penalties for accounting and auditing improprieties at publicly traded companies and to protect investors by improving the accuracy and reliability of corporate disclosures pursuant to the securities laws. Sarbanes-Oxley generally applies to all companies, both U.S. and non-U.S., that file or are required to file periodic reports under the Securities Exchange Act of 1934 (the "Exchange Act").

Sarbanes-Oxley includes very specific additional disclosure requirements and corporate governance rules, required the SEC and securities exchanges to adopt extensive additional disclosure, corporate governance and other related rules and mandates further studies of certain issues. Sarbanes-Oxley represents significant federal involvement in matters traditionally left to state regulatory systems, such as the regulation of the accounting profession, and to state corporate law, such as the relationship between a board of directors and management and between a board of directors and its committees and public company shareholders. Sarbanes-Oxley addresses, among other matters: (i) independent audit committees for reporting companies whose securities are listed on national exchanges or automated quotation systems (the "Exchanges") and expanded duties and responsibilities for audit committees; (ii) certification of financial statements by the chief executive officer and the chief financial officer; (iii) the forfeiture of bonuses or other incentive-based compensation and profits from the sale of an issuer's securities by directors and senior officers in the twelve month period following initial publication of any financial statements that later require restatement; (iv) a prohibition on insider trading during pension plan black out periods; (v) disclosure of off-balance sheet transactions; (vi) a prohibition on personal loans to directors and officers under most circumstances with exceptions for certain normal course transactions by regulated financial institutions; (vii) expedited electronic filing requirements related to trading by insiders in an issuer's securities on Form 4; (viii) disclosure of a code of ethics and filing a Form 8-K for a change or waiver of such code; (ix) accelerated filing of periodic reports; (x) the formation of the Public Company

Accounting Oversight Board (“PCAOB”) to regulate public accounting firms and the audit of public companies that are subject to the securities laws; (xi) auditor independence; (xii) internal control evaluation and reporting; and (xiii) various increased criminal penalties for violations of securities laws.

Programs To Mitigate Identity Theft

In November 2007, federal banking agencies together with the National Credit Union Administration and Federal Trade Commission adopted regulations under the Fair and Accurate Credit Transactions Act of 2003 to require financial institutions and other creditors to develop and implement a written identity theft prevention program to detect, prevent and mitigate identity theft in connection with certain new and existing accounts. Covered accounts generally include consumer accounts and other accounts that present a reasonably foreseeable risk of identity theft. Each institution’s program must include policies and procedures designed to: (i) identify indicators, or “red flags,” of possible risk of identity theft; (ii) detect the occurrence of red flags; (iii)

respond appropriately to red flags that are detected; and (iv) ensure that the program is updated periodically as appropriate to address changing circumstances. The regulations include guidelines that each institution must consider and, to the extent appropriate, include in its program.

Pending Legislation

Changes to state laws and regulations (including changes in interpretation or enforcement) can affect the operating environment of BHCs and their subsidiaries in substantial and unpredictable ways. From time to time, various legislative and regulatory proposals are introduced. These proposals, if codified, may change banking statutes and regulations and the Company's operating environment in substantial and unpredictable ways. If codified, these proposals could increase or decrease the cost of doing business, limit or expand permissible activities or affect the competitive balance among banks, savings associations, credit unions and other financial institutions. The Company cannot accurately predict whether those changes in laws and regulations will occur, and, if those changes occur, the ultimate effect they would have upon our financial condition or results of operations. It is likely, however, that the current level of enforcement and compliance-related activities of federal and state authorities will continue and potentially increase.

Competition

In the past, the Bank's principal competitors for deposits and loans have been major banks and smaller community banks, savings and loan associations and credit unions. To a lesser extent, competition was also provided by thrift and loans, mortgage brokerage companies and insurance companies. Other institutions, such as brokerage houses, mutual fund companies, credit card companies, and certain retail establishments have offered investment vehicles which also compete with banks for deposit business. Federal legislation in recent years has encouraged competition between different types of financial institutions and fostered new entrants into the financial services market.

Legislative changes, as well as technological and economic factors, can be expected to have an ongoing impact on competitive conditions within the financial services industry. While the future impact of regulatory and legislative changes cannot be predicted with certainty, the business of banking will remain highly competitive.

ITEM 1A. RISK FACTORS

Readers and prospective investors in the Company's securities should carefully consider the following risk factors as well as the other information contained or incorporated by reference in this report.

The risks and uncertainties described below are not the only ones facing the Company. Additional risks and uncertainties that Management is not aware of or focused on or that Management currently deems immaterial may also impair the Company's business operations. This report is qualified in its entirety by these risk factors.

If any of the following risks actually occur, the Company's financial condition and results of operations could be materially and adversely affected. If this were to happen, the value of the company's securities could decline significantly, and investors could lose all or part of their investment in the Company's common stock.

Market and Interest Rate Risk

Changes in interest rates could reduce income and cash flow.

The discussion in this report under "Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations – Asset, Liability and Market Risk Management" and "- Liquidity and Funding" and "Item 7A Quantitative

and Qualitative Disclosures About Market Risk" is incorporated by reference in this paragraph. The Company's income and cash flow depend to a great extent on the difference between the interest earned on loans and investment securities compared to the interest paid on deposits and other borrowings, and the Company's success in competing for loans and deposits. The Company cannot control or prevent changes in the level of interest rates which fluctuate in response to general economic conditions, the policies of various governmental and regulatory agencies, in particular, the Federal Open Market Committee of the FRB, and pricing practices of the Company's competitors. Changes in monetary policy, including changes in interest rates, will influence the origination of loans, the purchase of investments, the generation of deposits and other borrowings, and the rates received on loans and investment securities and paid on deposits and other liabilities.

Changes in capital market conditions could reduce asset valuations.

Capital market conditions, including liquidity, investor confidence, bond issuer credit worthiness, perceived counter-party risk, the supply of and demand for financial instruments, the financial strength of market participants, and other factors, can materially impact the value of the Company's assets. An impairment in the value of the Company's assets could result in asset write-downs, reducing the Company's asset values, earnings, and equity.

Current market developments may adversely affect the Company's industry, business and results of operations.

Declines in the housing market during recent years, with significantly reduced home prices and higher levels of foreclosures and unemployment, have resulted in significant write-downs of asset values by financial institutions, including government-sponsored entities and major commercial and investment banks. These write-downs caused many financial institutions to seek additional capital, to merge with larger and stronger institutions and, in some cases, to fail. During the recent financial crisis and recession, liquidity within the financial system was challenged due to institutions evaluating counter-party risk, margin requirements rose, and other liquidity reducing activities and actions. While liquidity has generally returned to the United States financial system, a recurrence of economic weakness or asset valuation declines could reduce domestic liquidity levels. Further, global economic and financial difficulties, including within Europe, could reduce liquidity in the United States. The Company has no direct operating exposure to European sovereign debt; however, the Company clears daily transactions through large domestic banks which have global operations and exposure. Any resulting lack of available credit, volatility in the financial markets and reduced business activity could materially and adversely affect the Company's business, financial condition and results of operations.

The weakness of other financial institutions could adversely affect the Company.

Financial services institutions are interrelated as a result of trading, clearing, counterparty, or other relationships. The Company routinely executes transactions with counterparties in the financial services industry, including brokers and dealers, commercial banks, investment banks, and other institutional clients. Many of these transactions expose the Company to credit risk in the event of default of the Company's counterparty or client. In addition, the Company's credit risk may be increased when the collateral the Company holds cannot be realized or is liquidated at prices not sufficient to recover the full amount of the secured obligation. There is no assurance that any such losses would not materially and adversely affect the Company's results of operations or earnings.

Shares of Company common stock eligible for future sale or grant of stock options could have a dilutive effect on the market for Company common stock and could adversely affect the market price.

The Articles of Incorporation of the Company authorize the issuance of 150 million shares of common stock (and two additional classes of 1 million shares each, denominated "Class B Common Stock" and "Preferred Stock", respectively) of which approximately 27.2 million shares of common stock were outstanding at December 31, 2012. Pursuant to its stock option plans, at December 31, 2012, the Company had outstanding options for 2.3 million shares of common stock, of which 1.8 million were currently exercisable. As of December 31, 2012, 1.6 million shares of Company common stock remained available for grants under the Company's stock option plans. Sales of substantial amounts of Company common stock in the public market could adversely affect the market price of its common stock.

The Company's payment of dividends on common stock could be eliminated or reduced.

Holders of the Company's common stock are entitled to receive dividends only when, as and if declared by the Company's Board of Directors. Although the Company has historically paid cash dividends on the Company's common stock, the Company is not required to do so and the Company's Board of Directors could reduce or eliminate the Company's common stock dividend in the future.

The Company could repurchase shares of its common stock at price levels considered excessive.

The Company repurchases and retires its common stock in accordance with Board of Directors-approved share repurchase programs. At December 31, 2012, approximately 1.5 million shares remained available to repurchase under such plans. The Company has been active in repurchasing and retiring shares of its common stock when alternative uses of excess capital, such as acquisitions, have been limited. The Company could repurchase shares of its common stock at price levels considered excessive, thereby spending more cash on such repurchases as deemed reasonable and effectively retiring fewer shares than would be retired if repurchases were affected at lower prices.

Risks Related to the Nature and Geographical Location of the Company's Business

The Company invests in loans that contain inherent credit risks that may cause the Company to incur losses.

The Company can provide no assurance that the credit quality of the loan portfolio will not deteriorate in the future and that such deterioration will not adversely affect the Company. As described in this report under "Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations, Loan Portfolio Credit Risk," $372 million of the Company's purchased loans as of December 31, 2012 are indemnified by the FDIC; such indemnification expires February 6, 2014 for approximately 93% percent of the loans and February 6, 2019 for approximately 7 percent of the loans. The risk inherent in such loans will increase with the expiration of FDIC indemnification.

The Company's operations are concentrated geographically in California, and poor economic conditions may cause the Company to incur losses.

Substantially all of the Company's business is located in California. A portion of the loan portfolio of the Company is dependent on real estate. At December 31, 2012, real estate served as the principal source of collateral with respect to approximately 55% of the Company's loan portfolio. The Company's financial condition and operating results will be subject to changes in economic conditions in California. The California economy is currently weak following a severe recession. Much of the California real estate market has experienced a decline in values of varying degrees. This decline is having an adverse impact on the business of some of the Company's borrowers and on the value of the collateral for many of the Company's loans. Generally, the counties surrounding and near San Francisco Bay have been recovering from the recent recession more soundly than counties in the California "Central Valley," from Sacramento in the north to Bakersfield in the south. Approximately 29 percent of the Company's loans are to borrowers in the California "Central Valley." Economic conditions in California are subject to various uncertainties at this time, including the decline in construction and real estate sectors, the California state government's budgetary difficulties and continuing fiscal difficulties. The Company can provide no assurance that conditions in the California economy will not deteriorate in the future and that such deterioration will not adversely affect the Company.

The markets in which the Company operates are subject to the risk of earthquakes and other natural disasters.

Most of the properties of the Company are located in California. Also, most of the real and personal properties which currently secure some of the Company's loans are located in California. California is prone to earthquakes, brush fires, flooding, drought and other natural disasters. In addition to possibly sustaining damage to its own properties, if there is a major earthquake, flood, fire or other natural disaster, the Company faces the risk that many of its borrowers may experience uninsured property losses, or sustained job interruption and/or loss which may materially impair their ability to meet the terms of their loan obligations. A major earthquake, flood, prolonged drought, fire or other natural disaster in California could have a material adverse effect on the Company's business, financial condition, results of operations and cash flows.

Adverse changes in general business or economic conditions could have a material adverse effect on the Company's financial condition and results of operations.

A sustained or continuing weakness or weakening in business and economic conditions generally or specifically in the principal markets in which the Company does business could have one or more of the following adverse impacts on the Company's business:

- a decrease in the demand for loans and other products and services offered by the Company;
- an increase or decrease in the usage of unfunded credit commitments;
- a decrease in the amount of deposits;
- a decrease in non-depository funding available to the Company;

- an impairment of certain intangible assets, such as goodwill;
- an increase in the number of clients and counterparties who become delinquent, file for protection under bankruptcy laws or default on their loans or other obligations to the Company, which could result in a higher level of nonperforming assets, net charge-offs, provision for loan losses, and valuation adjustments on assets;
- an impairment in the value of investment securities;
- an impairment in the value of life insurance policies owned by the Company;
- an impairment in the value of real estate owned by the Company.

Recent market conditions led to the failure or merger of a number of financial institutions. Financial institution failures can result in further losses as a consequence of defaults on securities issued by them and defaults under contracts entered into with such entities as counterparties. Weak economic conditions can significantly weaken the strength and liquidity of financial institutions.

The Company's financial performance generally, and in particular the ability of borrowers to pay interest on and repay principal of outstanding loans and the value of collateral securing those loans, is highly dependent upon on the business environment in the markets where the Company operates, in the State of California and in the United States as a whole. A favorable business environment is generally characterized by, among other factors, economic growth, healthy labor markets, efficient capital markets, low inflation, high business and investor confidence, and strong business earnings. Unfavorable or uncertain economic and market conditions can be caused by: declines in economic growth, high rates of unemployment, declines in business activity or consumer, investor or business confidence; limitations on the availability of or increases in the cost of credit and capital; increases in inflation or interest rates; natural disasters; or a combination of these or other factors.

Such business conditions could adversely affect the credit quality of the Company's loans, the demand for loans, loan volumes and related revenue, securities valuations, amounts of deposits, availability of funding, results of operations and financial condition.

The value of securities in the Company's investment securities portfolio may be negatively affected by disruptions in securities markets

The market for some of the investment securities held in the Company's portfolio can be extremely volatile. Volatile market conditions may detrimentally affect the value of these securities, such as through reduced valuations due to the perception of heightened credit and liquidity risks. There can be no assurance that the declines in market value will not result in other than temporary impairments of these assets, which would lead to accounting charges that could have a material adverse effect on the Company's net income and capital levels.

Regulatory Risks

Restrictions on dividends and other distributions could limit amounts payable to the Company.

As a holding company, a substantial portion of the Company's cash flow typically comes from dividends paid by the Bank. Various statutory provisions restrict the amount of dividends the Company's subsidiaries can pay to the Company without regulatory approval. A reduction in subsidiary dividends paid to the Company could limit the capacity of the Company to pay dividends. In addition, if any of the Company's subsidiaries were to liquidate, that subsidiary's creditors will be entitled to receive distributions from the assets of that subsidiary to satisfy their claims against it before the Company, as a holder of an equity interest in the subsidiary, will be entitled to receive any of the assets of the subsidiary.

Adverse effects of changes in banking or other laws and regulations or governmental fiscal or monetary policies could adversely affect the Company.

The Company is subject to significant federal and state regulation and supervision, which is primarily for the benefit and protection of the Company's customers and not for the benefit of investors. In the past, the Company's business has been materially affected by these regulations. As an example, the FRB amended Regulation E, which implements the Electronic Fund Transfer Act, in a manner that limits the ability of a financial institution to assess an overdraft fee for paying automated teller machine (ATM) and one-time debit card transactions that overdraw a consumer's account, unless the consumer affirmatively consents, or opts in, to the institution's payment of overdrafts for these transactions. Implementation of the new provisions significantly reduced overdraft fees assessed by the Bank.

Laws, regulations or policies, including accounting standards and interpretations currently affecting the Company and the Company's subsidiaries, may change at any time. Regulatory authorities may also change their interpretation of these statutes and regulations. Therefore, the Company's business may be adversely affected by any future changes in laws, regulations, policies or interpretations or regulatory approaches to compliance and enforcement including future

acts of terrorism, major U.S. corporate bankruptcies and reports of accounting irregularities at U.S. public companies.

Additionally, the Company's business is affected significantly by the fiscal and monetary policies of the federal government and its agencies. The Company is particularly affected by the policies of the FRB, which regulates the supply of money and credit in the United States of America. Under long- standing policy of the FRB, a BHC is expected to act as a source of financial strength for its subsidiary banks. As a result of that policy, the Company may be required to commit financial and other resources to its subsidiary bank in circumstances where the Company might not otherwise do so. Among the instruments of monetary policy available to the FRB are (a) conducting open market operations in U.S. government securities, (b) changing the discount rates of borrowings by depository institutions, (c) changing interest rates paid on balances financial institutions deposit with the FRB, and (d) imposing or changing reserve requirements against certain borrowings by banks and their affiliates. These methods are used in

varying degrees and combinations to directly affect the availability of bank loans and deposits, as well as the interest rates charged on loans and paid on deposits. The policies of the FRB may have a material effect on the Company's business, results of operations and financial condition.

The FRB has been providing vast amounts of liquidity into the banking system due to current economic and capital market conditions. The FRB has been purchasing large quantities of U.S. government securities, including agency-backed mortgage securities, increasing the demand for such securities thereby reducing interest rates. A reduction in the FRB's activities or capacity could reduce liquidity in the markets and cause interest rates to rise, thereby increasing funding costs to the Bank or reducing the availability of funds to the Bank to finance its existing operations and causing investment securities and loans to decline in value.

Federal and state governments could pass legislation detrimental to the Company's performance.

As an example, the Company could experience higher credit losses because of federal or state legislation or regulatory action that reduces the amount the Bank's borrowers are otherwise contractually required to pay under existing loan contracts. Also, the Company could experience higher credit losses because of federal or state legislation or regulatory action that limits or delays the Bank's ability to foreclose on property or other collateral or makes foreclosure less economically feasible.

The FDIC insures deposits at insured financial institutions up to certain limits. The FDIC charges insured financial institutions premiums to maintain the Deposit Insurance Fund. Recent economic conditions have increased bank failures, in which case the FDIC takes control of failed banks and insures payment of deposits up to insured limits using the resources of the Deposit Insurance Fund. In such case, the FDIC may increase premium assessments to maintain adequate funding of the Deposit Insurance Fund.

The behavior of depositors in regard to the level of FDIC insurance could cause our existing customers to reduce the amount of deposits held at the Bank, and could cause new customers to open deposit accounts at the Bank. The level and composition of the Bank's deposit portfolio directly impacts the Bank's funding cost and net interest margin.

Systems, Accounting and Internal Control Risks

The accuracy of the Company's judgments and estimates about financial and accounting matters will impact operating results and financial condition.

The discussion under "Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Policies" in this report and the information referred to in that discussion is incorporated by reference in this paragraph. The Company makes certain estimates and judgments in preparing its financial statements. The quality and accuracy of those estimates and judgments will have an impact on the Company's operating results and financial condition.

The Company's information systems may experience an interruption or breach in security.

The Company relies heavily on communications and information systems to conduct its business. Any failure, interruption or breach in security of these systems could result in failures or disruptions in the Company's accounting, customer relationship management and other systems. Communication and information systems failures can result from a variety of risks including, but not limited to, telecommunication line integrity, weather, terrorist acts, natural disasters, accidental disasters, unauthorized breaches of security systems, and other events. There can be no assurance that any such failures, interruptions or security breaches will not occur or, if they do occur, that they will be adequately corrected by the Company or its vendors. The occurrence of any such failures, interruptions or security breaches could damage the Company's reputation, result in a loss of customer business, subject the Company to

additional regulatory scrutiny, or expose the Company to litigation and possible financial liability, any of which could have a material adverse effect on the Company's financial condition and results of operations.

The Company's controls and procedures may fail or be circumvented.

Management regularly reviews and updates the Company's internal control over financial reporting, disclosure controls and procedures, and corporate governance policies and procedures. The Company maintains controls and procedures to mitigate against risks such as processing system failures and errors, and customer or employee fraud, and maintains insurance coverage for certain of these risks. Any system of controls and procedures, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Events could occur which are not prevented or detected by the Company's internal controls or are not insured against or are in excess of the Company's

insurance limits or insurance underwriters' financial capacity. Any failure or circumvention of the Company's controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on the Company's business, results of operations and financial condition.

The Company may have underestimated losses on purchased loans.

On February 6, 2009, the Bank acquired approximately $1.2 billion in loans and repossessed loan collateral of the former County Bank from the FDIC as its receiver. At December 31, 2012, $372.3 million in loans and $13.7 million in repossessed loan collateral remained outstanding. On August 20, 2010, the Bank acquired approximately $217 million in loans and repossessed loan collateral of the former Sonoma Valley Bank from the FDIC as its receiver. At December 31, 2012, $74.9 million in loans and $3.4 million in repossessed loan collateral remained outstanding. These purchased assets had suffered substantial deterioration at the respective acquisition dates, and the Company can provide no assurance that they will not continue to deteriorate now that they are the Bank's assets. If Management's estimates of purchased asset fair values as of the acquisition dates are higher than ultimate cash flows, the recorded carrying amount of the assets may need to be reduced with a corresponding charge to earnings, net of FDIC loss indemnification on former County Bank assets.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None

ITEM 2. PROPERTIES

Branch Offices and Facilities

Westamerica Bank is engaged in the banking business through 95 branch offices in 21 counties in Northern and Central California. WAB believes all of its offices are constructed and equipped to meet prescribed security requirements.

The Company owns 33 branch office locations and one administrative facility and leases 70 facilities. Most of the leases contain multiple renewal options and provisions for rental increases, principally for changes in the cost of living index, and for changes in other operating costs such as property taxes and maintenance.

ITEM 3. LEGAL PROCEEDINGS

Neither the Company nor any of its subsidiaries is a party to any material pending legal proceeding, nor is their property the subject of any material pending legal proceeding, other than ordinary routine legal proceedings arising in the ordinary course of the Company's business. None of these proceedings is expected to have a material adverse impact upon the Company's business, financial position or results of operations.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable

PART II

## ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDERS MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

The Company's common stock is traded on the NASDAQ Global Select Market ("NASDAQ") under the symbol "WABC". The following table shows the high and the low sales prices for the common stock, for each quarter, as reported by NASDAQ:

| | High | Low |
|---|---|---|
| 2012: | | |
| First quarter | $49.53 | $43.90 |
| Second quarter | 48.62 | 43.01 |
| Third quarter | 49.39 | 44.08 |
| Fourth quarter | 47.72 | 40.50 |
| 2011: | | |
| First quarter | $56.96 | $49.25 |
| Second quarter | 52.53 | 46.91 |
| Third quarter | 50.52 | 36.32 |
| Fourth quarter | 46.73 | 36.34 |

As of January 31, 2013, there were approximately 6,800 shareholders of record of the Company's common stock.

The Company has paid cash dividends on its common stock in every quarter since its formation in 1972, and it is currently the intention of the Board of Directors of the Company to continue payment of cash dividends on a quarterly basis. There is no assurance, however, that any dividends will be paid since they are dependent upon earnings, cash balances, financial condition and capital requirements of the Company and its subsidiaries as well as policies of the FRB pursuant to the BHCA. See Item 1, "Business - Supervision and Regulation." As of December 31, 2012, $170 million was available for payment of dividends by the Company to its shareholders, under applicable laws and regulations.

The notes to the consolidated financial statements included in this report contain additional information regarding the Company's capital levels, regulations affecting subsidiary bank dividends paid to the Company, the Company's earnings, financial condition and cash flows, and cash dividends declared and paid on common stock.

On February 13, 2009, the Company issued a warrant to purchase 246,640 shares of its common stock at an exercise price of $50.92 per share with an expiration date of February 13, 2019. The warrant remained outstanding as of December 31, 2012.

Stock performance

The following chart compares the cumulative return on the Company's stock during the ten years ended December 31, 2012 with the cumulative return on the S&P 500 composite stock index and NASDAQ'S Bank Index. The comparison assumes $100 invested in each on December 31, 2002 and reinvestment of all dividends.

| | Period ending | | | | | |
|---|---|---|---|---|---|---|
| | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 |
| Westamerica Bancorporation (WABC) | $100.00 | $126.71 | $151.61 | $141.25 | $138.30 | $125.20 |
| S&P 500 (SPX) | 100.00 | 128.67 | 142.65 | 149.65 | 173.26 | 182.78 |
| NASDAQ Bank Index (CBNK) | 100.00 | 133.03 | 151.18 | 148.26 | 168.72 | 135.16 |

| | Period ending | | | | |
|---|---|---|---|---|---|
| | 2008 | 2009 | 2010 | 2011 | 2012 |
| Westamerica Bancorporation (WABC) | $147.53 | $164.37 | $169.12 | $138.00 | $138.32 |
| S&P 500 (SPX) | 115.17 | 145.65 | 167.62 | 171.12 | 198.48 |
| NASDAQ Bank Index (CBNK) | 106.06 | 88.78 | 101.36 | 90.71 | 107.70 |

The following chart compares the cumulative return on the Company's stock during the five years ended December 31, 2012 with the cumulative return on the S&P 500 composite stock index and NASDAQ'S Bank Index. The comparison assumes $100 invested in each on December 31, 2007 and reinvestment of all dividends.

| | Period ending | | | | | |
|---|---|---|---|---|---|---|
| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
| Westamerica Bancorporation (WABC) | $100.00 | $117.83 | $131.29 | $135.08 | $110.22 | $110.48 |
| S&P 500 (SPX) | 100.00 | 63.01 | 79.69 | 91.71 | 93.62 | 108.59 |
| NASDAQ Bank Index (CBNK) | 100.00 | 78.47 | 65.69 | 75.00 | 67.12 | 79.69 |

ISSUER PURCHASES OF EQUITY SECURITIES

The table below sets forth the information with respect to purchases made by or on behalf of Westamerica Bancorporation or any "affiliated purchaser" (as defined in Rule 10b-18(a)(3) under the Securities Exchange Act of 1934), of common stock during the quarter ended December 31, 2012 (in thousands, except per share data).

| Period | (a) Total Number of Shares Purchased | (b) Average Price Paid per Share | (c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs* | (d) Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs |
|---|---|---|---|---|
| October 1 through October 31 | 72 | $45.12 | 72 | 1,715 |
| November 1 through November 30 | 173 | 42.24 | 173 | 1,542 |
| December 1 through December 31 | 54 | 42.19 | 54 | 1,488 |
| Total | 299 | 42.92 | 299 | 1,488 |

*Includes 1 thousand, 3 thousand and 1 thousand shares purchased in October, November and December, respectively, by the Company in private transactions with the independent administrator of the Company's Tax Deferred Savings/Retirement Plan (ESOP). The Company includes the shares purchased in such transactions within the total number of shares authorized for purchase pursuant to the currently existing publicly announced program.

The Company repurchases shares of its common stock in the open market to optimize the Company’s use of equity capital and enhance shareholder value and with the intention of lessening the dilutive impact of issuing new shares to meet stock performance, option plans, and other ongoing requirements.

Shares were repurchased during the fourth quarter of 2012 pursuant to a program approved by the Board of Directors on July 26, 2012 authorizing the purchase of up to 2 million shares of the Company’s common stock from time to time prior to September 1, 2013.

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ITEM 6. SELECTED FINANCIAL DATA

The following financial information for the five years ended December 31, 2012 has been derived from the Company's audited consolidated financial statements. This information should be read in conjunction with those statements, notes and other information included elsewhere herein.

WESTAMERICA BANCORPORATION
FINANCIAL SUMMARY
(Dollars in thousands, except per share data)

| Year ended December 31: | 2012 | 2011 | 2010 | 2009 | 2008 |
|---|---|---|---|---|---|
| Interest and fee income | $183,364 | $207,979 | $221,155 | $241,949 | $208,469 |
| Interest expense | 5,744 | 8,382 | 12,840 | 19,380 | 33,243 |
| Net interest income | 177,620 | 199,597 | 208,315 | 222,569 | 175,226 |
| Provision for loan losses | 11,200 | 11,200 | 11,200 | 10,500 | 2,700 |
| Noninterest income: | | | | | |
| Net losses from securities | (1,287) | — | — | — | (56,955) |
| Gain on acquisition | — | — | 178 | 48,844 | — |
| Deposit service charges and other | 58,309 | 60,097 | 61,276 | 63,167 | 54,899 |
| Total noninterest income (loss) | 57,022 | 60,097 | 61,454 | 112,011 | (2,056) |
| Noninterest expense | | | | | |
| Settlements | — | 2,100 | 43 | 158 | 134 |
| Visa litigation | — | — | — | — | (2,338) |
| Other noninterest expense | 116,885 | 125,578 | 127,104 | 140,618 | 102,965 |
| Total noninterest expense | 116,885 | 127,678 | 127,147 | 140,776 | 100,761 |
| Income before income taxes | 106,557 | 120,816 | 131,422 | 183,304 | 69,709 |
| Provision for income taxes | 25,430 | 32,928 | 36,845 | 57,878 | 9,874 |
| Net income | 81,127 | 87,888 | 94,577 | 125,426 | 59,835 |
| Preferred stock dividends and discount accretion | — | — | — | 3,963 | — |
| Net income applicable to common equity | $81,127 | $87,888 | $94,577 | $121,463 | $59,835 |
| Average common shares outstanding | 27,654 | 28,628 | 29,166 | 29,105 | 28,892 |
| Average diluted common shares outstanding | 27,699 | 28,742 | 29,471 | 29,353 | 29,273 |
| Shares outstanding at December 31 | 27,213 | 28,150 | 29,090 | 29,208 | 28,880 |
| Per common share: | | | | | |
| Basic earnings | $2.93 | $3.07 | $3.24 | $4.17 | $2.07 |
| Diluted earnings | 2.93 | 3.06 | 3.21 | 4.14 | 2.04 |
| Book value at December 31 | 20.58 | 19.85 | 18.74 | 17.31 | 14.19 |
| Financial Ratios: | | | | | |
| Return on assets | 1.64% | 1.78% | 1.95% | 2.39% | 1.42% |
| Return on common equity | 14.93% | 16.14% | 18.11% | 25.84% | 14.77% |
| Net interest margin * | 4.79% | 5.32% | 5.54% | 5.42% | 5.13% |
| Net loan losses to average loans | | | | | |
| Originated loans | 0.72% | 0.68% | 0.79% | 0.60% | 0.44% |
| Purchased covered loans | 0.18% | 0.16% | — | — | — |
| Purchased non-covered loans | 0.11% | — | — | — | — |
| Efficiency ratio ** | 46.01% | 45.77% | 44.13% | 39.74% | 51.88% |
| Equity to assets | 11.31% | 11.08% | 11.06% | 10.16% | 10.16% |
| Period End Balances: | | | | | |

| | | | | | |
|---|---|---|---|---|---|
| Assets | $4,952,193 | $5,042,161 | $4,931,524 | $4,975,501 | $4,032,934 |
| Originated loans | 1,664,183 | 1,862,607 | 2,029,541 | 2,201,088 | 2,382,426 |
| Purchased covered loans | 372,283 | 535,278 | 692,972 | 855,301 | — |
| Purchased non-covered loans | 74,891 | 125,921 | 199,571 | — | — |
| Allowance for loan losses | 30,234 | 32,597 | 35,636 | 41,043 | 44,470 |
| Investment securities | 1,981,677 | 1,561,556 | 1,252,212 | 1,111,143 | 1,237,779 |
| Deposits | 4,232,492 | 4,249,921 | 4,132,961 | 4,060,208 | 3,095,054 |
| Identifiable intangible assets and goodwill | 144,934 | 150,302 | 156,277 | 157,366 | 136,907 |
| Short-term borrowed funds | 53,687 | 115,689 | 107,385 | 128,134 | 457,275 |
| Federal Home Loan Bank advances | 25,799 | 26,023 | 61,698 | 85,470 | — |
| Term repurchase agreement | 10,000 | 10,000 | — | 99,044 | — |
| Debt financing and notes payable | 15,000 | 15,000 | 26,363 | 26,497 | 26,631 |
| Shareholders' equity | 560,102 | 558,641 | 545,287 | 505,448 | 409,852 |
| Capital Ratios at Period End: | | | | | |
| Total risk based capital | 16.33 % | 15.75 % | 15.50 % | 14.50 % | 11.76 % |
| Tangible equity to tangible assets | 8.64 % | 8.35 % | 8.15 % | 7.22 % | 7.01 % |
| Dividends Paid Per Common Share | $1.48 | $1.45 | $1.44 | $1.41 | $1.39 |

* Yields on securities and certain loans have been adjusted upward to a "fully taxable equivalent" ("FTE") basis, which is a non-GAAP financial measure, in order to reflect the effect of income which is exempt from federal income taxation at the current statutory tax rate.

** The efficiency ratio is defined as noninterest expense divided by total revenue (net interest income on an FTE basis, which is a non-GAAP financial measure, and noninterest income).

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

The following discussion addresses information pertaining to the financial condition and results of operations of Westamerica Bancorporation and subsidiaries (the "Company") that may not be otherwise apparent from a review of the consolidated financial statements and related footnotes. It should be read in conjunction with those statements and notes found on pages 49 through 89, as well as with the other information presented throughout the Report.

### Critical Accounting Policies

The Company's consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States and follow general practices within the banking industry. Application of these principles requires the Company to make certain estimates, assumptions, and judgments that affect the amounts reported in the financial statements and accompanying notes. These estimates, assumptions, and judgments are based on information available as of the date of the financial statements; accordingly, as this information changes, the financial statements could reflect different estimates, assumptions, and judgments. Certain policies inherently have a greater reliance on the use of estimates, assumptions and judgments and as such have a greater possibility of producing results that could be materially different than originally reported. Estimates, assumptions and judgments are necessary when assets and liabilities are required to be recorded at fair value, when a decline in the value of an asset not carried on the financial statements at fair value warrants an impairment writedown or valuation reserve to be established, or when an asset or liability needs to be recorded contingent upon a future event. Carrying assets and liabilities at fair value inherently results in more financial statement volatility. The fair values and the information used to record valuation adjustments for certain assets and liabilities are based either on quoted market prices or are provided by other third-party sources, when available. The Company utilizes third-party sources to value its investment securities; securities individually valued using quoted prices in active markets are classified as Level 1 assets in the fair value hierarchy, and securities valued using quoted prices in active markets for similar securities (commonly referred to as "matrix" pricing) are classified as Level 2 assets in the fair value hierarchy. The Company validates the reliability of third-party provided values by comparing individual security pricing for a sample of securities between more than one third-party source. When third-party information is not available, valuation adjustments are estimated in good faith by Management.

The most significant accounting policies followed by the Company are presented in Note 1 to the consolidated financial statements. These policies, along with the disclosures presented in the other financial statement notes and in this discussion, provide information on how significant assets and liabilities are valued in the financial statements and how those values are determined. Based on the valuation techniques used and the sensitivity of financial statement amounts to the methods, assumptions, and estimates underlying those amounts, Management has identified the allowance for loan losses accounting and purchased loan accounting to be the accounting areas requiring the most subjective or complex judgments, and as such could be most subject to revision as new information becomes available. A discussion of the factors affecting accounting for the allowance for loan losses and purchased loans is included in the "Loan Portfolio Credit Risk" discussion below.

### Acquisitions

As described in Note 2, Westamerica Bank ("Bank") acquired assets and assumed liabilities of the former Sonoma Valley Bank ("Sonoma") on August 20, 2010 from the Federal Deposit Insurance Corporation ("FDIC").

On February 6, 2009, the Bank acquired assets and assumed liabilities of the former County Bank ("County") from the FDIC. The Bank acquired approximately $1.62 billion assets and assumed approximately $1.58 billion liabilities. The Bank and the FDIC entered loss-sharing agreements regarding future losses incurred on acquired loans and foreclosed loan collateral. Under the terms of the loss-sharing agreements, the FDIC absorbs 80 percent of losses and is entitled to 80 percent of loss recoveries on the first $269 million of losses, and absorbs 95 percent of losses and is entitled to

95 percent of loss recoveries on losses exceeding $269 million. The loss-sharing agreement on residential real estate loans expires February 6, 2019 and the loss-sharing agreement on non-residential real estate loans expires February 6, 2014 as to losses and February 6, 2017 as to loss recoveries. For further information regarding the FDIC loss-sharing agreements, see the “Loan Portfolio Credit Risk” section of this report.

In both acquisitions, the acquired assets and assumed liabilities were measured at estimated fair values, as required by FASB ASC 805, Business Combinations. Management made significant estimates and exercised significant judgment in accounting for the acquisition. Management judgmentally measured loan fair values based on loan file reviews (including borrower financial statements and tax returns), appraised collateral values, expected cash flows, and historical loss factors. Repossessed loan collateral was primarily valued based upon appraised collateral values. The Bank also recorded identifiable intangible assets representing the value of the core deposit customer bases based on an evaluation of the cost of such deposits relative to alternative

funding sources. In determining the value of the identifiable intangible asset, Management used significant estimates including average lives of depository accounts, future interest rate levels, the cost of servicing various depository products, future FDIC insurance assessments, and other significant estimates. Management used quoted market prices to determine the fair value of investment securities, FHLB advances and other borrowings.

Net Income

During the three years ended December 31, 2012, market interest rates declined to low levels. The Federal Reserve's Federal Open Market Committee has maintained highly accommodative monetary polices to influence interest rates to low levels in order to provide stimulus to the economy following the "financial crisis" recession. The Company's principal source of revenue is net interest and fee income, which represents interest earned on loans and investment securities ("earning assets") reduced by interest paid on deposits and other borrowings ("interest bearing liabilities"). The change in market interest rates in the three years ended December 31, 2012 has reduced the spread between interest rates on earning assets and interest bearing liabilities. As a result, the Company's net interest income has declined. The Company also earns revenue from service charges on deposit accounts, merchant processing services, debit card fees, and other fees ("noninterest income"). Service charges on deposit accounts are subject to laws and regulations; recent regulations and customer activity have caused service charges on deposit account to decline in the three years ended December 31, 2012; however, merchant processing fees, debit card fees and trust fees have increased due to higher transaction volumes and the Company's sales efforts. The Company incurs noninterest expenses to deliver products and services to our customers. Management is focused on controlling noninterest expense levels, particularly due to the recent market interest rate pressure on net interest and fee income.

Components of Net Income

| Year ended December 31,<br>(Dollars in thousands except per share amounts) | 2012 | 2011 | 2010 |
|---|---|---|---|
| Net interest and fee income * | $197,027 | $218,867 | $226,683 |
| Provision for loan losses | (11,200 ) | (11,200 ) | (11,200 ) |
| Noninterest income | 57,022 | 60,097 | 61,454 |
| Noninterest expense | (116,885) | (127,678) | (127,147) |
| Income before income taxes * | 125,964 | 140,086 | 149,790 |
| Taxes * | (44,837 ) | (52,198 ) | (55,213 ) |
| Net income | $81,127 | $87,888 | $94,577 |
| Net income applicable to common equity per average fully-diluted common share | $2.93 | $3.06 | $3.21 |
| Net income applicable to common equity as a percentage of average shareholders' equity | 14.93 % | 16.14 % | 18.11 % |
| Net income applicable to common equity as a percentage of average total assets | 1.64 % | 1.78 % | 1.95 % |

* Fully taxable equivalent (FTE)

Comparing 2012 to 2011, net income applicable to common equity decreased $6.8 million, primarily due to lower net interest income (FTE) and a $1.3 million loss on sale of securities, partially offset by decreases in noninterest expense and income tax provision (FTE). The lower net interest income (FTE) was primarily caused by a lower average volume of loans and lower yields on interest earning assets, partially offset by higher average balances of investments, lower average balances of interest-bearing liabilities and lower rates on interest-bearing deposits. The provision for loan losses remained the same, reflecting Management's evaluation of losses inherent in the loan portfolio not covered by loss-sharing agreements with the FDIC and purchased loan credit-default discounts. Noninterest expense declined primarily due to a $2.1 million settlement accrual in 2011 and reduced costs related to personnel and nonperforming assets.

Comparing 2011 to 2010, net income applicable to common equity decreased $6.7 million or 7.1%, due to lower net interest income (FTE), lower noninterest income and higher noninterest expense, partially offset by a decrease in the income tax provision (FTE). The lower net interest income (FTE) was mainly caused by a lower average volume of loans and lower yields on interest earning assets, partially offset by higher average balances of investments and lower rates paid on interest-bearing liabilities. The provision for loan losses was unchanged, reflecting Management's evaluation of losses inherent in the loan portfolio not covered by loss-sharing agreements with the FDIC and purchased loan credit-default discounts. Noninterest income decreased $1.4 million largely due to lower service charges on deposit accounts. Noninterest expense increased $531 thousand mostly due to the $2.1 million settlement accrual, offset by lower personnel costs and deposit insurance assessments.

Net Interest and Fee Income

The Company's primary source of revenue is net interest income, or the difference between interest income earned on loans and investment securities and interest expense paid on interest-bearing deposits and other borrowings. Net interest and fee income (FTE) in 2012 decreased $21.8 million or 10.0% from 2011, to $197.0 million. Comparing 2011 to 2010, net interest and fee income (FTE) decreased $7.8 million or 3.4% to $218.9 million.

Components of Net Interest and Fee Income

| Year ended December 31,<br>(Dollars in thousands) | 2012 | 2011 | 2010 |
|---|---|---|---|
| Interest and fee income | $183,364 | $207,979 | $221,155 |
| Interest expense | (5,744) | (8,382) | (12,840) |
| FTE adjustment | 19,407 | 19,270 | 18,368 |
| Net interest and fee income (FTE) | $197,027 | $218,867 | $226,683 |
| Net interest margin (FTE) | 4.79% | 5.32% | 5.54% |

Comparing 2012 with 2011, net interest income and fee (FTE) declined $21.8 million mostly due to a lower average volume of loans (down $422 million) and lower yields on interest earning assets (down 0.59%), partially offset by higher average balances of investments (up $424 million), lower average balances of interest-bearing liabilities (down $103 million) and lower rates on interest-bearing deposits (down 0.09%).

Loan volumes have declined due to problem loan workout activities, particularly with purchased loans, and reduced volumes of loan originations. In Management’s opinion, current levels of competitive loan pricing do not provide adequate forward earnings potential. As a result, the Company has not currently taken an aggressive posture relative to loan portfolio growth. Management has maintained relatively stable interest-earning asset volumes by increasing investment securities as loan volumes have declined.

Yields on interest-earning assets have declined due to relatively low interest rates prevailing in the market. Economic conditions, competitive pricing and deleveraging by businesses and individuals have reduced loan volumes, placing greater reliance on lower-yielding investment securities. Rates on interest-bearing deposits and borrowings have declined to offset some of the decline in asset yields.

Interest and fee income (FTE) was down $24.5 million or 10.8% from 2012 to 2011. The decrease resulted from a lower average volume of loans and lower yields on interest-earning assets, partially offset by higher average balances of investments. Average interest earning assets increased $2 million in 2012 compared with 2011 due to a $424 million increase in average investments, offset by a $422 million decrease in average loans. The average investment portfolio increased mostly due to higher average balances of collateralized mortgage obligations and mortgage backed securities (up $271 million), municipal securities (up $108 million) and corporate securities (up $92 million), partially offset by a $57 million decline in securities issued by U.S. government sponsored entities. The decrease in the average balance of the loan portfolio was attributable to decreases in average balances of commercial real estate loans (down $183 million), taxable commercial loans (down $118 million), construction loans (down $31 million), residential real estate loans (down $48 million), tax-exempt commercial loans (down $19 million) and consumer loans (down $22 million).

The average yield on earning assets in 2012 was 4.93% compared with 5.52% in 2011. The loan portfolio yield for 2012 compared with 2011 was lower by 0.22% mostly due to lower yields on consumer loans (down 0.76%), residential real estate loans (down 0.33%) and tax-exempt commercial loans (down 0.35%) and taxable commercial loans (down 0.09%), partially offset by higher yields on commercial real estate loans (up 0.15%). Nonperforming loans are included in average loan volumes used to compute loan yields; fluctuations in nonaccrual loan volumes

impact loan yields. The yield on commercial real estate loans in 2012 and 2011 was elevated due to interest received on nonaccrual loans and discount accretion on purchased loans. The investment portfolio yield decreased 0.76% to 3.84% from 2012 to 2011 primarily due to lower yields on collateralized mortgage obligations and mortgage backed securities (down 1.18%), municipal securities (down 0.55%), and securities of U.S. government sponsored entities (down 0.26%), partially offset by a 0.05% increase in yields on corporate securities which contain floating interest rate structures.

Interest expense has been reduced by lowering rates paid on interest-bearing deposits and borrowings and by reducing the volume of higher-cost funding sources. Lower-cost checking and savings deposits accounted for 82.8% of total average deposits in 2012 compared with 79.6% in 2011. In 2012 interest expense declined $2.6 million or 31.5% from 2011, due to lower average balances of interest-bearing liabilities and lower rates paid on interest-bearing deposits. In 2012 average interest-bearing deposits fell $62 million compared with 2011 primarily due to declines in the average balances of time deposits $100 thousand or more (down $75

million), time deposits less than $100 thousand (down $49 million), and preferred money market savings (down $38 million), partially offset by increases in the average balances of money market checking accounts (up $41 million), money market savings (up $30 million) and regular savings (up $29 million). Average balances of debt financing declined $7 million due to the redemption of a $10 million subordinated note in August 2011. Increases were partially offset by higher average balances of term repurchase agreement (up $6 million). Rates paid on interest-bearing deposits averaged 0.16% in 2012 compared with 0.25% in 2011 mainly due to lower rates on money market savings (down 0.07%), preferred money market savings (down 0.32%), regular savings (down 0.05%), time deposits $100 thousand and more (down 0.10%) and time deposits less than $100 thousand (down 0.10%).

Comparing 2011 with 2010, net interest and fee income (FTE) decreased $7.8 million or 3.4%, primarily due to a lower average volume of loans (down $217 million) and lower yields on interest earning assets (down 0.33%), partially offset by higher average balances of investments ($236 million) and lower rates paid on interest-bearing liabilities (down 0.16%).

In 2011, interest and fee income (FTE) was down $12.3 million or 5.1% from 2010. The decrease resulted from a lower average volume of loans and lower yields on interest earning assets, partially offset by higher average balances of investments. A lower average balance of the loan portfolio was mostly attributable to decreases in average balances of taxable commercial loans (down $99 million), commercial real estate loans (down $46 million), residential real estate loans (down $45 million), tax-exempt commercial loans (down $19 million) and construction loans (down $11 million). The average investment portfolio increased mostly due to higher average balances of municipal securities (up $91 million), U.S. government sponsored entity obligations (up $80 million), and corporate securities (up $61 million).

The average yield on earning assets for 2011 was 5.52% compared with 5.85% in 2010. The loan portfolio yield for 2011 decreased 0.14% compared with 2010 primarily due to lower yields on consumer loans (down 0.58%), residential real estate loans (down 0.43%), tax-exempt commercial loans (down 0.15%) and commercial real estate loans (down 0.04%), partially offset by increases in yields on construction loans (up 2.12%) and taxable commercial loans (up 0.06%). The higher yield on construction loans in 2011 was attributable to higher interest receipts on construction loans on nonaccrual status. The investment portfolio yield declined from 5.13% in 2010 to 4.60% in 2011 mainly due to decreases in yields on collateralized mortgage obligations (down 1.23%), residential mortgage-backed securities (down 0.23%) and municipal securities (down 0.20%), partially offset by a 0.39% increase in yields on corporate securities which contain floating interest rate structures.

Comparing 2011 with 2010, interest expense declined $4.5 million or 34.7%, due to lower rates paid on interest-bearing liabilities and a shift from higher costing term repurchase agreements, time deposits less than $100 thousand to low-cost checking and savings accounts. Higher average balances of preferred money market savings (up $48 million), money market savings (up $43 million), money market checking accounts (up $31 million), regular savings (up $27 million) and Federal Home Loan Bank advances (up $7 million) were partially offset by lower average balances of short-term borrowed funds (down $94 million), time deposits less than $100 thousand (down $45 million), time deposits $100 thousand or more (down $15 million) and long-term debt (down $4 million). Lower average balances of short-term borrowed funds were attributable to repayment of the $100 million term repurchase agreement in December of 2010. Lower average balances of long-term debt were attributable to the redemption of a $10 million subordinated note.

Rates paid on interest-bearing liabilities averaged 0.29% in 2011 compared with 0.45% in 2010 mainly due to lower rates on time deposits over $100 thousand (down 0.19%), money market savings (down 0.15%), preferred money market savings (down 0.27%), short-term borrowed funds (down 0.74%), and debt financing and notes payable (down 2.78%), partially offset by a 0.18% increase in rates on time deposits less than $100 thousand. Rates on short-term borrowed funds decreased as the Company repaid the $100 million term repurchase agreement in December of 2010. Rates on debt financing payable declined due to adjustments to the premium amortization on a $10 million

subordinated note, which the Company redeemed in August 2011.

Summary of Average Balances, Yields/Rates and Interest Differential

The following tables present information regarding the consolidated average assets, liabilities and shareholders' equity, the amounts of interest income earned from average interest earning assets and the resulting yields, and the amounts of interest expense incurred on average interest-bearing liabilities and the resulting rates. Average loan balances include nonperforming loans. Interest income includes proceeds from loans on nonaccrual status only to the extent cash payments have been received and applied as interest income and accretion of purchased loan discounts. Yields on tax-exempt securities and loans have been adjusted upward to reflect the effect of income exempt from federal income taxation at the current statutory tax rate.

Distribution of Assets, Liabilities & Shareholders' Equity and Yields, Rates & Interest Margin

| | Year Ended December 31, 2012 | | |
|---|---|---|---|
| (Dollars in thousands) | Average Balance | Interest Income/ Expense | Yields/ Rates |
| Assets | | | |
| Investment securities: | | | |
| Available for sale | | | |
| Taxable | $ 491,338 | $ 11,430 | 2.33 % |
| Tax-exempt (1) | 214,268 | 12,603 | 5.88 % |
| Held to maturity | | | |
| Taxable | 460,381 | 9,916 | 2.15 % |
| Tax-exempt (1) | 634,482 | 35,277 | 5.56 % |
| Loans: | | | |
| Commercial | | | |
| Taxable | 319,235 | 20,216 | 6.33 % |
| Tax-exempt (1) | 128,887 | 7,815 | 6.06 % |
| Commercial real estate | 1,016,805 | 67,863 | 6.67 % |
| Real estate construction | 26,314 | 1,946 | 7.40 % |
| Real estate residential | 264,497 | 9,583 | 3.62 % |
| Consumer | 559,132 | 26,122 | 4.67 % |
| Total Loans (1) | 2,314,870 | 133,545 | 5.77 % |
| Interest-earning assets (1) | 4,115,339 | 202,771 | 4.93 % |
| Other assets | 838,963 | | |
| Total assets | $ 4,954,302 | | |
| Liabilities and shareholders' equity | | | |
| Deposits: | | | |
| Noninterest bearing demand | $ 1,603,981 | — | — |
| Savings and interest-bearing transaction | 1,887,959 | 1,238 | 0.07 % |
| Time less than $100,000 | 264,466 | 1,515 | 0.57 % |
| Time $100,000 or more | 460,833 | 1,530 | 0.33 % |
| Total interest-bearing deposits | 2,613,258 | 4,283 | 0.16 % |
| Short-term borrowed funds | 81,323 | 77 | 0.09 % |
| Federal Home Loan Bank advances | 25,916 | 483 | 1.86 % |
| Term repurchase agreement | 10,000 | 99 | 0.99 % |
| Debt financing and notes payable | 15,000 | 802 | 5.35 % |
| Total interest-bearing liabilities | 2,745,497 | 5,744 | 0.21 % |
| Other liabilities | 61,515 | | |
| Shareholders' equity | 543,309 | | |

| | | | |
|---|---|---|---|
| Total liabilities and shareholders’ equity | $ 4,954,302 | | |
| Net interest spread (2) | | | 4.72 % |
| Net interest income and interest margin (1)(3) | | $ 197,027 | 4.79 % |

(1) Amounts calculated on a fully taxable equivalent basis using the current statutory federal tax rate.

(2) Net interest spread represents the average yield earned on interest earning assets less the average rate incurred on interest-bearing liabilities.

(3) Net interest margin is computed by calculating the difference between interest income and expense, divided by the average balance of interest-earning assets.

Distribution of Assets, Liabilities & Shareholders' Equity and Yields, Rates & Interest Margin

| | Year Ended December 31, 2011 | | |
|---|---|---|---|
| (Dollars in thousands) | Average Balance | Interest Income/ Expense | Yields/ Rates |
| Assets | | | |
| Money market assets and funds sold | $ 430 | $ — | — % |
| Investment securities: | | | |
| Available for sale | | | |
| Taxable | 445,527 | 11,166 | 2.51 % |
| Tax-exempt (1) | 258,867 | 15,989 | 6.18 % |
| Held to maturity | | | |
| Taxable | 188,751 | 6,238 | 3.30 % |
| Tax-exempt (1) | 483,255 | 29,878 | 6.18 % |
| Loans: | | | |
| Commercial | | | |
| Taxable | 437,581 | 28,087 | 6.42 % |
| Tax-exempt (1) | 148,144 | 9,494 | 6.41 % |
| Commercial real estate | 1,199,390 | 78,179 | 6.52 % |
| Real estate construction | 57,529 | 4,331 | 7.53 % |
| Real estate residential | 312,615 | 12,340 | 3.95 % |
| Consumer | 581,286 | 31,547 | 5.43 % |
| Total Loans (1) | 2,736,545 | 163,978 | 5.99 % |
| Interest-earning assets (1) | 4,113,375 | 227,249 | 5.52 % |
| Other assets | 837,379 | | |
| Total assets | $ 4,950,754 | | |
| Liabilities and shareholders' equity | | | |
| Deposits: | | | |
| Noninterest bearing demand | $ 1,496,362 | — | — |
| Savings and interest-bearing transaction | 1,826,118 | 2,419 | 0.13 % |
| Time less than $100,000 | 313,548 | 2,090 | 0.67 % |
| Time $100,000 or more | 535,866 | 2,296 | 0.43 % |
| Total interest-bearing deposits | 2,675,532 | 6,805 | 0.25 % |
| Short-term borrowed funds | 105,157 | 216 | 0.21 % |
| Federal Home Loan Bank advances | 41,741 | 520 | 1.25 % |
| Term repurchase agreement | 3,945 | 39 | 0.98 % |
| Debt financing and notes payable | 22,066 | 802 | 3.63 % |
| Total interest-bearing liabilities | 2,848,441 | 8,382 | 0.29 % |
| Other liabilities | 61,493 | | |
| Shareholders' equity | 544,458 | | |
| Total liabilities and shareholders' equity | $ 4,950,754 | | |
| Net interest spread (2) | | | 5.23 % |
| Net interest income and interest margin (1)(3) | | $ 218,867 | 5.32 % |

(1) Amounts calculated on a fully taxable equivalent basis using the current statutory federal tax rate.

(2) Net interest spread represents the average yield earned on interest earning assets less the average rate incurred on interest-bearing liabilities.

(3) Net interest margin is computed by calculating the difference between interest income and expense, divided by the average balance of interest-earning assets.

Distribution of Assets, Liabilities & Shareholders' Equity and Yields, Rates & Interest Margin

| | Year Ended December 31, 2010 | | | |
|---|---|---|---|---|
| (Dollars in thousands) | Average Balance | Interest Income/ Expense | Yields/ Rates | |
| Assets | | | | |
| Money market assets and funds sold | $1,820 | $2 | 0.11 | % |
| Investment securities: | | | | |
| Available for sale | | | | |
| Taxable | 299,730 | 8,806 | 2.94 | % |
| Tax-exempt (1) | 183,484 | 11,982 | 6.53 | % |
| Held to maturity | | | | |
| Taxable | 175,475 | 7,641 | 4.35 | % |
| Tax-exempt (1) | 479,969 | 30,075 | 6.27 | % |
| Loans: | | | | |
| Commercial | | | | |
| Taxable | 536,530 | 34,140 | 6.36 | % |
| Tax-exempt (1) | 166,702 | 10,941 | 6.56 | % |
| Commercial real estate | 1,245,369 | 81,755 | 6.56 | % |
| Real estate construction | 68,602 | 3,711 | 5.41 | % |
| Real estate residential | 357,398 | 15,668 | 4.38 | % |
| Consumer | 579,432 | 34,802 | 6.01 | % |
| Total Loans (1) | 2,954,033 | 181,017 | 6.13 | % |
| Interest-earning assets (1) | 4,094,511 | 239,523 | 5.85 | % |
| Other assets | 758,969 | | | |
| Total assets | $4,853,480 | | | |
| Liabilities and shareholders' equity | | | | |
| Deposits: | | | | |
| Noninterest bearing demand | $1,412,702 | — | — | |
| Savings and interest-bearing transaction | 1,676,882 | 3,543 | 0.21 | % |
| Time less than $100,000 | 358,096 | 1,769 | 0.49 | % |
| Time $100,000 or more | 550,810 | 3,406 | 0.62 | % |
| Total interest-bearing deposits | 2,585,788 | 8,718 | 0.34 | % |
| Short-term borrowed funds | 107,821 | 463 | 0.43 | % |
| Federal Home Loan Bank advances | 34,378 | 437 | 1.25 | % |
| Term repurchase agreement | 94,842 | 1,528 | 1.61 | % |
| Debt financing and notes payable | 26,433 | 1,694 | 6.41 | % |
| Total interest-bearing liabilities | 2,849,262 | 12,840 | 0.45 | % |
| Other liabilities | 69,333 | | | |
| Shareholders' equity | 522,183 | | | |
| Total liabilities and shareholders' equity | $4,853,480 | | | |
| Net interest spread (2) | | | 5.40 | % |
| Net interest income and interest margin (1)(3) | | $226,683 | 5.54 | % |

(1) Amounts calculated on a fully taxable equivalent basis using the current statutory federal tax rate.

(2) Net interest spread represents the average yield earned on interest earning assets less the average rate incurred on interest-bearing liabilities.

(3) Net interest margin is computed by calculating the difference between interest income and expense, divided by the average balance of interest-earning assets.

The following tables set forth a summary of the changes in interest income and interest expense due to changes in average assets and liability balances (volume) and changes in average interest yields/rates for the periods indicated. Changes not solely attributable to volume or yields/rates have been allocated in proportion to the respective volume and yield/rate components.

Summary of Changes in Interest Income and Expense

| Years Ended December 31, | 2012 Compared with 2011 | | |
|---|---|---|---|
| (In thousands) | Volume | Yield/Rate | Total |
| Increase (decrease) in interest and fee income: | | | |
| Investment securities: | | | |
| Available for sale Taxable | $ 1,112 | $ (848) | $ 264 |
| Tax- exempt (1) | (2,644) | (742) | (3,386) |
| Held to maturity Taxable | 6,464 | (2,786) | 3,678 |
| Tax- exempt (1) | 8,659 | (3,260) | 5,399 |
| Loans: | | | |
| Commercial: | | | |
| Taxable | (7,497) | (374) | (7,871) |
| Tax- exempt (1) | (1,181) | (498) | (1,679) |
| Commercial real estate | (12,123) | 1,807 | (10,316) |
| Real estate construction | (2,310) | (75) | (2,385) |
| Real estate residential | (1,788) | (969) | (2,757) |
| Consumer | (1,109) | (4,316) | (5,425) |
| Total loans (1) | (26,008) | (4,425) | (30,433) |
| Total decrease in interest and fee income (1) | (12,417) | (12,061) | (24,478) |
| Increase (decrease) in interest expense: | | | |
| Deposits: | | | |
| Savings/ interest-bearing | 82 | (1,263) | (1,181) |
| Time less than $100,000 | (301) | (274) | (575) |
| Time $100,000 or more | (291) | (475) | (766) |
| Total interest-bearing | (510) | (2,012) | (2,522) |
| Short-term borrowed funds | (41) | (98) | (139) |
| Federal Home Loan Bank advances | (37) | — | (37) |
| Term repurchase agreement | 46 | 14 | 60 |
| Notes and mortgages payable | (305) | 305 | — |
| Total decrease in interest expense | (847) | (1,791) | (2,638) |
| Decrease in net interest income (1) | $ (11,570) | $ (10,270) | $ (21,840) |

(1) Amounts calculated on a fully taxable equivalent basis using the current statutory federal tax rate.

Summary of Changes in Interest Income and Expense

| Years Ended December 31, (In thousands) | 2011 Compared with 2010 Volume | Yield/Rate | Total |
|---|---|---|---|
| (Decrease) increase in interest and fee income: | | | |
| Money market assets and funds sold | $ (1) | $ (1) | $ (2) |
| Investment securities: | | | |
| Available for sale Taxable | 3,800 | (1,440) | 2,360 |
| Tax- exempt (1) | 4,687 | (680) | 4,007 |
| Held to maturity Taxable | 545 | (1,948) | (1,403) |
| Tax- exempt (1) | 205 | (402) | (197) |
| Loans: | | | |
| Commercial: | | | |
| Taxable | (6,349) | 296 | (6,053) |
| Tax- exempt (1) | (1,194) | (253) | (1,447) |
| Commercial real estate | (3,000) | (576) | (3,576) |
| Real estate construction | (667) | 1,287 | 620 |
| Real estate residential | (1,854) | (1,474) | (3,328) |
| Consumer | 111 | (3,366) | (3,255) |
| Total loans (1) | (12,953) | (4,086) | (17,039) |
| Total decrease in interest and fee income (1) | (3,717) | (8,557) | (12,274) |
| Increase (decrease) in interest expense: | | | |
| Deposits: | | | |
| Savings/ interest-bearing | 293 | (1,417) | (1,124) |
| Time less than $100,000 | (240) | 561 | 321 |
| Time $100,000 or more | (90) | (1,020) | (1,110) |
| Total interest-bearing | (37) | (1,876) | (1,913) |
| Short-term borrowed funds | (11) | (236) | (247) |
| Federal Home Loan Bank advances | 92 | (9) | 83 |
| Term repurchase agreement | (1,061) | (428) | (1,489) |
| Notes and mortgages payable | (246) | (646) | (892) |
| Total decrease in interest expense | (1,263) | (3,195) | (4,458) |
| Decrease in net interest income (1) | $ (2,454) | $ (5,362) | $ (7,816) |

(1) Amounts calculated on a fully taxable equivalent basis using the current statutory federal tax rate.

Provision for Loan Losses

The Company manages credit costs by consistently enforcing conservative underwriting and administration procedures and aggressively pursuing collection efforts with debtors experiencing financial difficulties. The provision for loan losses reflects Management's assessment of credit risk in the loan portfolio during each of the periods presented.

The Company provided $11.2 million each for loan losses in 2012, 2011 and 2010. The Company recorded purchased County Bank (“County”) and Sonoma loans at estimated fair value upon the acquisition dates, February 6, 2009 and August 20, 2010, respectively. Such estimated fair values were recognized for individual loans, although small balance homogenous loans were pooled for valuation purposes. The valuation discounts recorded for purchased loans included Management’s assessment of the risk of principal loss under economic and borrower conditions prevailing on the dates of purchase. The purchased County loans are “covered” by loss-sharing agreements the Company entered with the FDIC which mitigates losses during the term of the agreements. Any deterioration in estimated value related to

principal loss subsequent to the acquisition dates requires additional loss recognition through a provision for loan losses. Of the total recorded provision, the Company provided $1.9 million and $987 thousand for purchased loans in 2012 and 2011, respectively. No assurance can be given future provisions for loan losses related to purchased loans will not be necessary. For further information regarding credit risk, the FDIC loss-sharing agreements, net credit losses and the allowance for loan losses, see the “Loan Portfolio Credit Risk” and “Allowance for Credit Losses” sections of this report.

Noninterest Income

Components of Noninterest Income

| Years Ended December 31, (In thousands) | 2012 | 2011 | 2010 |
|---|---|---|---|
| Service charges on deposit accounts | $27,691 | $29,523 | $33,517 |
| Merchant processing services | 9,734 | 9,436 | 9,057 |
| Debit card fees | 5,173 | 4,956 | 4,888 |
| ATM processing fees | 3,396 | 3,815 | 3,848 |
| Other service charges | 2,801 | 2,827 | 2,768 |
| Trust fees | 2,078 | 1,887 | 1,705 |
| Check sale income | 818 | 844 | 893 |
| Safe deposit rental | 761 | 695 | 678 |
| Financial services commissions | 689 | 423 | 747 |
| Gain on acquisition | — | — | 178 |
| Loss on sale of securities | (1,287 ) | — | — |
| Other noninterest income | 5,168 | 5,691 | 3,175 |
| Total | $57,022 | $60,097 | $61,454 |

In 2012, noninterest income decreased $3.1 million compared with 2011. The decline in 2012 noninterest income is primarily due to a $1.3 million loss realized from the sale of a collateralized mortgage obligation bond whose underlying support tranches began experiencing escalating losses, which began deteriorating the creditworthiness of the bond. Service charges on deposits decreased $1.8 million or 6.2% due to declines in fees charged on overdrawn and insufficient funds accounts (down $2.2 million), partially offset by higher deficit fees charged on analyzed accounts (up $298 thousand) and higher fees charged on checking accounts (up $134 thousand). ATM processing fees decreased $419 thousand or 11.0% primarily due to a lower transaction volume at non-Westamerica Bank terminals. Merchant processing services income increased $298 thousand or 3.2% mainly due to increased transactions. Financial services commissions and Trust fees increased $266 thousand and $191 thousand, respectively, from improved sales activities.

In 2011, noninterest income decreased $1.4 million or 2.2% compared with 2010. Service charges on deposits decreased $4.0 million due to declines in fees charged on overdrawn accounts and insufficient funds (down $3.3 million) and deficit fees charged on analyzed accounts (down $580 thousand). Financial services commissions decreased $324 thousand due to lower sales of mutual funds and annuities. Merchant processing services income increased $379 thousand mainly due to higher transaction volumes. Trust fees increased $182 thousand due to increased accounts.

Noninterest Expense

Components of Noninterest Expense

| Years Ended December 31,<br>(Dollars in thousands) | 2012 | 2011 | 2010 |
|---|---|---|---|
| Salaries and related benefits | $57,388 | $58,501 | $61,748 |
| Occupancy | 15,460 | 16,209 | 15,633 |
| Outsourced data processing services | 8,531 | 8,844 | 8,957 |
| Amortization of intangible assets | 5,368 | 5,975 | 6,333 |
| Professional fees | 3,217 | 4,802 | 3,376 |
| Furniture and equipment | 3,775 | 3,837 | 4,325 |
| Courier service | 3,117 | 3,342 | 3,495 |
| Other Real Estate Owned | 1,235 | 2,458 | 895 |
| Loan expenses | 1,884 | 2,104 | 1,639 |
| Settlements | — | 2,100 | 43 |
| Telephone | 1,735 | 1,705 | 1,590 |
| Postage | 1,326 | 1,467 | 1,540 |
| Stationery and supplies | 1,038 | 1,259 | 1,285 |
| Operational losses | 546 | 1,051 | 828 |
| Advertising and public relations | 649 | 704 | 880 |
| Other | 11,616 | 13,320 | 14,580 |
| Total | $116,885 | $127,678 | $127,147 |

In 2012, noninterest expense decreased $10.8 million or 8.5% compared with 2011 mainly due to a $2.1 million settlement accrual in 2011 and lower costs related to personnel and nonperforming assets. Additionally, the first quarter 2011 included $679 thousand in expenses related to pre-integration costs for the acquired Sonoma, primarily outsourced data processing and personnel costs. Sonoma operations were fully integrated in February 2011. Professional fees declined $1.6 million or 33.0% largely due to lower legal fees. Other real estate owned expense decreased $1.2 million or 49.8% mainly due to higher gains on sale of foreclosed assets and lower maintenance costs, partially offset by higher writedowns. Salaries and related benefits decreased $1.1 million or 1.9% primarily due to lower salaries resulting from employee attrition, partially offset by higher employee benefit costs. Occupancy expense declined $749 thousand or 4.6% mostly due to lower lease rates on bank premises and lower maintenance expense. Operational losses declined $505 thousand or 48.0% due to lower losses for fraudulent deposit account and debit card activities. Loan expense decreased $220 thousand or 10.5% mainly due to lower expenses relating to problem loans.

Noninterest expense increased $531 thousand or 0.4% in 2011 compared with 2010. The 2011 results included $2.1 million in litigation settlement accruals and $679 thousand related to pre-integration costs for the acquired Sonoma, primarily outsourced data processing and personnel costs. Sonoma operations were fully integrated in February 2011. Expenses related to other real estate owned were $1.6 million higher in 2011 due to recognition of declines in value and payment of delinquent property taxes on real estate repossessed during the period. Professional fees increased $1.4 million due to higher legal fees. Occupancy expense increased $576 thousand primarily due to increased rental of bank premises. Loan expense increased $465 thousand primarily due to increases in foreclosure expense, appraisal fees and waived fees on foreclosed loans. Operational losses increased $223 thousand due to increased fraudulent deposit account and debit card activity and branch robberies. Salaries and related benefits decreased $3.2 million primarily due to a reduction in salaries, decreases in incentives, bonuses and other benefits, partially offset by higher group health insurance costs. Deposit insurance assessments declined $1.7 million due to new assessment rules effective April 1, 2011. Equipment expense declined $488 thousand primarily due to lower depreciation and repairs and maintenance expenses. Amortization of identifiable intangible assets declined $358 thousand as intangible assets are amortized on a declining balance method. Advertising and public relations expense decreased $176 thousand.

Provision for Income Tax

In 2012, the Company recorded an income tax provision (FTE) of $44.8 million compared with $52.2 million for 2011. The 2012 provision represents an effective tax rate (FTE) of 35.6%, compared with 37.3% for 2011. The effective tax rates without FTE adjustments were 23.9% and 27.3% for 2012 and 2011, respectively. The lower tax rate in 2012 was attributable to a $968 thousand tax refund from an amended 2006 federal income tax return. This claim for tax refund was processed by the Internal Revenue Service in conjunction with the conclusion of an examination of the Company's 2008 federal income tax return. In addition, the decline in the tax rate is attributable to a higher proportion of pre-tax income represented by tax exempt elements, such as interest earned on municipal loans and investment securities.

The income tax provision (FTE) was $52.2 million in 2011 compared with $55.2 million in 2010. The 2011 effective tax rate (FTE) was 37.3% compared to 36.9% in 2010. The effective tax rates without FTE adjustments were 27.3% and 28.0% for 2011 and 2010, respectively. The lower effective tax rate (FTE) in 2011 is primarily attributable to tax-exempt interest income representing a higher proportion of pre-tax income and increased limited partnership tax credits.

Investment Portfolio

The Company maintains a securities portfolio consisting of securities issued by U.S. Government sponsored entities, state and political subdivisions, corporations and asset-backed and other securities. Investment securities are held in safekeeping by an independent custodian.

Management has maintained relatively stable interest-earning asset volumes by increasing investment securities as loan volumes have declined.

Investment securities assigned to the available for sale portfolio are generally used to supplement the Company's liquidity, provide a prudent yield, and provide collateral for public deposits and other borrowing facilities. Unrealized net gains and losses on available for sale securities are recorded as an adjustment to equity, net of taxes, but are not reflected in the current earnings of the Company. If Management determines depreciation, due to credit risk, in any available for sale security is “other than temporary,” a securities loss will be recognized as a charge to earnings. If a security is sold, any gain or loss is reflected in current earnings and the equity adjustment is reversed. At December 31, 2012, the Company held $825.6 million in securities classified as investments available for sale with a duration of 4.0 years. At December 31, 2012, an unrealized gain, net of taxes, of $14.8 million related to these securities was included in shareholders' equity.

Securities assigned to the held to maturity portfolio earn a prudent yield, provide liquidity from maturities and paydowns, and provide collateral to pledge for federal, state and local government deposits and other borrowing facilities. At December 31, 2012, the held to maturity investment portfolio had a duration of 4.4 years and included $1.1 billion in fixed-rate and $33.2 million in adjustable-rate securities. If Management determines depreciation in any held to maturity security is “other than temporary,” a securities loss will be recognized as a charge to earnings. The Company had no trading securities at December 31, 2012. For more information on investment securities, see the notes accompanying the consolidated financial statements.

The following table shows the fair value carrying amount of the Company’s investment securities available for sale as of the dates indicated:

Available for Sale Portfolio

| At December 31,<br>(In thousands) | 2012 | 2011 | 2010 |
|---|---|---|---|
| U.S. Treasury securities | $3,558 | $3,596 | $3,542 |
| Securities of U.S. Government sponsored entities | 49,525 | 117,472 | 172,877 |
| Residential mortgage backed securities | 56,932 | 90,408 | 109,829 |
| Commercial mortgage backed securities | 4,145 | 4,530 | 5,065 |
| Obligations of States and political subdivisions | 215,247 | 246,093 | 261,133 |
| Residential collateralized mortgage obligations | 221,105 | 51,164 | 25,603 |
| Asset-backed securities | 16,005 | 7,306 | 8,286 |
| FHLMC and FNMA stock | 2,880 | 1,847 | 655 |
| Corporate securities | 252,838 | 112,199 | 79,191 |

| | | | |
|---|---|---|---|
| Other securities | 3,401 | 4,138 | 5,303 |
| Total | $825,636 | $638,753 | $671,484 |

The following table sets forth the relative maturities and contractual yields of the Company's available for sale securities (stated at fair value) at December 31, 2012. Yields on state and political subdivision securities have been calculated on a fully taxable equivalent basis using the current federal statutory rate. Mortgage-backed securities are shown separately because they are typically paid in monthly installments over a number of years.

Available for Sale Maturity Distribution

| At December 31, 2012 (Dollars in thousands) | Within one year | After one but within five years | After five but within ten years | After ten years | Mortgage-backed | Other | Total |
|---|---|---|---|---|---|---|---|
| U.S. Treasury securities | $3,039 | $519 | $— | $— | $— | $— | $3,558 |
| Interest rate | 0.97 % | 1.45 % | — % | — % | — % | — % | 1.04 % |
| U.S. Government sponsored entities | — | 48,584 | 941 | — | — | — | 49,525 |
| Interest rate | — | 0.90 % | 5.85 % | — | — | — | 0.99 % |
| States and political subdivisions | 7,420 | 30,589 | 62,599 | 114,639 | — | — | 215,247 |
| Interest rate (FTE) | 6.91 % | 5.53 % | 6.03 % | 6.23 % | — | — | 6.09 % |
| Asset-backed securities | — | 10,177 | — | 5,828 | — | — | 16,005 |
| Interest rate | — | 0.69 % | — | 0.53 % | — | — | 0.63 % |
| Corporate securities | 30,227 | 222,611 | — | — | — | — | 252,838 |
| Interest rate | 1.72 % | 1.96 % | — | — | — | — | 1.94 % |
| Subtotal | 40,686 | 312,480 | 63,540 | 120,467 | — | — | 537,173 |
| Interest rate (FTE) | 2.61 % | 2.10 % | 6.03 % | 5.95 % | — | — | 3.47 % |
| Mortgage backed securities and residential collateralized mortgage obligations | — | — | — | — | 282,182 | — | 282,182 |
| Interest rate | — | — | — | — | 2.26 % | — | 2.26 % |
| Other without set maturities | — | — | — | — | — | 6,281 | 6,281 |
| Interest rate (FTE) | — | — | — | — | — | 3.40 % | 3.40 % |
| Total | $40,686 | $312,480 | $63,540 | $120,467 | $282,182 | $6,281 | $825,636 |
| Interest rate (FTE) | 2.61 % | 2.10 % | 6.03 % | 5.95 % | 2.26 % | 3.40 % | 3.06 % |

The following table shows the carrying amount (amortized cost) and fair value of the Company's investment securities held to maturity as of the dates indicated:

Held to Maturity Portfolio

| At December 31, (In thousands) | 2012 | 2011 | 2010 |
|---|---|---|---|
| Securities of U.S. Government sponsored entities | $3,232 | $— | $— |
| Residential mortgage backed securities | 72,807 | 54,869 | 40,531 |
| Obligations of States and political subdivisions | 680,802 | 625,390 | 455,372 |
| Residential collateralized mortgage obligations | 399,200 | 242,544 | 84,825 |
| Total | $1,156,041 | $922,803 | $580,728 |
| Fair value | $1,184,557 | $947,493 | $594,711 |

The following table sets forth the relative maturities and contractual yields of the Company's held to maturity securities at December 31, 2012. Yields on state and political subdivision securities have been calculated on a fully taxable equivalent basis using the current federal statutory rate. Mortgage-backed securities are shown separately because they are typically paid in monthly installments over a number of years.

Held to Maturity Maturity Distribution

| At December 31, 2012, (Dollars in thousands) | Within One year | After one but within five years | After five but within ten years | After ten years | Mortgage-backed | Total |
|---|---|---|---|---|---|---|
| Securities of U.S. Government sponsored entities | $— | $— | $ 3,232 | $— | $ — | $3,232 |
| Interest rate | — % | — % | 1.44 % | — % | — % | 1.44 % |
| States and political subdivisions | 10,265 | 167,162 | 224,371 | 279,004 | — | 680,802 |
| Interest rate (FTE) | 5.13 % | 5.74 % | 5.50 % | 5.58 % | — | 5.59 % |
| Subtotal | 10,265 | 167,162 | 227,603 | 279,004 | — | 684,034 |
| Interest rate (FTE) | 5.13 % | 5.74 % | 5.44 % | 5.58 % | — | 5.57 % |
| Mortgage backed securities and residential collateralized mortgage obligations | — | — | — | — | 472,007 | 472,007 |
| Interest rate | — | — | — | — | 1.86 % | 1.86 % |
| Total | $10,265 | $ 167,162 | $ 227,603 | $279,004 | $ 472,007 | $1,156,041 |
| Interest rate (FTE) | 5.13 % | 5.74 % | 5.44 % | 5.58 % | 1.86 % | 4.05 % |

Loan Portfolio

For management purposes, the Company segregates its loan portfolio into three segments. Loans originated by the Company following its loan underwriting policies and procedures are separated from purchased loans. Former County Bank loans purchased from the FDIC with loss-sharing agreements ("purchased covered loans") are segregated as are former Sonoma Valley Bank loans purchased from the FDIC without loss-sharing agreements ("purchased non-covered loans"). Loan volumes have declined due to problem loan workout activities, particularly with purchased loans, and reduced volumes of loan originations. In Management's opinion, current levels of competitive loan pricing do not provide adequate forward earnings potential. As a result, the Company has not currently taken an aggressive posture relative to loan portfolio growth.

The following table shows the composition of the loan portfolio of the Company by type of loan and type of borrower, on the dates indicated:

Originated Loan Portfolio

| At December 31, (In thousands) | 2012 | 2011 | 2010 | 2009 | 2008 |
|---|---|---|---|---|---|
| Commercial | $340,116 | $398,446 | $474,183 | $498,594 | $524,786 |
| Commercial real estate | 632,927 | 704,655 | 757,140 | 801,008 | 817,423 |
| Real estate construction | 7,984 | 14,580 | 26,145 | 32,156 | 52,664 |
| Real estate residential | 222,458 | 271,111 | 310,196 | 371,197 | 458,447 |
| Consumer | 460,698 | 473,815 | 461,877 | 498,133 | 529,106 |
| Total loans | $1,664,183 | $1,862,607 | $2,029,541 | $2,201,088 | $2,382,426 |

Purchased Covered Loan Portfolio

| At December 31,<br>(In thousands) | 2012 | 2011 | 2010 | 2009 |
|---|---|---|---|---|
| Commercial | $50,984 | $99,538 | $168,985 | $253,349 |
| Commercial real estate | 239,979 | 331,807 | 390,682 | 445,440 |
| Real estate construction | 7,007 | 13,876 | 28,380 | 40,460 |
| Real estate residential | 8,941 | 12,492 | 18,374 | 18,521 |
| Consumer | 65,372 | 77,565 | 86,551 | 97,531 |
| Total loans | $372,283 | $535,278 | $692,972 | $855,301 |

Purchased Non-covered Loan Portfolio

| At December 31,<br>(In thousands) | 2012 | 2011 | 2010 |
|---|---|---|---|
| Commercial | $10,231 | $15,378 | $15,420 |
| Commercial real estate | 43,688 | 78,034 | 122,888 |
| Real estate construction | 1,524 | 5,981 | 21,620 |
| Real estate residential | 2,636 | 3,124 | 7,055 |
| Consumer | 16,812 | 23,404 | 32,588 |
| Total loans | $74,891 | $125,921 | $199,571 |

The following table shows the maturity distribution and interest rate sensitivity of commercial, commercial real estate, and construction loans at December 31, 2012. Balances exclude residential real estate loans and consumer loans totaling $776.9 million. These types of loans are typically paid in monthly installments over a number of years.

Loan Maturity Distribution

| At December 31, 2012<br>(In thousands) | Within<br>One Year | One to<br>Five Years | After<br>Five Years | Total |
|---|---|---|---|---|
| Commercial and commercial real estate | $622,833 | $ 540,324 | $ 154,768 | $1,317,925 |
| Real estate construction | 16,515 | — | — | 16,515 |
| Total | $639,348 | $ 540,324 | $ 154,768 | $1,334,440 |
| Loans with fixed interest rates | $309,371 | $ 160,480 | $ 19,354 | $489,205 |
| Loans with floating or adjustable interest rates | 329,977 | 379,844 | 135,414 | 845,235 |
| Total | $639,348 | $ 540,324 | $ 154,768 | $1,334,440 |

Commitments and Letters of Credit

The Company issues formal commitments on lines of credit to well-established and financially responsible commercial enterprises. Such commitments can be either secured or unsecured and are typically in the form of revolving lines of credit for seasonal working capital needs. Occasionally, such commitments are in the form of letters of credit to facilitate the customers' particular business transactions. Commitment fees are generally charged for commitments and letters of credit. Commitments on lines of credit and letters of credit typically mature within one year. For further information, see the accompanying notes to the consolidated financial statements.

Loan Portfolio Credit Risk

The risk that loan customers do not repay loans extended by the Bank is a significant risk to the Company. The Company closely monitors the markets in which it conducts its lending operations and follows a strategy to control exposure to loans with high credit risk. The Bank's organization structure separates the functions of business development and loan underwriting; Management believes this segregation of duties avoids inherent conflicts of combining business development and loan approval functions. In measuring and managing credit risk, the Company adheres to the following practices.

- The Bank maintains a Loan Review Department which reports directly to the Board of Directors. The Loan Review Department performs independent evaluations of loans and assigns credit risk grades to evaluated loans using grading standards employed by bank regulatory agencies. Those loans judged to carry higher risk attributes are referred to as "classified loans." Classified loans receive elevated management attention to maximize collection.

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The Bank maintains two loan administration offices whose sole responsibility is to manage and collect classified loans.

Classified loans with higher levels of credit risk are further designated as “nonaccrual loans.” Management places classified loans on nonaccrual status when full collection of contractual interest and principal payments is in doubt. Uncollected interest previously accrued on loans placed on nonaccrual status is charged against interest income, net of estimated FDIC reimbursements under loss-sharing agreements. The Company does not accrue interest income on loans following placement on nonaccrual status. Interest payments received on nonaccrual loans are applied to reduce the carrying amount of the loan unless the carrying amount is well secured by loan collateral or covered by FDIC loss-sharing agreements. “Nonperforming assets” include nonaccrual loans, loans 90 or more days past due and still accruing, and repossessed loan collateral (commonly referred to as “Other Real Estate Owned”).

Nonperforming Assets

| | At December 31, | | | | |
|---|---|---|---|---|---|
| | 2012 | 2011 | 2010 | 2009 | 2008 |
| | (In thousands) | | | | |
| Originated: | | | | | |
| Nonperforming nonaccrual loans | $10,016 | $ 10,291 | $ 20,845 | $ 19,837 | $ 8,883 |
| Performing nonaccrual loans | 1,759 | 5,256 | 23 | 25 | 1,143 |
| Total nonaccrual loans | 11,775 | 15,547 | 20,868 | 19,862 | 10,026 |
| Accruing loans 90 or more days past due | 455 | 2,047 | 766 | 800 | 755 |
| Total nonperforming loans | 12,230 | 17,594 | 21,634 | 20,662 | 10,781 |
| Other real estate owned | 9,295 | 14,868 | 11,424 | 12,642 | 3,505 |
| Total nonperforming assets | $21,525 | $ 32,462 | $ 33,058 | $ 33,304 | $ 14,286 |
| | | | | | |
| Purchased covered: | | | | | |
| Nonperforming nonaccrual loans | $11,698 | $ 9,388 | $ 28,581 | $ 66,965 | $ - |
| Performing nonaccrual loans | 1,323 | 4,924 | 18,564 | 18,183 | - |
| Total nonaccrual loans | 13,021 | 14,312 | 47,145 | 85,148 | - |
| Accruing loans 90 or more days past due | 155 | 241 | 355 | 210 | - |
| Total nonperforming loans | 13,176 | 14,553 | 47,500 | 85,358 | - |
| Other real estate owned | 13,691 | 19,135 | 21,791 | 23,297 | - |
| Total nonperforming assets | $26,867 | $ 33,688 | $ 69,291 | $ 108,655 | $ - |
| | | | | | |
| Purchased non-covered: | | | | | |
| Nonperforming nonaccrual loans | $7,038 | $ 16,170 | $ 29,311 | $ - | $ - |
| Performing nonaccrual loans | 461 | 7,037 | 9,852 | - | - |
| Total nonaccrual loans | 7,499 | 23,207 | 39,163 | - | - |
| Accruing loans 90 or more days past due | 4 | 34 | 1 | - | - |
| Total nonperforming loans | 7,503 | 23,241 | 39,164 | - | - |
| Other real estate owned | 3,366 | 11,632 | 2,196 | - | - |
| Total nonperforming assets | $10,869 | $ 34,873 | $ 41,360 | $ - | $ - |

The Bank’s commercial loan customers are primarily small businesses and professionals. As a result, average loan balances are relatively small, providing risk diversification within the overall loan portfolio. At December 31, 2012, the Bank’s nonaccrual loans reflected this diversification: nonaccrual originated loans with a carrying value totaling $12 million comprised twenty borrowers, nonaccrual purchased covered loans with a carrying value totaling $13 million comprised fifteen borrowers, and nonaccrual purchased non-covered loans with a carrying value totaling $8 million comprised eleven borrowers.

Management believes the overall credit quality of the loan portfolio is reasonably stable; however, classified and nonperforming assets could fluctuate from period to period. The performance of any individual loan can be affected by external factors such as the interest rate environment, economic conditions, and collateral values or factors particular to the borrower. No assurance can be given that additional increases in nonaccrual and delinquent loans will not occur in the future.

The former County Bank loans and repossessed loan collateral were purchased from the FDIC with indemnifying loss-sharing agreements. The loss-sharing agreements significantly reduce the credit risk of these purchased assets during the term of the agreements. Under the terms of the loss-sharing agreements, the FDIC absorbs 80 percent of losses and shares in 80 percent of loss recoveries on the first $269 million in losses on purchased covered assets (“First Tier”), and absorbs 95 percent of losses and shares in 95 percent of loss recoveries if losses on purchased covered assets exceed $269 million (“Second Tier”). The loss-sharing agreement on covered residential real estate assets expires

February 6, 2019 and the loss-sharing agreement on covered non-residential assets expires February 6, 2014 as to losses and February 6, 2017 as to loss recoveries.

The purchased covered assets are primarily located in the California Central Valley, including Merced County. This geographic area currently has some of the weakest economic conditions within California and has experienced significant declines in real estate values. Management expects higher loss rates on purchased covered assets than on originated assets.

The Bank recorded purchased covered assets at estimated fair value on the February 6, 2009 acquisition date. The credit risk discount ascribed to the $1.3 billion acquired loan and repossessed loan collateral portfolio was $161 million representing estimated losses inherent in the assets at the acquisition date.

Purchased Covered Assets
(In thousands)

| | At December 31, | | | | February 6, |
|---|---|---|---|---|---|
| | 2012 | 2011 | 2010 | 2009 | 2009 |
| Non-residential assets | $384,285 | $567,041 | $736,367 | $924,755 | $1,298,526 |
| Residential assets | 25,570 | 31,311 | 33,285 | 33,452 | 40,955 |
| Total indemnified assets | 409,855 | 598,352 | 769,653 | 958,206 | 1,339,481 |
| Credit risk discount | (26,128 ) | (46,282 ) | (61,784 ) | (93,251 ) | (161,203 ) |
| Other adjustments | 2,247 | 2,343 | 6,894 | 13,643 | 5,407 |
| Carrying value of covered assets | $385,974 | $554,413 | $714,763 | $878,598 | $1,183,685 |
| | | | | | |
| Comprised of: | | | | | |
| Purchased covered loans | $372,283 | $535,278 | $692,972 | $855,301 | $1,174,353 |
| Covered other real estate owned | 13,691 | 19,135 | 21,791 | 23,297 | 9,332 |
| Carrying value of covered assets | $385,974 | $554,413 | $714,763 | $878,598 | $1,183,685 |

Aggregate indemnified losses from February 6, 2009 through December 31, 2012 have been $132 million, which includes principal losses, loss in value of other real estate owned, loss on sale of other real estate owned, and reimbursement of incurred collection and asset management expenses such as legal fees, property taxes, appraisals and other customary expenses. Purchased covered asset principal losses have been primarily offset against the estimated credit risk discount, although some losses exceeding the purchase date estimated credit risk discount have been provided for and charged-off against the allowance for credit losses.

Purchased covered assets are evaluated for risk classification without regard to FDIC indemnification such that Management can identify purchased covered assets with potential payment problems and devote appropriate credit administration practices to maximize collections. Classified purchased covered assets without regard to FDIC indemnification totaled $122 million and $168 million at December 31, 2012 and December 31, 2011, respectively.

As noted above, FDIC loss indemnification of covered non-residential assets expires February 6, 2014; loss exposure on such assets after February 6, 2014 will be represented by such assets' carrying values at such time. Loss exposure for loans is mitigated by the borrowers' financial condition and ability to repay their loans, loan collateral values, the amount of credit risk discount remaining at such time, any existing borrower guarantees which are perfected and have economic value, and the allowance for credit losses. Loss exposure for other real estate owned is mitigated by the value of the repossessed loan collateral, less disposition costs.

Allowance for Credit Losses

The Company's allowance for credit losses represents Management's estimate of credit losses inherent in the loan portfolio. In evaluating credit risk for loans, Management measures loss potential of the carrying value of loans. As described above, payments received on nonaccrual loans may be applied against the principal balance of the loans until such time as full collection of the remaining recorded balance is expected. Further, the carrying value of purchased loans includes fair value discounts assigned at the time of purchase under the provisions of FASB ASC 805, Business Combinations, and FASB ASC 310-30, Loans or Debt Securities with Deteriorated Credit Quality. The allowance for credit losses represents Management's estimate of credit losses in excess of these reductions to the carrying value of loans within the loan portfolio.

The following table summarizes the allowance for credit losses, chargeoffs and recoveries of the Company for the periods indicated:

| Year ended December 31, (Dollars in thousands) | 2012 | 2011 | 2010 | 2009 | 2008 |
|---|---|---|---|---|---|
| Analysis of the Allowance for Credit Losses | | | | | |
| Balance, beginning of period | $35,290 | $38,329 | $43,736 | $47,563 | $55,799 |
| Provision for loan losses | 11,200 | 11,200 | 11,200 | 10,500 | 2,700 |
| Provision for unfunded commitments | — | — | — | (400) | (200) |
| Loans charged off: | | | | | |
| Commercial | (6,851) | (8,280) | (6,844) | (6,066) | (1,262) |
| Commercial real estate | (1,202) | (1,332) | (1,256) | — | (34) |
| Real estate construction | (2,217) | (2,167) | (1,668) | (1,333) | (5,348) |
| Real estate residential | (1,156) | (739) | (1,686) | (506) | (131) |
| Consumer and other installment | (5,685) | (6,754) | (8,814) | (9,362) | (5,638) |
| Purchased covered loans | (953) | (987) | — | — | — |
| Purchased non-covered loans | (110) | — | — | — | — |
| Total chargeoffs | (18,174) | (20,259) | (20,268) | (17,267) | (12,413) |
| Recoveries of loans previously charged off: | | | | | |
| Commercial | 1,317 | 3,129 | 948 | 490 | 331 |
| Commercial real estate | 203 | — | 4 | — | — |
| Real estate construction | 224 | 1 | — | 664 | — |
| Consumer and other installment | 2,723 | 2,890 | 2,709 | 2,186 | 1,346 |
| Purchased covered loans | 144 | — | — | — | — |
| Total recoveries | 4,611 | 6,020 | 3,661 | 3,340 | 1,677 |
| Net loan losses | (13,563) | (14,239) | (16,607) | (13,927) | (10,736) |
| Balance, end of period | $32,927 | $35,290 | $38,329 | $43,736 | $47,563 |
| Components: | | | | | |
| Allowance for loan losses | $30,234 | $32,597 | $35,636 | $41,043 | $44,470 |
| Liability for off-balance sheet credit exposure | 2,693 | 2,693 | 2,693 | 2,693 | 3,093 |
| Allowance for credit losses | $32,927 | $35,290 | $38,329 | $43,736 | $47,563 |
| Net loan losses: | | | | | |
| Originated loans | $(12,644) | $(13,252) | $(16,607) | $(13,927) | $(10,736) |
| Purchased covered loans | (809) | (987) | — | — | — |
| Purchased non-covered loans | (110) | — | — | — | — |
| Net loan losses as a percentage of average loans: | | | | | |
| Originated loans | 0.72 % | 0.68 % | 0.79 % | 0.60 % | 0.44 % |
| Purchased covered loans | 0.18 % | 0.16 % | — % | — % | — % |
| Purchased non-covered loans | 0.11 % | — % | — % | — % | — % |

The Company's allowance for credit losses is maintained at a level considered appropriate to provide for losses that can be estimated based upon specific and general conditions. These include conditions unique to individual borrowers, as well as overall credit loss experience, the amount of past due, nonperforming and classified loans, FDIC loss-sharing indemnification, recommendations of regulatory authorities, prevailing economic conditions and other factors. A portion of the allowance is specifically allocated to impaired loans whose full collectability of principal is uncertain. Such allocations are determined by Management based on loan-by-loan analyses. The Company evaluates all classified loans and nonaccrual loans with outstanding principal balances in excess of $500 thousand, and all “troubled debt restructured” loans for impairment. A second allocation is based in part on quantitative analyses of historical credit loss experience, in which historical originated classified credit balances are analyzed using a statistical model to determine standard loss rates for originated loans. The results of this analysis are applied to

originated classified loan balances to allocate the allowance to the respective segments of the loan portfolio. In addition, originated loans with similar characteristics not usually criticized using regulatory guidelines are analyzed based on the historical loss rates and delinquency trends, grouped by the number of days the payments on these loans are delinquent. Given currently weak economic conditions, Management is applying further analysis to originated consumer installment loans. Current levels of originated consumer installment loan losses are compared to initial allowance allocations and, based on Management's judgment, additional allocations are applied, if needed, to estimate losses. For originated residential real estate loans, Management is comparing ultimate loss rates on foreclosed residential real estate properties and applying such loss rates to nonaccrual originated residential real estate loans. Based on this analysis, Management exercises judgment in allocating additional allowance if deemed appropriate to estimate losses on originated residential real estate loans. Last, allocations are made to originated non-classified commercial and commercial real estate loans based on historical loss rates and other statistical data.

Purchased loans were not underwritten using the Company's credit policies and practices. Thus, the historical loss rates for originated loans are not applied to estimate credit losses for purchased loans. Purchased loans were recorded on the date of purchase at estimated fair value; fair value discounts include a component for estimated credit losses. The Company evaluates all nonaccrual purchased loans with outstanding principal balances in excess of $500 thousand for impairment; the impaired loan value is compared to the recorded investment in the loan, which has been reduced by the credit default discount estimated on the date of purchase. If Management's impairment analysis determines the impaired loan value is less than the recorded investment in the purchased loan, an allocation of the allowance for credit losses is established, net of estimated FDIC indemnification. For all other purchased loans, Management evaluates post-acquisition historical credit losses on purchased loans, credit default discounts on purchased loans, and other data to evaluate the likelihood of realizing the recorded investment of purchased loans. Management establishes allocations of the allowance for credit losses for any estimated deficiency.

The remainder of the allowance is considered to be unallocated. The unallocated allowance is established to provide for probable losses that have been incurred as of the reporting date but not reflected in the allocated allowance. The unallocated allowance addresses additional qualitative factors consistent with Management's analysis of the level of risks inherent in the loan portfolio, which are related to the risks of the Company's general lending activity. Included in the unallocated allowance is the risk of losses that are attributable to national or local economic or industry trends which have occurred but have not yet been recognized in loan chargeoff history (external factors). The external factors evaluated by the Company and the judgmental amount of unallocated reserve assigned by Management as of December 31, 2012 are: economic and business conditions $1 million, external competitive issues $700 thousand, and other factors. Also included in the unallocated allowance is the risk of losses attributable to general attributes of the Company's loan portfolio and credit administration (internal factors). The internal factors evaluated by the Company and the judgmental amount of unallocated reserve assigned by Management are: loan review system $700 thousand, adequacy of lending Management and staff $800 thousand, loan policies and procedures $700 thousand, purchased loans $670 thousand, concentrations of credit $800 thousand, and other factors. By their nature, these risks are not readily allocable to any specific loan category in a statistically meaningful manner and are difficult to quantify with a specific number. Management assigns a range of estimated risk to the qualitative risk factors described above based on Management's judgment as to the level of risk, and assigns a quantitative risk factor from the range of loss estimates to determine the appropriate level of the unallocated portion of the allowance.

Allowance for Credit Losses
For the Year Ended December 31, 2012

| | Commercial | Commercial Real Estate | Construction | Residential Real Estate | Consumer Installment and Other | Purchased Non-covered Loans | Purchased Covered Loans | Unallocated | Total |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | (In thousands) | | | | |
| Allowance for loan losses: | | | | | | | | | |
| Balance at beginning of period | $6,012 | $ 10,611 | $ 2,342 | $ 781 | $ 3,072 | $ - | $ - | $ 9,779 | $32,597 |
| Additions: | | | | | | | | | |
| Provision | 5,967 | 451 | 135 | 755 | 3,084 | 110 | 1,814 | (1,116 ) | 11,200 |
| Deductions: | | | | | | | | | |
| Chargeoffs | (6,851 ) | (1,202 ) | (2,217 ) | (1,156 ) | (5,685 ) | (110 ) | (953 ) | - | (18,174) |
| Recoveries | 1,317 | 203 | 224 | - | 2,723 | - | 144 | - | 4,611 |
| Net loan losses | (5,534 ) | (999 ) | (1,993 ) | (1,156 ) | (2,962 ) | (110 ) | (809 ) | - | (13,563) |
| | 6,445 | 10,063 | 484 | 380 | 3,194 | - | 1,005 | 8,663 | 30,234 |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Balance at end of period | | | | | | | | | |
| Liability for off-balance sheet credit exposure | 1,734 | 9 | - | - | 419 | - | - | 531 | 2,693 |
| Total allowance for credit losses | $8,179 | $ 10,072 | $ 484 | $ 380 | $ 3,613 | $ - | $ 1,005 | $ 9,194 | $32,927 |

Recorded Investment in Loans Evaluated for Impai
At December 31, 2012

| | Commercial | Commercial Real Estate | Construction | Residential Real Estate | Consumer Installment and Other | Purchased Non-covered Loans | Purcha Cove Loar |
|---|---|---|---|---|---|---|---|
| | | | | | (In thousands) | | |
| Allowance for credit losses: | | | | | | | |
| Individually evaluated for impairment | $1,865 | $134 | $- | $- | $100 | $- | $753 |
| Collectively evaluated for impairment | 6,314 | 9,938 | 484 | 380 | 3,513 | - | 252 |
| Purchased loans with evidence of credit deterioration | - | - | - | - | - | - | - |
| Total | $8,179 | $10,072 | $484 | $380 | $3,613 | $- | $1,00 |
| Carrying value of loans: | | | | | | | |
| Individually evaluated for impairment | 5,153 | 4,161 | - | - | - | 3,029 | 16,6 |
| Collectively evaluated for impairment | 334,963 | 628,766 | 7,984 | 222,458 | 460,698 | 65,098 | 347, |
| Purchased loans with evidence of credit deterioration | - | - | - | - | - | 6,764 | 7,86 |
| Total | $340,116 | $632,927 | $7,984 | $222,458 | $460,698 | $74,891 | $372, |

Management considers the $30.2 million allowance for credit losses to be adequate as a reserve against credit losses inherent in the loan portfolio as of December 31, 2012.

See Note 4 to the consolidated financial statements for additional information related to the loan portfolio, loan portfolio credit risk, and allowance for credit losses.

Asset/Liability and Market Risk Management

Asset/liability management involves the evaluation, monitoring and management of interest rate risk, market risk, liquidity and funding. The fundamental objective of the Company's management of assets and liabilities is to maximize its economic value while maintaining adequate liquidity and a conservative level of interest rate risk.

Interest Rate Risk

Interest rate risk is a significant market risk affecting the Company. Interest rate risk results from many factors. Assets and liabilities may mature or re-price at different times. Assets and liabilities may re-price at the same time but by different amounts. Short-term and long-term market interest rates may change by different amounts. The timing and amount of cash flows of various assets or liabilities may shorten or lengthen as interest rates change. In addition, interest rates may have an impact on loan demand, demand for various deposit products, credit losses, and other sources of earnings such as account analysis fees on commercial deposit accounts and correspondent bank service charges.

The Federal Open Market Committee’s January 30, 2013 press release stated ”the Committee decided to keep the target range for the federal funds rate at 0 to 1/4 percent and currently anticipates that this exceptionally low range for the federal funds rate will be appropriate at least as long as the unemployment rate remains above 6-1/2 percent, inflation between one and two years ahead is projected to be no more than a half percentage point above the Committee’s 2 percent longer-run goal, and longer-term inflation expectations continue to be well anchored. In determining how long to maintain a highly accommodative stance of monetary policy, the Committee will also consider other information, including additional measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial developments. When the Committee decides to begin to remove policy accommodation, it will take a balanced approach consistent with its longer-run goals of maximum employment and inflation of 2 percent”. In this context, Management’s most likely earnings forecast for the twelve months ending December 31, 2013 assumes market interest rates remain relatively stable and yields on newly originated or refinanced loans and on purchased investment securities will reflect current interest rates, which are lower than yields on the Company’s older dated loans and investment securities.

In adjusting the Company's asset/liability position, Management attempts to manage interest rate risk while enhancing the net interest margin and net interest income. At times, depending on expected increases or decreases in general interest rates, the relationship between long and short term interest rates, market conditions and competitive factors, Management may adjust the Company's interest rate risk position in order to manage its net interest margin and net interest income. The Company's results of operations and net portfolio values remain subject to changes in interest rates and to fluctuations in the difference between long and short term interest rates.

The Company’s asset and liability position ranged from “neutral” to slightly “liability sensitive” at December 31, 2012, depending on the interest rate assumptions applied to the simulation model employed by Management to measure interest rate risk. A “neutral” position results in similar amounts of change in interest income and interest expense resulting from application of assumed interest rate changes. A slightly “liability sensitive” position results in a slightly larger change in interest expense than in interest income resulting from application of assumed interest rate changes. Simulation estimates depend on, and will change with, the size and mix of the actual and projected balance sheet at the time of each simulation. Management’s interest rate risk management is currently biased toward stable interest rates in the near-term, and ultimately, rising interest rates. Management continues to monitor the interest rate environment as well as economic conditions and other factors it deems relevant in managing the Company's exposure to interest rate risk.

The Company does not currently engage in trading activities or use derivative instruments to control interest rate risk, even though such activities may be permitted with the approval of the Company's Board of Directors.

Market Risk - Equity Markets

Equity price risk can affect the Company. As an example, any preferred or common stock holdings, as permitted by banking regulations, can fluctuate in value. Management regularly assesses the extent and duration of any declines in market value, the causes of such declines, the likelihood of a recovery in market value, and its intent to hold securities until a recovery in value occurs. Declines in value of preferred or common stock holdings that are deemed "other than temporary" could result in loss recognition in the Company's income statement.

Fluctuations in the Company's common stock price can impact the Company's financial results in several ways. First, the Company has regularly repurchased and retired its common stock; the market price paid to retire the Company's common stock can affect the level of the Company's shareholders' equity, cash flows and shares outstanding. Second, the Company's common

stock price impacts the number of dilutive equivalent shares used to compute diluted earnings per share. Third, fluctuations in the Company's common stock price can motivate holders of options to purchase Company common stock through the exercise of such options thereby increasing the number of shares outstanding. Finally, the amount of compensation expense associated with share based compensation fluctuates with changes in and the volatility of the Company's common stock price.

Market Risk - Other

Market values of loan collateral can directly impact the level of loan charge-offs and the provision for loan losses. The financial condition and liquidity of debtors issuing bonds and debtors whose mortgages or other obligations are securitized can directly impact the credit quality of the Company’s investment portfolio requiring the Company to recognize other than temporary impairment charges. Other types of market risk, such as foreign currency exchange risk and commodity price risk, are not significant in the normal course of the Company's business activities.

Liquidity and Funding

The Company's routine sources of liquidity are operating earnings, investment securities, consumer and other loans, deposits, and other borrowed funds. During 2012, the Company’s operating activities generated $119 million in liquidity providing adequate funds to pay common shareholders $41 million in dividends and fund $51 million in stock repurchases. In 2011, the Company’s operating activities generated $120 million in liquidity providing funds to pay common shareholders $42 million in dividends, fund $61 million in stock repurchases and redeem $10 million in subordinated debt. In 2012, loans provided $385 million in liquidity from scheduled payments, paydowns and maturities, net of loan fundings. The Company purchased $868 million in investment securities using $431 million in cash and $437 million from paydowns, maturities and sale of investment securities. The Company primarily purchased residential collateralized mortgage obligations and corporate securities to offset decreases in securities of U.S. Government sponsored entities. Other sources of cash from investing activities include proceeds of $28 million under FDIC loss-sharing agreements and proceeds of $28 million from sale of foreclosed assets. Cash was applied to reduce short term borrowings by $62 million and to meet a net reduction in deposits totaling $17 million. In 2011, investment securities provided $430 million in liquidity from sales, paydowns and maturities, and loans provided $342 million in liquidity from scheduled payments and maturities, net of loan fundings. Additionally, deposit growth increased cash $118 million. In 2011, liquidity provided funds to purchase securities of $733 million and to reduce short-term borrowings by $17 million and redeem a $10 million subordinated debt.

At December 31, 2012, the Company’s assets included $491 million in cash and amounts due from other banks from daily transaction settlements. The Bank maintains cash balances for its branches of approximately $50 million to meet the routine needs of its customers. Further, the Bank must maintain approximately $30 million at the Federal Reserve Bank (FRB) to meet its reserve requirement; this reserve requirement is reduced by cash held for branches. Excluding cash for branch needs and cash required at the FRB, cash and amounts due from other banks of approximately $410 million provided excess liquidity, equivalent to ten percent of total deposits. Cash balances fluctuate regularly with deposit flows. Economic activity which causes noticeable deposit and cash flow fluctuations include monthly government transfer payments such as social security benefit payments, common payroll dates, and property and income tax payment cycles. The fluctuation in deposit volumes directly affects available cash balances. Further, cash balances can be affected by loan and investment activity.

The Company projects $278 million in additional liquidity from investment security paydowns and maturities during the twelve months ending December 31, 2013. At December 31, 2012, $750 million in residential collateralized mortgage obligations (“CMOs”) and residential mortgage backed securities (“MBSs”) were held in the Company's investment portfolios. None of the CMOs or MBSs are backed by sub-prime mortgages. The residential CMOs and MBSs provided $43 million in liquidity from paydowns during the three months ended December 31, 2012. At December 31, 2012, indirect automobile loans totaled $402 million, which were experiencing stable monthly principal

payments of approximately $16 million during the fourth quarter of 2012.

The Company held $2.0 billion in total investment securities at December 31, 2012. Under certain deposit, borrowing and other arrangements, the Company must hold and pledge investment securities as collateral. At December 31, 2012, such collateral requirements totaled approximately $850 million. At December 31, 2012, $826 million of the Company's investment securities were classified as "available-for-sale", and as such, could provide additional liquidity if sold, subject to the Company's ability to meet continuing collateral requirements. In addition, at December 31, 2012, the Company had customary lines for overnight borrowings from other financial institutions of approximately $160 million, under which $-0- was outstanding. Additionally, the Company has access to borrowing from the Federal Reserve. Management expects the Company could access additional long-term debt financing if desired. In Management's judgment, the Company's liquidity position is strong and asset liquidations or additional long-term debt are considered unnecessary to meet the ongoing liquidity needs of the Company.

Management will monitor the Company's cash levels throughout 2013. Loan demand from credit-worthy borrowers will be dictated by economic and competitive conditions. The Company aggressively solicits non-interest bearing demand deposits and money market checking deposits, which are the least sensitive to changes in interest rates. The growth of these deposit balances is subject to heightened competition, the success of the Company's sales efforts, delivery of superior customer service, new regulations and market conditions. The Company does not aggressively solicit higher-costing time deposits; as a result, Management anticipates such deposits will decline. Changes in interest rates, most notably rising interest rates, could impact deposit volumes. Depending on economic conditions, interest rate levels, and a variety of other conditions, deposit growth may be used to fund loans, reduce borrowings or purchase investment securities. However, due to concerns such as uncertainty in the general economic environment, competition and political uncertainty, loan demand and levels of customer deposits are not certain. Shareholder dividends are expected to continue subject to the Board's discretion and continuing evaluation of capital levels, earnings, asset quality and other factors.

The Company performs liquidity stress tests on a periodic basis to evaluate the sustainability of its liquidity. Under the stress testing, the Company assumes outflows of funds increase beyond expected levels. Measurement of such heightened outflows considers the composition of the Company's deposit base, including any concentration of deposits, non-deposit funding such as short-term borrowings and Federal Home Loan Bank advances, and unfunded lending commitments. The Company evaluates its stock of highly liquid assets to meet the assumed higher levels of outflows. Highly liquid assets include cash and amounts due from other banks from daily transaction settlements, reduced by branch cash needs and FRB reserve requirement, and investment securities based on regulatory risk-weighting guidelines. Based on the results of the most recent liquidity stress test, Management is satisfied with the liquidity condition of the Bank and the Company. However, no assurance can be given the Bank or Company will not experience a period of reduced liquidity.

Westamerica Bancorporation ("Parent Company") is a separate entity and apart from Westamerica Bank ("Bank") and must provide for its own liquidity. In addition to its operating expenses, the Parent Company is responsible for the payment of dividends declared for its shareholders, and interest and principal on outstanding debt. The $15 million note issued by the Parent Company, as described in Note 8 to the consolidated financial statements, matures October 31, 2013. Substantially all of the Parent Company's revenues are obtained from subsidiary dividends and service fees. Payment of dividends to the Parent Company by the Bank is limited under California and Federal laws. The Company believes that regulatory dividend restrictions will not have an impact on the Parent Company's ability to meet its ongoing cash obligations.

Contractual Obligations

The following table sets forth the known contractual obligations, except short-term borrowing arrangements and post-retirement benefit plans, of the Company at December 31, 2012:

| At December 31, 2012 (In thousands) | Within One Year | Over One to Three Years | Over Three to Five Years | After Five Years | Total |
|---|---|---|---|---|---|
| Long-Term Debt Obligations | $ 15,000 | $ — | $ — | $ — | $ 15,000 |
| Term Repurchase Agreement | — | 10,000 | — | — | 10,000 |
| Federal Home Loan Bank advances | 5,035 | 20,764 | — | — | 25,799 |
| Operating Lease Obligations | 8,840 | 12,523 | 2,751 | 854 | 24,968 |
| Purchase Obligations | 8,007 | 16,013 | 8,007 | — | 32,027 |
| Total | $ 36,882 | $ 59,300 | $ 10,758 | $ 854 | $ 107,794 |

Long-term debt obligations and operating lease obligations may be retired prior to the contractual maturity as discussed in the notes to the consolidated financial statements. The purchase obligation consists of the Company's minimum liability under a contract with a third-party automation services provider.

Capital Resources

The Company has historically generated high levels of earnings, which provides a means of raising capital. The Company's net income as a percentage of average shareholders' equity ("return on equity" or "ROE") has been 14.9% in 2012, 16.1% in 2011 and 18.1% in 2010. The Company also raises capital as employees exercise stock options. Capital raised through the exercise of stock options totaled $7.6 million in 2012, $14.4 million in 2011 and $16.7 million in 2010.

The Company paid common dividends totaling $41.0 million in 2012, $41.7 million in 2011 and $42.1 million in 2010, which represent dividends per common share of $1.48, $1.45 and $1.44, respectively. The Company's earnings have historically exceeded dividends paid to shareholders. The amount of earnings in excess of dividends gives the Company resources to finance

growth and maintain appropriate levels of shareholders' equity. In the absence of profitable growth opportunities, the Company has repurchased and retired its common stock as another means to return earnings to shareholders. The Company repurchased and retired 1.1 million shares valued at $51.5 million in 2012, 1.3 million shares valued at $60.5 million in 2011 and 533 thousand shares valued at $28.7 million in 2010.

The Company's primary capital resource is shareholders' equity, which increased $1.5 million or 0.3% in 2012 from the previous year. For 2012, the Company earned $81.1 million in net income, raised $7.6 million from the issuance of stock in connection with exercises of employee stock options, paid $41.0 million in common dividends, and repurchased $51.5 million in common stock.

The Company's ratio of equity to total assets was 11.31% at December 31, 2012 and 11.08% at December 31, 2011.

The Company performs capital stress tests on a periodic basis to evaluate the sustainability of its capital. Under the stress testing, the Company assumes various scenarios such as deteriorating economic and operating conditions, unanticipated asset devaluations, and significant operational lapses. The Company measures the impact of these scenarios on its earnings and capital. Based on the results of the most recent stress tests, Management is satisfied with the capital condition of the Bank and the Company. However, no assurance can be given the Bank or Company will not experience a period of reduced earnings or a reduction in capital from unanticipated events and circumstances.

Capital to Risk-Adjusted Assets

The following summarizes the ratios of regulatory capital to risk-adjusted assets for the Company on the dates indicated:

| At December 31, | 2012 | | 2011 | | Minimum Regulatory Requirement | | Well Capitalized | |
|---|---|---|---|---|---|---|---|---|
| Tier I Capital | 15.06 | % | 14.54 | % | 4.00 | % | 6.00 | % |
| Total Capital | 16.33 | % | 15.83 | % | 8.00 | % | 10.00 | % |
| Leverage ratio | 8.56 | % | 8.38 | % | 4.00 | % | 5.00 | % |

The following summarizes the ratios of capital to risk-adjusted assets for the Bank on the dates indicated:

| At December 31, | 2012 | | 2011 | | Minimum Regulatory Requirement | | Well Capitalized | |
|---|---|---|---|---|---|---|---|---|
| Tier I Capital | 14.14 | % | 13.84 | % | 4.00 | % | 6.00 | % |
| Total Capital | 15.62 | % | 15.32 | % | 8.00 | % | 10.00 | % |
| Leverage ratio | 7.99 | % | 7.93 | % | 4.00 | % | 5.00 | % |

FDIC-covered assets are generally included in the 20% risk-weighted category due to loss-sharing agreements, which expire on February 6, 2019 as to the residential real estate covered assets and on February 6, 2014 as to non-residential real estate covered assets. Subsequent to such dates, previously FDIC-indemnified assets will generally be included in the 100% risk-weight category.

On June 7, 2012, the Federal Reserve Board invited comment on three proposed rules intended to improve the quality and increase the quantity of capital in the banking industry. The proposals’ provisions which would most affect the regulatory capital requirements of the Company and the Bank:

•

Redefine the type of capital which qualifies as regulatory capital in a manner which is more restrictive than current rules,

- Introduce a new “Common Equity Tier 1” capital measurement,
- Establish higher minimum levels of capital,
- Introduce a “capital conservation buffer,”
- Increase the risk-weighting of certain assets and commitments, in particular construction loans, loans on nonaccrual status, loans 90 days or more past due, short-term credit commitments, and deferred tax assets, and
- Alter the risk-weightings on residential real estate loans based on loan quality (underwriting standards and terms) and the loan-to-value ratio determined at time of origination or subsequent restructuring or modification.

Under the proposals, any bank subject to the rules which is unable to maintain its “capital conservation buffer” will be restricted in the payment of shareholder distributions, as an example dividends and share repurchases, and restricted in the payment of

discretionary executive compensation. The proposals have phase-in schedules for the various provisions; the higher minimum capital requirements are fully phased-in by January 1, 2015 and the “capital conservation buffer” and changed risk-weightings are fully phased-in by January 1, 2019.

These proposals do not supersede the Federal Deposit Insurance Corporation Improvement Act (FDICIA) requiring federal banking agencies to take prompt corrective action (PCA) to resolve problems of insured depository institutions. The proposals would revise the PCA thresholds to incorporate the proposed regulatory capital minimums, including the newly proposed “common equity tier 1” ratios.

Management has evaluated the capital structure and assets for the Company and the Bank as of December 31, 2012 assuming (1) the Federal Reserve’s proposed rules were currently fully phased-in and (2) the FDIC indemnification of the Bank’s purchased covered assets had expired, causing an increase in risk-weightings on such assets. Based on this evaluation, the Company and the Bank currently maintain capital in excess of all the proposed regulatory ratios, as follows:

| | Proposed Minimum Capital Requirement | | "Well-capitalized" Under PCA Proposal | | Proposed Minimum Plus "Capital Conservation Buffer" | | Proforma Measurements as of December 31, 2012 Assuming New Proposals Fully Phased-in and Covered Asset Indemnification Expired | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | Company | | Bank | |
| Capital Measurement: | | | | | | | | | | |
| Leverage | 4.00 | % | 5.00 | % | 4.00 | % | 8.82 | % | 8.24 | % |
| Common Equity Tier 1 | 4.50 | % | 6.50 | % | 7.00 | % | 13.97 | % | 13.10 | % |
| Tier I Capital | 6.00 | % | 8.00 | % | 8.50 | % | 13.97 | % | 13.10 | % |
| Total Capital | 8.00 | % | 10.00 | % | 10.50 | % | 15.06 | % | 14.20 | % |

The Company and the Bank intend to maintain regulatory capital in excess of the highest regulatory standard. The Company and the Bank routinely project capital levels by analyzing forecasted earnings, credit quality, securities valuations, shareholder dividends, asset volumes, share repurchase activity, stock option exercise proceeds, and other factors. Based on current capital projections, the Company and the Bank expect to maintain regulatory capital levels exceeding the highest effective regulatory standard and pay quarterly dividends to shareholders. No assurance can be given that changes in capital management plans will not occur.

Deposit categories

The Company primarily attracts deposits from local businesses and professionals, as well as through retail savings and checking accounts, and, to a more limited extent, certificates of deposit.

The following table summarizes the Company’s average daily amount of deposits and the rates paid for the periods indicated:

Deposit Distribution and Average Rates Paid

| | 2012 | | | 2011 | | | 2010 | | |
|---|---|---|---|---|---|---|---|---|---|
| | Average | Percentage | Rate | Average | Percentage | Rate | Average | Percentage | Rate |

| Years Ended December 31, (Dollars in thousands) | Balance | of Total Deposits | | Balance | of Total Deposits | | Balance | of Total Deposits | |
|---|---|---|---|---|---|---|---|---|---|
| Noninterest bearing demand | $1,603,981 | 38.0 % | — % | $1,496,362 | 35.9 % | — % | $1,412,702 | 35.3 % | — % |
| Interest bearing: | | | | | | | | | |
| Transaction | 754,979 | 17.9 % | 0.04 % | 713,754 | 17.1 % | 0.10 % | 682,278 | 17.1 % | 0.13 % |
| Savings | 1,132,980 | 26.9 % | 0.08 % | 1,112,364 | 26.7 % | 0.15 % | 994,604 | 24.9 % | 0.27 % |
| Time less than $100 thousand | 264,466 | 6.3 % | 0.57 % | 313,548 | 7.5 % | 0.67 % | 358,096 | 8.9 % | 0.49 % |
| Time $100 thousand or more | 460,833 | 10.9 % | 0.33 % | 535,866 | 12.8 % | 0.43 % | 550,810 | 13.8 % | 0.62 % |
| Total | $4,217,239 | 100.0 % | 0.16 % | $4,171,894 | 100.0 % | 0.25 % | $3,998,490 | 100.0 % | 0.34 % |

The Company’s strategy includes building the value of its deposit base by building balances of lower-costing deposits and avoiding reliance on higher-costing time deposits. From 2011 to 2012 the deposit composition shifted from higher costing time

deposits to lower costing checking and savings accounts. The Company's average balances of checking and savings accounts represented 83% of average balances of total deposits in 2012 compared with 80% in 2011 and 77% in 2010.

Total time deposits were $642.6 million and $804.5 million at December 31, 2012 and 2011, respectively. The following table sets forth, by time remaining to maturity, the Company's total domestic time deposits. The Company has no foreign time deposits.

| (In thousands) | December 31, 2012 |
|---|---|
| 2012 | $ 530,623 |
| 2013 | 53,852 |
| 2014 | 26,726 |
| 2015 | 14,719 |
| 2016 | 14,550 |
| Thereafter | 2,101 |
| Total | $ 642,571 |

The following sets forth, by time remaining to maturity, the Company's domestic time deposits in amounts of $100 thousand or more:

Deposits Over $100,000 Maturity Distribution

| (In thousands) | December 31, 2012 |
|---|---|
| Three months or less | $ 289,871 |
| Over three through six months | 37,135 |
| Over six through twelve months | 38,324 |
| Over twelve months | 53,752 |
| Total | $ 419,082 |

Short-term Borrowings

The following table sets forth the short-term borrowings of the Company:

Short-Term Borrowings Distribution

| | At December 31, | | |
|---|---|---|---|
| (In thousands) | 2012 | 2011 | 2010 |
| Federal funds purchased | $— | $— | $— |
| Other borrowed funds: | | | |
| Customer sweep accounts | 51,039 | 114,777 | 105,237 |
| Securities sold under repurchase agreements with customers | 2,648 | 912 | 1,148 |
| Line of credit | — | — | 1,000 |
| Total short term borrowings | $53,687 | $115,689 | $107,385 |

Further detail of federal funds purchased and other borrowed funds is as follows:

| Years Ended December 31,<br>(Dollars in thousands) | 2012 | | 2011 | | 2010 | |
|---|---|---|---|---|---|---|
| Federal funds purchased balances and rates paid on outstanding amount: | | | | | | |
| Average balance for the year | $8 | | $96 | | $— | |
| Maximum month-end balance during the year | — | | — | | — | |
| Average interest rate for the year | 0.58 | % | 0.11 | % | — | % |
| Average interest rate at period end | — | % | — | % | — | % |
| Securities sold under repurchase agreements balances and rates paid on outstanding amount: | | | | | | |
| Average balance for the year | $81,315 | | $103,127 | | $104,004 | |
| Maximum month-end balance during the year | 116,974 | | 115,689 | | 119,478 | |
| Average interest rate for the year | 0.07 | % | 0.15 | % | 0.32 | % |
| Average interest rate at period end | 0.07 | % | 0.09 | % | 0.22 | % |
| FHLB advances balances and rates paid on outstanding amount: | | | | | | |
| Average balance for the year | $25,916 | | $41,741 | | $34,378 | |
| Maximum month-end balance during the year | 26,004 | | 61,619 | | 72,016 | |
| Average interest rate for the year | 1.86 | % | 1.25 | % | 1.25 | % |
| Average interest rate at period end | 1.88 | % | 1.84 | % | 1.15 | % |
| Term repurchase agreement balances and rates paid on outstanding amount: | | | | | | |
| Average balance for the year | $10,000 | | $3,945 | | $94,842 | |
| Maximum month-end balance during the year | 10,000 | | 10,000 | | 99,920 | |
| Average interest rate for the year | 0.99 | % | 0.98 | % | 1.61 | % |
| Average interest rate at period end | 0.97 | % | 0.97 | % | — | % |
| Line of credit balances and rates paid on outstanding amount: | | | | | | |
| Average balance for the year | $— | | $1,933 | | $3,817 | |
| Maximum month-end balance during the year | — | | 10,150 | | 9,200 | |
| Average interest rate for the year | — | % | 2.95 | % | 3.42 | % |
| Average interest rate at period end | — | % | — | % | 4.10 | % |

The term repurchase agreement balance declined from 2010 to 2011 because a $100 million term repurchase agreement matured on December 15, 2010.

Financial Ratios

The following table shows key financial ratios for the periods indicated:

| At and for the years ended December 31, | 2012 | | 2011 | | 2010 | |
|---|---|---|---|---|---|---|
| Return on average total assets | 1.64 | % | 1.78 | % | 1.95 | % |
| Return on average common shareholders' equity | 14.93 | % | 16.14 | % | 18.11 | % |
| Average shareholders' equity as a percentage of: | | | | | | |
| Average total assets | 10.97 | % | 11.00 | % | 10.76 | % |
| Average total loans | 23.47 | % | 19.90 | % | 17.68 | % |
| Average total deposits | 12.88 | % | 13.05 | % | 13.06 | % |
| Common dividend payout ratio | 51 | % | 47 | % | 45 | % |

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company does not currently engage in trading activities or use derivative instruments to control interest rate risk, even though such activities may be permitted with the approval of the Company's Board of Directors.

Credit risk and interest rate risk are the most significant market risks affecting the Company, and equity price risk can also affect the Company's financial results. These risks are described in the preceding sections regarding "Loan Portfolio Credit Risk," and "Asset/Liability and Market Risk Management." Other types of market risk, such as foreign currency exchange risk and commodity price risk, are not significant in the normal course of the Company's business activities.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Management of Westamerica Bancorporation and subsidiaries (the "Company") is responsible for establishing and maintaining adequate internal control over financial reporting, and for performing an assessment of the effectiveness of internal control over financial reporting as of December 31, 2012. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. The Company's system of internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of Management and Directors of the Company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Management performed an assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2012 based upon criteria in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). Based on this assessment, Management determined that the Company's internal control over financial reporting was effective as of December 31, 2012 based on the criteria in Internal Control - Integrated Framework issued by COSO.

The Company's independent registered public accounting firm has issued an attestation report on Management's assessment of the Company's internal control over financial reporting. This report is included below.

Dated: February 27, 2013

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
Westamerica Bancorporation:

We have audited Westamerica Bancorporation and subsidiaries (the Company) internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.