

STERLING FINANCIAL CORP /WA/
Form DEF 14A
March 25, 2005
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of the Securities
Exchange Act of 1934 (Amendment No.)

Filed by the Registrant

Filed by a Party other than the Registrant

Check the appropriate box:

- Preliminary Proxy Statement
 Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))
 Definitive Proxy Statement
 Definitive Additional Materials
 Soliciting Material Pursuant to §240.14a-12

Sterling Financial Corporation

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

- No fee required.
 Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.
- | | |
|-----|---|
| (1) | Title of each class of securities to which transaction applies: |
| (2) | Aggregate number of securities to which transaction applies: |
| (3) | Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined): |
| (4) | Proposed maximum aggregate value of transaction: |
| (5) | Total fee paid: |
- Fee paid previously with preliminary materials.
 Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.
- | | |
|-----|---|
| (1) | Amount Previously Paid: |
| (2) | Form, Schedule or Registration Statement No.: |
| (3) | Filing Party: |
| (4) | Date Filed: |

Persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB control number.

111 North Wall Street
Spokane, Washington 99201

March 25, 2005

Dear Fellow Shareholder:

It is my pleasure to invite you to attend the Annual Meeting of Shareholders of Sterling Financial Corporation. The Annual Meeting will be held on Tuesday, April 26, 2005, at 10:00 a.m., local time, at the Spokane Agricultural Trade Center.

As set forth in the attached Notice of Annual Meeting of Shareholders and Proxy Statement, you will have an opportunity to vote on the election of Directors, the ratification of the independent registered public accounting firm, and any other matters properly brought before the meeting. We will also report on Sterling's operations and respond to questions of general interest to Shareholders.

It is very important that you be represented at the Annual Meeting regardless of the number of shares you own or whether you are able to attend the Annual Meeting in person. We urge you to mark, sign and date your proxy card today and return it in the envelope provided, even if you plan to attend the Annual Meeting. This will not prevent you from voting in person but will ensure that your vote is counted if you are unable to attend.

Your continued support is sincerely appreciated.

Sincerely,
/s/ HAROLD B. GILKEY
Harold B. Gilkey
*Chairman of the Board
and Chief Executive Officer*

STERLING FINANCIAL CORPORATION

111 North Wall Street
Spokane, Washington 99201

**NOTICE OF ANNUAL MEETING
OF SHAREHOLDERS**

The Annual Meeting of Shareholders of Sterling Financial Corporation (Sterling) will be held in the Conference Theater of the Agricultural Trade Center (located in the Spokane Convention Center), 334 West Spokane Falls Boulevard, Spokane, Washington, on Tuesday, April 26, 2005, at 10:00 a.m., local time, for the following purposes:

1. To elect three Directors of Sterling for terms ending in the year 2008;
2. To ratify the appointment of BDO Seidman, LLP as the independent registered public accounting firm for Sterling for 2005; and
3. To transact such other business as may properly come before the Annual Meeting.

These matters are more fully described in the attached Proxy Statement. Only Shareholders of record at the close of business on March 4, 2005, the record date, will be entitled to vote at the Annual Meeting.

YOUR VOTE IS IMPORTANT REGARDLESS OF THE NUMBER OF SHARES YOU OWN OR WHETHER OR NOT YOU PLAN TO ATTEND THE ANNUAL MEETING. EVEN IF YOU EXPECT TO ATTEND THE ANNUAL MEETING, WE URGE YOU TO COMPLETE, SIGN AND DATE THE ENCLOSED PROXY AND RETURN IT PROMPTLY IN THE POSTAGE-PAID ENVELOPE.

By Order of the Board of Directors,
/s/ NED M. BARNES
NED M. BARNES
Secretary

Spokane, Washington
March 25, 2005

TABLE OF CONTENTS

	Page
<u>PROXY STATEMENT</u>	1
<u>Date, time, place and purpose of Sterling's Annual Meeting</u>	1
<u>Record date; outstanding shares; shares entitled to vote</u>	1
<u>Quorum; vote required</u>	1
<u>Voting of proxies</u>	1
<u>How to revoke your proxy</u>	2
<u>Voting electronically via Internet or telephone</u>	2
<u>Expenses of proxy solicitation</u>	2
<u>Recommendation of the Board of Directors</u>	3
<u>PROPOSAL 1: ELECTION OF DIRECTORS</u>	3
<u>BOARD OF DIRECTORS OF STERLING FINANCIAL CORPORATION</u>	3
<u>PROPOSAL 2: RATIFICATION OF APPOINTMENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM</u>	5
<u>INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM'S FEES</u>	6
<u>PRE-APPROVAL OF AUDIT AND NON-AUDIT SERVICES</u>	6
<u>CORPORATE GOVERNANCE</u>	6
<u>Affirmative Determinations Regarding Director Independence and Other Matters</u>	7
<u>Communication with the Board of Directors</u>	7
<u>Compensation and Attendance of Directors</u>	7
<u>Committees of the Board of Directors</u>	8
<u>EXECUTIVE OFFICERS</u>	9
<u>SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS</u>	11
<u>SECURITY OWNERSHIP OF MANAGEMENT</u>	11
<u>Equity Compensation Plan Information</u>	12
<u>PERSONNEL COMMITTEE REPORT ON EXECUTIVE COMPENSATION</u>	13
<u>Compensation Philosophy</u>	13
<u>Components of Compensation</u>	13
<u>Compensation of CEO</u>	15
<u>Personnel Committee Interlocks and Insider Participation</u>	15
<u>EXECUTIVE COMPENSATION</u>	16
<u>Summary Compensation Table</u>	16
<u>Option Grants in 2004</u>	17
<u>Aggregated Option Exercises in 2004 and Year-End Option Values</u>	17
<u>Employment and Change in Control Agreements</u>	17
<u>SHAREHOLDER RETURN COMPARISON</u>	19
<u>INTERESTS OF DIRECTORS, OFFICERS AND OTHERS IN CERTAIN TRANSACTIONS</u>	20
<u>AUDIT COMMITTEE REPORT</u>	20
<u>SHAREHOLDER PROPOSALS</u>	21
<u>SECTION 16(A) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE</u>	21
<u>OTHER MATTERS</u>	21
<u>ANNUAL REPORT</u>	21

STERLING FINANCIAL CORPORATION

111 North Wall Street
Spokane, Washington 99201

PROXY STATEMENT

Annual Meeting of Shareholders

To be Held April 26, 2005

Date, time, place and purpose of Sterling's Annual Meeting

The 2005 annual meeting of Sterling's Shareholders, including any postponements or adjournments thereof (the Annual Meeting), will be held at 10:00 a.m., local time, on Tuesday, April 26, 2005, at 10:00 a.m. in the Conference Theater of the Agricultural Trade Center (located in the Spokane Convention Center), 334 West Spokane Falls Boulevard, Spokane, Washington. At the meeting, Sterling's Shareholders as of March 4, 2005 (the record date) will be asked to elect the nominees for the Board of Directors and ratify the appointment of BDO Seidman, LLP (BDO) as the independent registered public accounting firm for Sterling for 2005. This Proxy Statement is first being sent to holders of Sterling common stock on or about March 25, 2005, and is accompanied by a proxy that is being solicited by the Sterling Board of Directors for use at the Annual Meeting.

Record date; outstanding shares; shares entitled to vote

Only holders of record of Sterling common stock at the close of business on the record date are entitled to notice of and to vote at the Annual Meeting. Each holder of Sterling common stock is entitled to one vote for each share of Sterling common stock owned as of the record date. As of the record date, there were 23,005,545 shares of Sterling common stock outstanding.

Quorum; vote required

Under Washington law, any Shareholder action at a meeting requires that a quorum exist with respect to that action. A quorum for the actions to be taken at the Annual Meeting will consist of a majority of the outstanding shares of Sterling common stock entitled to vote, present in person or by proxy at the Annual Meeting. Shareholders of record, including brokers holding customers' shares of record, who are present at the Annual Meeting in person or by proxy and who abstain from voting, are considered present and entitled to vote and will count toward the quorum.

If a quorum exists at the Annual Meeting, those nominees for election to the Board of Directors who receive the greatest number of affirmative votes cast for Directors will be elected as Directors. If a quorum exists, the ratification of the appointment of BDO as the independent registered public accounting firm for Sterling for 2005, and all other matters that properly come before the Annual Meeting, will be approved if the number of votes cast in favor of the proposed action exceeds the number of votes cast against it. Abstentions and broker non-votes will have no impact on the election of Directors or other proposals. Proxies and ballots will be received and tabulated by American Stock Transfer & Trust Company, Sterling's transfer agent and inspector of elections for the Annual Meeting.

Voting of proxies

The Board of Directors requests that you complete, date and sign the proxy card accompanying this Proxy Statement and promptly return the card in the enclosed postage-paid envelope. Unless contrary instructions are specified, all properly signed proxies received by Sterling and not revoked before the vote at the Annual Meeting will be voted: 1) FOR the election of the three Directors nominated by the Board of Directors; 2) FOR the ratification of the appointment of BDO as the independent registered public accounting firm for Sterling for 2005; and 3) in accordance with the best judgment of the proxy agents on

any other matters properly brought before the Annual Meeting. If the Annual Meeting is postponed or adjourned, your proxy will still be effective and may be voted at the rescheduled meeting. You will still be able to change or revoke your proxy until it is voted.

If you own your shares in street name, that is, through a brokerage account or in another nominee form, you must provide instructions to the broker or nominee as to how your shares should be voted. Otherwise, your shares may not be voted and will be recorded as broker non-votes. Your broker or nominee will usually provide you with the appropriate instruction forms at the time you receive this Proxy Statement. If you own your shares in this manner, you cannot vote in person at the Annual Meeting unless you receive a proxy to do so from the broker or the nominee and you bring the proxy to the Annual Meeting.

If you are a participant in Sterling's 401(k) Employee Savings and Investment Plan and Trust, your completed proxy will serve as voting instructions to the plan trustee. However, your voting instructions must be received at least five days prior to the Annual Meeting to count. In accordance with the terms of the plan, if you fail to instruct the plan trustee how to vote your plan shares, the trustee will vote your plan shares in accordance with the recommendations of the 401(k) Advisory Committee.

If you are a participant in the Klamath First Federal Employee Stock Ownership Plan (the Klamath ESOP), the proxy card represents a voting instruction to the trustee of the Klamath ESOP as to the number of shares in the participant's plan account. Each participant may direct the trustee as to the manner in which shares of common stock allocated to the participant's plan account are to be voted. Unallocated shares of common stock held by the Klamath ESOP, and allocated shares for which no voting instructions are received from participants, will be voted by the trustee, to the extent not inconsistent with its fiduciary obligations, in the same proportion as shares for which the trustee has received voting instructions.

How to revoke your proxy

You may revoke your proxy at any time by taking any of the following actions before your proxy is voted at the Annual Meeting:

- delivering to Sterling a written notice bearing a date later than the date of the proxy card, stating that you revoke the proxy;
- signing and delivering to Sterling a proxy card relating to the same shares and bearing a later date; or
- attending the meeting and voting in person, although attendance at the meeting will not, by itself, revoke a proxy.

Also, please note that if you have voted through your broker, bank or other nominee and you wish to change your vote, you must follow the instructions received from such entity to change your vote.

Voting electronically via Internet or telephone

A large number of banks and brokerage firms provide Shareholders whose shares are registered in the name of such firms the opportunity to vote via the Internet or by telephone. The voting form sent to a beneficial owner will provide instructions if such options are available.

Expenses of proxy solicitation

The expense of preparing, printing and mailing this Proxy Statement and the proxies solicited hereby will be borne by Sterling. Proxies will be solicited by Sterling by mail and may also be solicited on behalf of Sterling by directors, officers and other employees of Sterling, without additional remuneration, in person

or by telephone or facsimile transmission. Sterling will also request brokerage firms, banks, nominees, custodians and fiduciaries to forward proxy materials to the beneficial owners of shares of Sterling common stock as of the record date and will reimburse such entities for the cost of forwarding the proxy materials in accordance with customary practice.

Recommendation of the Board of Directors

The Board of Directors of Sterling believes the proposals described herein are in the best interests of Sterling and its Shareholders and, accordingly, recommends that the Shareholders vote FOR the proposals identified in the Notice.

PROPOSAL 1: ELECTION OF DIRECTORS

The Board of Directors currently consists of nine Directors who are divided as closely as possible into three classes. The members of each class serve three-year terms, and one class is elected annually. The Board of Directors has nominated current Directors Donald N. Bauhofer, Thomas H. Boone and Harold B. Gilkey for election at this year's Annual Meeting as Directors to serve terms of three years ending at the annual meeting of Shareholders of Sterling in the year 2008, or when their respective successors have been duly elected and qualified.

Each nominee for election as a Director at the Annual Meeting has consented to serve if elected. Sterling has no reason to believe that any of the nominees will be unable to serve. Should any nominee become unable to serve as a Director for any reason, the Board of Directors shall designate a substitute nominee. Unless instructions to the contrary are specified on the proxy card, proxies will be voted in favor of the persons who have been nominated by the Board of Directors.

The Board of Directors recommends that Shareholders
vote FOR the nominees.

BOARD OF DIRECTORS OF STERLING FINANCIAL CORPORATION

HAROLD B. GILKEY

Mr. Gilkey, 65, has served as Chairman of the Board and Chief Executive Officer (CEO) of Sterling Financial Corporation since its inception, and served as Chairman of the Board and CEO of Sterling Savings Bank (Sterling Savings) from 1981 until October 2003. Mr. Gilkey co-founded Sterling Savings in 1981. Additionally, he is Chairman of the Board of INTERVEST-Mortgage Investment Company (INTERVEST), Action Mortgage Company (Action Mortgage) and Harbor Financial Services, Inc. (Harbor Financial), each of which are wholly owned subsidiaries of Sterling Savings. Mr. Gilkey brought to Sterling Savings over 20 years of commercial and mortgage banking experience. He served as President of Bancshares Mortgage Company of Spokane, Washington, and Senior Vice President of Old National Bank of Spokane, Washington. Prior to this, Mr. Gilkey was employed by Bank of America for 12 years. Mr. Gilkey serves on the Federal Home Loan Bank of Seattle Board of Directors. Mr. Gilkey is a past Director of the Washington Savings League and a member of the Savings Association Insurance Fund Industry Advisory Committee, an advisory committee of the Federal Deposit Insurance Corporation. Mr. Gilkey received his degree in Business Administration from the University of Montana in 1962 and his Master of Business Administration degree from the University of Southern California in 1970. If reelected, his term will expire in 2008.

WILLIAM W. ZUPPE

Mr. Zuppe, 63, has served as Director, President and Chief Operating Officer of Sterling since its inception and served as Director, President and Chief Operating Officer of Sterling Savings from 1981 until October 2003 when he was promoted to lead Sterling Savings as Chairman of the Board and CEO. Mr. Zuppe co-founded Sterling Savings in 1981. Mr. Zuppe is also Vice President and serves as a Director of INTERVEST, Action Mortgage and Harbor Financial. Mr. Zuppe brought to Sterling Savings 18 years of mortgage lending experience as Vice President of Bancshares Mortgage Company and Manager of Loan Administration of Sherwood & Roberts, Inc. of Walla Walla, Washington, a mortgage banking company. Mr. Zuppe currently serves as Chairman of the Board for America's Community Bankers, a national trade association. He is past Chairman of the Washington Savings League Board of Directors and past member of the Federal Reserve Board - Thrift Institutions Advisory Council. His term will expire in 2006.

NED M. BARNES

Mr. Barnes, 68, has served as Secretary and a Director of Sterling since its inception, and as Secretary of Sterling Savings since 1981 and as a Director since 1983. Mr. Barnes is also Secretary and serves as a Director of INTERVEST, Action Mortgage and Harbor Financial. Mr. Barnes is a Principal in the law firm of Witherspoon, Kelley, Davenport & Toole, P.S. of Spokane, Washington, which he joined in 1965. Mr. Barnes law practice emphasizes the areas of real estate, banking and corporate law. He is a member of the Board of Directors of the Spokane Community Mental Health Center. He is also Trustee on the City of Spokane Library Board and a Director on the Board of the Downtown Spokane Partnership, a local downtown Spokane advocate. Mr. Barnes graduated from the University of Minnesota in 1958, earning a degree in Business Administration. He received his Juris Doctor degree from the University of Washington in 1961. His term will expire in 2007.

RODNEY W. BARNETT

Mr. Barnett, 61, has served as a Director of Sterling since its inception and as a Director of Sterling Savings since 1981. He is President and General Manager of Carr Sales Company, an electrical supply firm in Spokane, Washington. Mr. Barnett is also a past Director of the National Association of Electrical Distributors. His term will expire in 2006.

DONALD N. BAUHOFER

Mr. Bauhofer, 53, has served as a Director of Sterling since his appointment in January 2004. He is Founder and President of the Pennbrook Company, a real estate development firm in Bend, Oregon, established in 1985. In addition, he is Founder and CEO of Pennbrook Homes, Inc., and Praxis Medical Group; co-owner of Arrowood Development, LLC; and co-owner and Director of Pacific Education Corporation. Mr. Bauhofer served on the Board of Directors of Klamath First Bancorp, Inc. (Klamath) from November 2002 until December 2003. Mr. Bauhofer was then appointed to Sterling's Board of Directors after Klamath was merged into Sterling in January 2004. Mr. Bauhofer earned a Masters degree in Business Administration and an undergraduate degree from Stanford University and a Juris Doctor degree from the University of California at Davis. If reelected, his term will expire in 2008.

THOMAS H. BOONE

Mr. Boone, 64, has served as a Director of Sterling since 2000 and as a Director of Sterling Savings since 1998. Mr. Boone is an attorney, shareholder and President of the law firm of Boone Karlberg, P.C. of Missoula, Montana. He is a past member and President of the Missoula YMCA Board of Directors and the Western Montana Bar Association, a Director and President of the Missoula County Scholarship

Fund, a Director and President of the Missoula Symphony Association and a member of the Board of Visitors for the University of Montana School of Law. Mr. Boone graduated from Harvard College and received his Juris Doctor degree from Harvard Law School. Mr. Boone was a member of the Board of Directors of Big Sky Bancorp, Inc., which merged with Sterling in November 1998. If reelected, his term will expire in 2008.

WILLIAM IKE L. EISENHART

Mr. Eisenhart, 52, has served as a Director of Sterling since his appointment in January 2004. He serves as an independent financial advisor to privately held and publicly traded companies on investment banking matters. Previously, Mr. Eisenhart was a Managing Director at Dain Bosworth, Inc., in Seattle, Washington, a Partner in Corporate Finance for Cable Howse & Ragen in Seattle, Washington, and Vice President of Corporate Finance at Goldman, Sachs & Company in New York City. Currently, he serves as a member of the Finance Committee of the YMCA of Greater Seattle, and as a member of the Board of Directors of Jumbo Foods, Inc., a privately held business serving convenience stores in western states. He has been a board member of Emerald Hills Coffee, Inc., a privately held coffee distributor, since 2002. Mr. Eisenhart earned a Masters degree in Business Administration from the University of Chicago and his undergraduate degree from Harvard College. Mr. Eisenhart is Co-Chair of Harvard College Schools and Scholarship Committee of Western Washington. His term will expire in 2006.

JAMES P. FUGATE

Dr. Fugate, 72, has served as a Director of Sterling since 1989. He is the retired Superintendent of Auburn School District No. 408. Dr. Fugate is a former Director of Central Evergreen Savings & Loan Association. He is on the Board of Governors of the Auburn Regional Medical Center and serves as the Chairman of the Board. His term will expire in 2007.

ROBERT D. LARRABEE

Mr. Larrabee, 69, has served as a Director of Sterling since its inception and as a Director of Sterling Savings since 1983. Mr. Larrabee is the owner of Merchant Funeral Home in Clarkston, Washington. He is also a former Director of Laurentian Capital Corporation, a former Director of Lewis and Clark Savings & Loan Association and a past President of the Board of Regents of the University of Washington. His term will expire in 2007.

PROPOSAL 2: RATIFICATION OF APPOINTMENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Audit Committee of the Board of Directors has appointed BDO to serve as the independent registered public accounting firm for Sterling and its subsidiaries for the year ending December 31, 2005, and any interim periods. BDO has advised Sterling that it will have in attendance at the Annual Meeting one or more representatives who will be available to respond to appropriate questions presented at the Annual Meeting. Such representatives will have an opportunity to make a statement at the Annual Meeting if they desire to do so. If the required number of votes does not ratify the appointment of BDO, the Board will review its future selection of independent registered public accounting firms.

The Board of Directors unanimously recommends that Shareholders vote FOR
the Proposal to ratify the appointment of BDO as the
independent registered public accounting firm for Sterling for 2005.

INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM'S FEES

Audit Fees: The aggregate fees and expenses billed by BDO for professional services rendered for the audit of Sterling's annual financial statements, the reviews of the financial statements included in Sterling's periodic reports filed with the SEC on Forms 10-Q, SEC registration statement services, and the audits of the financial statements of Sterling's subsidiaries were \$317,384 and \$604,400 for the years ended December 31, 2003 and 2004, respectively. Fees for 2004 include the integrated audit of Sterling's consolidated financial statements and management's assessment of internal controls over financial reporting as required by the Public Company Accounting Oversight Board and the SEC.

Audit Related Fees: The aggregate fees and expenses billed by BDO for audit related services rendered during 2003 and 2004 were \$24,000 and \$29,250, respectively. Types of services in this category were primarily audits of the employee benefit plans and consultation on accounting standards.

Tax Fees: The aggregate fees billed by BDO for tax services rendered during 2003 and 2004 were \$89,220 and \$91,745, respectively. Types of tax services provided by BDO primarily consisted of advice related to preparing Sterling's corporate tax returns and tax consulting projects.

All Other Fees: There were no other services provided by BDO during 2003 and 2004.

PRE-APPROVAL OF AUDIT AND NON-AUDIT SERVICES

It is the responsibility of Sterling's Audit Committee to pre-approve all audit and non-audit services provided by BDO. The Audit Committee has adopted a policy authorizing certain permissible audit and non-audit services to be performed by BDO with subsequent reporting and oversight required by the Audit Committee. Permissible services, not pre-approved pursuant to this policy, require specific review and approval prior to the engagement by the Audit Committee, or a designated member. Specific pre-approval of such permissible services with estimated fees of \$2,500 or less may be waived via the *de minimis* exception rule. Procedures are in place to ensure the Audit Committee Chairman is notified in the event the *de minimis* rule is used. All services rendered by and fees paid to BDO are reported to and monitored quarterly by the Audit Committee. The Audit Committee considers whether the provision of related audit services are compatible with maintaining the independent registered public accounting firm's independence. To assist the Audit Committee in its oversight responsibilities, the pre-approval policy identifies the three basic principles of independence with respect to services provided by the independent registered public accounting firm, as well as the non-audit services the independent registered public accounting firm is prohibited from providing. One hundred percent of all services provided by BDO in each of the last two fiscal years were pre-approved by the Audit Committee.

CORPORATE GOVERNANCE

Sterling has proactively taken steps to establish a corporate governance framework that affirms our high standards of business conduct, emphasizes the importance of integrity and honesty in the conduct of our business, and ensures the integrity of the controls and procedures implemented by our Directors, officers and employees, including our internal control over financial reporting. Actions we have taken to establish this corporate governance framework include: maintaining a Board composed of a majority of independent directors; adoption of charters for various Directors' committees; adoption of a Code of Ethics for all of our Directors, officers and employees; and provision of a procedure for shareholders and employees to communicate with the Board. We believe that the ethical foundations outlined in our corporate governance framework are critical to our ongoing success and the maximization of shareholder value.

Affirmative Determinations Regarding Director Independence and Other Matters

The Board of Directors has determined that each of the following Directors is an independent director as such term is defined by the rules of the National Association of Securities Dealers (NASD) and the Securities Exchange Commission (SEC):

Rodney W. Barnett

Donald N. Bauhofer

Thomas H. Boone

William Ike L. Eisenhart

James P. Fugate

Robert D. Larrabee

The Board of Directors has also determined that each member of the three committees of the Board meets the independence requirements applicable to those committees prescribed by the rules of the NASD and the SEC.

The Board of Directors has adopted a Code of Ethics that applies to all Sterling employees and Directors, including Sterling s senior financial officers. The Code of Ethics is publicly available on Sterling s website at <http://www.sterlingsavingsbank.com>.

Communication with the Board of Directors

Shareholders may send communications to the Board of Directors of Sterling by addressing such correspondence to:

Harold B. Gilkey

Chairman of the Board

Sterling Financial Corporation

111 North Wall Street

Spokane, WA 99201

As Chairman of the Board, Mr. Gilkey monitors Shareholder communications, forwards correspondence to the appropriate committee(s) or Director(s) and facilitates an appropriate response.

Compensation and Attendance of Directors

Directors of Sterling who are not employees of Sterling are paid an annual fee of \$10,000 plus a fee, which is currently \$2,000, for every meeting attended. Directors of Sterling Savings who are not employees are paid an annual fee of \$10,000 plus a fee, which is currently \$2,000, for every meeting attended. Individuals who serve on both Boards receive a fee of \$2,000 for attending Sterling Savings meetings but do not receive an additional fee for attending Sterling meetings. Directors serving on committees of the respective Boards also receive a fee of \$500 for every committee meeting attended unless they serve as the chair of a committee in which case they receive a fee of \$1,000 for every committee meeting attended. Additionally, Directors who also serve as Directors of the subsidiaries of Sterling Savings receive a fee of \$250 for each meeting attended. Directors receive reimbursement for travel and other expenses incurred in connection with Board business.

Nonemployee Directors of Sterling also receive annual grants of non-qualified stock options. Such options have an exercise price equal to the fair market value of the Sterling common stock on the date of grant and generally expire ten years from the date of grant. In the event that a nonemployee Director is removed from office for cause, all options granted to such nonemployee Director pursuant to the automatic grants of non-qualified stock options described above will expire immediately upon such removal.

The Board of Directors of Sterling held 12 meetings during 2004. Each Director attended at least 75% of such meetings and those of the Board committees on which the Director served during the year. It is Sterling's policy that members of the Board of Directors should attend all annual meetings of Shareholders except for absences due to causes beyond the reasonable control of the Directors. At the 2004 annual meeting of Shareholders of Sterling Financial Corporation, all but one of the Directors were in attendance.

Committees of the Board of Directors

The Board of Directors of Sterling has established Audit, Personnel and Nominating Committees.

The primary responsibilities of the Audit Committee are to oversee the integrity of Sterling's financial reporting process, including its financial statements and systems of internal controls, as well as its compliance with legal and regulatory requirements. The Audit Committee reviews the independent registered public accounting firm's qualifications, independence and performance and oversees and monitors the performance of Sterling's internal audit function. The Audit Committee is responsible for the retention, supervision and termination of the independent registered public accounting firm for resolving disagreements between management and the independent registered public accounting firm. The independent registered public accounting firm reports directly to the Audit Committee. The Audit Committee is also responsible for reviewing the adequacy of the authority, responsibilities and functions of Sterling's internal audit department. The Audit Committee is not responsible for conducting reviews of auditing or accounting procedures. Management has primary responsibility for Sterling's financial reporting process and for preparing Sterling's financial statements. Sterling's independent registered public accounting firm is responsible for performing an independent audit of the consolidated financial statements in accordance with generally accepted auditing standards. The Audit Committee serves a board-level oversight role in which it provides advice, counsel and direction to management and the independent registered public accounting firm on the basis of the information it receives, discussions with the independent registered public accounting firm, and the experience of the Audit Committee's members in business, financial and accounting matters.

The Audit Committee held two meetings during 2004 and currently consists of Messrs. Barnett (Chairman), Boone and Eisenhart, each of whom has been determined by the Board to be independent and financially literate as required by the rules of the NASD and the SEC. Members of the Audit Committee have reviewed and discussed with management and the independent registered public accounting firm the periodic reports of Sterling prior to filing such reports with the SEC. No member of the Audit Committee has participated in the preparation of the financial statements of Sterling or its subsidiaries at any time during the past three years. The Board has determined that Mr. Barnett is an audit committee financial expert as defined by the SEC. The Audit Committee operates under a written charter reviewed and approved annually by Sterling's Board of Directors. Sterling's Audit Committee Charter is publicly available on Sterling's website at www.sterlingsavingsbank.com.

The Personnel Committee reviews and makes recommendations to the Board of Directors with respect to personnel policies that include, but are not limited to, officer and employee salaries and benefits. The Personnel Committee held three meetings during 2004 and currently consists of Messrs. Larrabee (Chairman), Fugate and Bauhofer, each of whom has been determined by the Board to be independent as that term is defined by the rules of the NASD and the SEC.

The Nominating Committee recommends to the Board of Directors a slate of nominees for election by the Shareholders at each annual meeting of Sterling. At the request of the Board, the Nominating Committee recommends for approval by the Board, nominees to fill vacancies or new positions on the Board as they may occur or be created from time to time, all in accordance with Sterling's Bylaws. The Nominating Committee identifies potential nominees from various sources, including recommendations from Directors and officers of Sterling. The Nominating Committee will consider nominees recommended

by Shareholders upon submission in writing to the Chairman of the Board of Directors the names of such nominees, together with their qualifications for service as Directors of Sterling. Individuals recommended by Shareholders are evaluated in the same manner as other potential nominees. The Nominating Committee reviews and discusses recommendations received for Director candidates and evaluates the qualifications of such candidates before selecting a slate of nominees to be recommended to the Board. Qualifications which the Nominating Committee will consider in evaluating Director candidates include contacts within Sterling's market area, skills, experience, time availability and such other criteria as the Nominating Committee shall determine to be relevant. The Nominating Committee held one meeting in 2004, and currently consists of Messrs. Fugate (Chairman), Larrabee and Bauhofer, each of whom has been determined by the Board to be independent as that term is defined by the rules of the NASD and the SEC. The Nominating Committee operates under a written charter approved by Sterling's Board of Directors. Sterling's Nominating Committee Charter is publicly available on Sterling's website at <http://www.sterlingsavingsbank.com>.

EXECUTIVE OFFICERS

In addition to Messrs. Gilkey and Zuppe, the Executive Officers of Sterling and its subsidiaries are Heidi B. Stanley, David P. Bobbitt, Daniel G. Byrne, Stephen L. Page, John M. Harlow, James L. Kirschbaum and Jeffery D. Schlenker. Each Executive Officer has held his or her present position for the past five years except as otherwise stated.

HEIDI B. STANLEY

Ms. Stanley, 48, has served as Vice Chair and Chief Operating Officer of Sterling Savings since October 2003. She previously served as Executive Vice President Corporate Administration after joining Sterling Savings in 1985. In 2004, she was named one of the 25 Women to Watch in Banking by *U.S. Banker* magazine. Prior to joining Sterling, Ms. Stanley was employed by IBM in San Francisco, California, and Tucson, Arizona. She is a past Chairman of the Board of the Association of Washington Business. She is Vice-Chairman of America's Community Bankers Membership Committee and a member of the Government Affairs Steering Committee. She serves on the Board of Governors of the WSU Foundation, and is Chairman of the Foundation Planning Committee. She also serves on the Board of the Spokane Chamber of Commerce. Ms. Stanley graduated from Washington State University in 1979 with a degree in Business Administration.

DAVID P. BOBBITT

Mr. Bobbitt, 57, serves as President of Sterling Savings. He joined Sterling Savings in 1996. Before joining Sterling Savings, Mr. Bobbitt was employed by West One Bank for 26 years. He serves as a Director of the Pacific Coast Banking School. He is an Advisory Director of the College of Business and Economics at the University of Idaho. He is a member of the Idaho Bankers Association Executive Council. He also serves as the Chairman of the North Idaho Fair Board. Mr. Bobbitt is a graduate of North Idaho College, the Pacific Coast Banking School and Harvard University's Advanced Management Program.

DANIEL G. BYRNE

Mr. Byrne, 50, serves as Executive Vice President-Finance, Chief Financial Officer and Assistant Secretary of Sterling. He has served in these capacities with Sterling Financial Corporation and Sterling Savings, both of which he joined in 1983. Mr. Byrne is also the Assistant Secretary and Treasurer of INTERVEST, Action Mortgage and Harbor Financial. Before joining Sterling, Mr. Byrne was employed by the accounting firm of Coopers & Lybrand in Spokane, Washington. He is a past Lieutenant Governor of Kiwanis International. Mr. Byrne is a past member of the Board of Trustees and its Executive