WESTAMERICA BANCORPORATION
Form 10-K
February 27, 2009

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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, 2008

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, and attached Common Stock Purchase Rights	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. YES þ 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 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. þ

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, 2008 as reported on the NASDAQ Global Select Market, was $1,464,904,391.65. 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 23, 2009 28,875,157 Shares

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement relating to registrant s Annual Meeting of Shareholders, to be held on April 23, 2009, 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 , pro continue , remain , will , should , may and other similar expressions are intended to identify forward-looking stater 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 difficulties in the national and California economies and the effects of federal government efforts to address those difficulties; (2) continued low 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) significantly increasing competitive pressure in the banking industry; (9) operational risks including data processing system failures or fraud; (10) volatility of rate sensitive loans, deposits and investments; (11) asset/liability management risks and liquidity risks; and (12) 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 Company also owned 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. In February 2008, the Company contributed 100% of the capital stock of CBSC to the Bank, such that CBSC became a wholly-owned subsidiary of the Bank.

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 additional 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 five aforementioned business combinations were accounted for as poolings-of-interests.

In August, 2000, the Company acquired First Counties Bank. The acquisition was valued at approximately $19.7 million and was accounted for using the purchase accounting method. The assets and liabilities of First Counties Bank were fully merged into WAB in September 2000. First Counties Bank had $91 million in assets and offices in Lake, Napa, and Colusa counties.

In June of 2002 the Company acquired Kerman State Bank. The acquisition was valued at approximately $14.6 million and was accounted for using the purchase accounting method. The assets and liabilities of Kerman State Bank were fully merged into WAB immediately upon consummation of the merger. Kerman State Bank had $95 million in assets and three offices in Fresno county.

On March 1, 2005, the Company acquired Santa Rosa based Redwood Empire Bancorp, the parent company of National Bank of the Redwoods (NBR). The acquisition was valued at approximately $150 million and was accounted for using the purchase accounting method. The assets and liabilities of NBR were fully merged into WAB as of close of business day on March 11, 2005. As of March 1, 2005, NBR had approximately $440 million in loans and $370 million in deposits.

On February 6, 2009, the Bank entered into a Purchase and Assumption Agreement (the Agreement) with the Federal Deposit Insurance Corporation) as Receiver (Receiver) of County Bank (County). At February 6, 2009, County s accounting records reflected total assets and loans to be purchased by the Bank of approximately $1.6 billion and approximately $1.3 billion, respectively, and total deposits to be assumed by the Bank of approximately $1.2 billion. Under the terms of the Agreement, the Bank purchased substantially all assets of County, including loans, investment securities and other assets, excluding premises, equipment and company owned life insurance. The Bank has a short-term option to purchase certain premises and equipment from the Receiver. Under the terms of the Agreement, the Bank also assumed all the deposits, secured liabilities, and certain other liabilities of County. The Agreement also provided a loss sharing arrangement over certain assets, primarily loans and loan collateral received in satisfaction of loans receivable. Losses on covered assets up to $269 million are shared 80% by the Receiver and 20% by the Bank. Losses on covered assets exceeding $269 million are shared 95% by the Receiver and 5% by the Bank. The Company filed a Form 8-K on February 11, 2009 containing the Agreement.

On February 13, 2009, the Company entered into a Letter Agreement and related Securities Purchase Agreement (collectively the Securities Purchase Agreement) with the United States Treasury (Treasury) to issue 83,726 preferred shares at $1,000 per share, $83,726,000 in total issuance (Treasury Preferred Stock). The Treasury Preferred Stock qualifies as tier one capital under bank regulatory capital standards, requires five percent annual dividends in each of the initial five years, and nine percent annual dividends thereafter. The Treasury Preferred Stock places certain restrictions on the Company: dividends to common shareholders may not be increased, share repurchases are limited to repurchases related to employee benefit programs, the Treasury Preferred Stock cannot be redeemed for three years unless the participating bank raises high-quality private capital, and executive compensation exceeding $500,000 may not be deducted for federal income tax purposes. In addition, executive compensation programs must not be structured to reward excessive risk-taking. The Company filed Form 8-Ks on February 13, 2009 and February 19, 2009 related to the issuance of Treasury Preferred Stock. The Company also issued a warrant to purchase 246,640 shares of its common stock at an exercise price of $50.92 per share (TARP Warrant).

At December 31, 2008, the Company had consolidated assets of approximately $4.0 billion, deposits of approximately $3.1 billion and shareholders equity of approximately $409.9 million. The Company and its subsidiaries employed approximately 881 full-time equivalent staff as of December, 2008.

The Company makes available free of charge its 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 as soon as reasonably practicable after they are electronically filed with or furnished to the Securities and Exchange Commission (SEC) through its website (http://www.westamerica.com). Such documents are also available through the SEC s website (http://www.sec.gov). Requests for the Form 10-K annual report, as well as the Company s director, officer and employee Code of Conduct and Ethics, can also be submitted 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

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Bank, banking, 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 costs of any examination by the FRB are payable by the Company. 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, adopted in 2003. 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.

On March 11, 2000, the Gramm-Leach-Bliley Act (the GLBA), or the Financial Services Act of 1999 became effective. The GLBA 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 bank and its deposits are insured by the Federal Deposit Insurance Corporation (the FDIC). Prior to January 14, 2008, the Bank was also a member of the Federal Reserve System. The Bank is subject to regulation, supervision and regular examination by the California Department of Financial Institutions (DFI), and the FRB prior to January 14, 2008 and, upon becoming a non-member bank, by the FDIC after January 14, 2008. 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. While a member of the Federal Reserve System, the Bank s investment authority was limited by regulations promulgated by the FRB. 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.

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, 2008, the Company s and the Bank s respective ratios exceeded applicable regulatory requirements. See Note 9 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.

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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 or the CGCL. The CGCL provides that a corporation may make a distribution to its shareholders if the corporation s retained earnings equal or exceed the amount of the proposed distribution. The CGCL further provides that, in the event that sufficient retained earnings are not available for the proposed distribution, a corporation may nevertheless make a distribution to its shareholders if the sum of the assets of the corporation (exclusive of goodwill, capitalized research and development expenses and deferred charges) would be at least equal to 1.25 times its liabilities (not including deferred taxes, deferred income and other deferred credits).

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 to 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 collectibility 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. Under the terms of the Treasury Preferred Stock, the Company is restricted from increasing common dividends.

Premiums for Deposit Insurance and Assessments for Examinations

The Bank s deposits are insured by the Deposit Insurance Fund (DIF) administered by the FDIC. FDICIA established several mechanisms to increase funds to protect deposits insured by the DIF. The FDIC is authorized to borrow up to $30 billion from the Treasury; up to 90% of the fair market value of assets of institutions acquired by the FDIC as receiver from the Federal Financing Bank; and from depository institutions which are members of the DIF. Any borrowings not repaid by asset sales are to be repaid through insurance premiums assessed to member institutions. Such premiums must be sufficient to repay any borrowed funds within 15 years and provide insurance fund reserves of $1.25 for each $100 of insured deposits. FDICIA also provides authority for special assessments against insured deposits.

Congress adopted the Federal Deposit Insurance Reform Act of 2005 as part of the Deficit Reduction Act of 2005 and the President signed it on February 8, 2006 and a companion bill, the Federal Deposit Insurance Reform Conforming Amendments Act of 2005, on February 15, 2006. This legislation provided for:

- merging the DIF and SAIF deposit insurance funds;
- annually adjusting the minimum insurance fund reserve ratio between $1.15 and $1.50 per $100 of insured deposits;
- increasing deposit coverage for retirement accounts to $250,000,
- indexing the insurance level for inflation, with any increases approved by the FDIC and National Credit Union Administration (NCUA) on a five-year cycle beginning in 2010 after review of the state of the deposit insurance fund and related factors;
- credits of up to $4.7 billion to offset premiums for banks that capitalized the FDIC by 1996; and
- a historical basis concept for distributing credits and dividends to reflect past contributions to the insurance funds.

In the fourth quarter of 2006, the FDIC adopted two final rules implementing the Federal Deposit Insurance Reform Act of 2005. One rule creates a new system for risk-based assessments and sets assessment rates beginning January 1, 2007. Assessment rates are three basis points above the base rates, ranging from 5 to 7 basis for Risk Category I institutions, 10 basis points for Risk Category II institutions, 28 basis points for Risk Category III institutions, and 43 basis points for Risk Category IV institutions. The Bank is categorized as a Risk Category I institution. The other rule sets the designated reserve ratio at 1.25%.

The FDIC has designated the DIF long-term target reserve ratio at 1.25% of insured deposits. Due to recent bank failures, the FDIC insurance fund reserve ratio has fallen below 1.15%, the statutory minimum. Effective January 1, 2009, the FDIC adopted a restoration plan that uniformly increased insurance assessments by 7 basis points (annualized) to the rates shown above. The FDIC has proposed changes to the deposit insurance assessment system beginning with the second quarter of 2009 to make the increase in assessments fairer by requiring riskier institutions to pay a larger share. Institutions would be classified into one of four risk categories. Within each category, the FDIC will be able to assess higher rates to institutions with a significant reliance on secured liabilities, which generally raises the FDIC s loss in the event of failure without providing additional assessment revenue. The proposal also would assess higher rates for institutions with a significant reliance on brokered deposits but, for well-managed and well-capitalized institutions, only when accompanied by rapid asset growth. The proposal also would provide incentives in the form of a reduction in assessment rates for institutions to hold long-term unsecured debt and, for smaller institutions, high levels of Tier 1 capital. Together, the changes would improve the way the system differentiates risk among insured institutions and help ensure that the reserve ratio returns to at least 1.15% percent by the end of 2013. The increase in premium assessments will increase the Company s expenses in 2009. The Company was assessed a $396 thousand quarterly premium for the fourth quarter 2008 at the 5 basis point assessment rate in effect at that time.

In October of 2006, FDIC s Board adopted a final rule governing the distribution and use of the $4.7 billion one-time assessment credit. The Bank was allowed to apply assessment credits of $357 thousand to offset premiums assessed in the fourth quarter 2008. Application of such credits toward the $396 thousand assessed premium caused the Bank to pay assessments of $39 thousand in the fourth quarter 2008. At December 31, 2008, the Bank s remaining assessment credits totaled $2.4 million.

Under the EESA, adopted on October 3, 2008, certain increases in FDIC deposit insurance have also been approved. From October 3, 2008, until December 31, 2009, the amount of deposit insurance provided by the FDIC is increased from $100,000 to $250,000. This temporary increase is automatic. In November 2008, the FDIC adopted the Transaction Account Guaranty

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Program (TAGP) that provides unlimited deposit insurance on funds in noninterest-bearing transaction deposit accounts, certain attorney trust accounts, and NOW accounts paying not more than 50 basis points of interest regardless of dollar amount. These accounts are mainly payment-processing accounts, such as payroll accounts used by businesses. The Bank has elected to participate in the TAGP, and, as a result, will be assessed an additional 10 basis point surcharge on the insured deposit balances exceeding $250,000.

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

On October 26, 2001, the President signed into law the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 or the USA Patriot Act. Title III of the 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 banking organizations, including 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

On July 30, 2002, the U.S. Congress enacted the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley). The stated goals of 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 oversee 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.

Given the extensive role of the SEC, the PCAOB and the Exchanges in implementing rules relating to Sarbanes-Oxley s requirements, the federalization of certain elements traditionally within the sphere of state corporate law, the impact of Sarbanes-Oxley on reporting companies has been and will continue to be significant.

Programs To Mitigate Identity Theft

In November 2007, federal banking agencies together with the NCUA and FTC 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 based; (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.

Recent Developments

On October 3, 2008, Congress adopted the EESA, including a Troubled Asset Relief Program (TARP). TARP gave the Treasury authority to deploy up to $700 billion into the financial system for the purpose of improving liquidity in capital markets. On October 14, 2008, Treasury announced plans to direct $250 billion of this authority into preferred stock investments in banks and bank holding companies through a Capital Purchase Program (CPP). EESA includes certain limitations on executive compensation, including limits on deductibility of executive compensation in excess of $500,000, and imposes certification and disclosure requirements concerning compliance with these limitations.

In November 2008, the FDIC adopted a Temporary Liquidity Guarantee Program, which includes a Debt Guarantee Program, under which the FDIC will guarantee the payment of certain newly-issued senior unsecured debt of financial institutions, and the Transaction Account Guarantee Program, under which the FDIC will guarantee certain noninterest-bearing transaction accounts and certain other accounts, in each case for financial institutions that elect to participate.

On February 10, 2009, Treasury announced a Financial Stability Plan to address aspects of the economy s difficulties. The plan intended to revise the form of capital injections into financial institutions, increases the size and scope of a previously announced non-recourse lending facility by the Federal Reserve s non-recourse lending facility, facilitate the creation of a public-private investment fund to purchase troubled assets from financial institutions, and allocate $50 billion for homeowner/foreclosure assistance. The plan would substantially increase the amount of funds injected into the nation s financial system.

On February 17, 2009, President Obama signed into law the American Recovery and Reinvestment Act of 2009 (ARRA). ARRA provides similar and additional limitations and requirements with respect to executive compensation and also amends Section 111 of EESA, which was the source of many of the executive compensation restrictions referenced above. The actual effect of the combination of the limitations in EESA, certain guidance issued by Treasury on February 4, 2009, and ARRA is not yet certain.

Competition

In the past, the Bank s principal competitors for deposits and loans have been other banks (particularly 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, and it is anticipated that this trend will continue.

The enactment of the Interstate Banking and Branching Act in 1994 and the California Interstate Banking and Branching Act of 1995 have increased competition within California. Regulatory reform, as well as other changes in federal and California law, will also affect competition. While the future impact of these changes, and of other proposed changes, cannot be predicted with certainty, it is clear that the business of banking will remain highly competitive.

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. As an active participant in the financial markets, the Company believes that it continually adapts to these changing competitive conditions.

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 and Liability Management and - Liquidity 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. They fluctuate in response to general economic conditions and the policies of various governmental and regulatory agencies, in particular, the Federal Open Market Committee of the FRB. 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, perceived counter-party risk, the supply of and demand for financial instruments, the financial strength of market participants, and other factors, have materially deteriorated in the past 12 months. This deterioration could negatively impact the value of financial instruments. 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.
Dramatic declines in the housing market during the prior year, with falling home prices and increasing 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, initially of mortgage-backed securities but spreading to credit default swaps and other derivative securities, have caused many financial institutions to seek additional capital, to merge with larger and stronger institutions and, in some cases, to fail. Many lenders and institutional investors, concerned about the stability of the financial markets generally and the strength of counterparties, have reduced or ceased to provide funding to borrowers, including other financial institutions. The resulting lack of available credit, lack of confidence in the financial sector, increased 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 soundness 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.
Current levels of market volatility are unprecedented.
The capital and credit markets have been experiencing volatility and disruption for more than 12 months. Recently, the volatility and disruption has reached unprecedented levels. In some cases, the markets have produced downward pressure on stock prices and credit availability for certain issuers without regard to those issuers underlying financial strength. If current levels of market disruption and volatility continue or worsen, there can be no assurance that the Company will not experience an adverse effect, which may be material, on the Company s ability to access capital and on the Company s business, financial condition and results of operations.
There can be no assurance that the recently enacted legislation will help stabilize the U.S. financial system.
On October 3, 2008, President Bush signed into law the Emergency Economic Stabilization Act of 2008 (the EESA), which evolved from the Treasury s initial proposal in response to the financial crises affecting the banking system and financial markets and going concern threats to investment banks and other financial institutions. On February 17, 2009, President Obama signed the American Recovery and Reinvestment Act of 2009 (the ARRA) into law. The Treasury and banking regulators are implementing a number of programs under this legislation to address capital and liquidity issues in the banking system. There can be no assurance, however, as to the actual impact that the EESA or ARRA will have on the financial markets, including the extreme levels of volatility and limited credit availability currently being experienced. The failure of the EESA OR ARRA to help stabilize the financial markets and a continuation or worsening of current financial market conditions could materially and adversely affect the Company s business, financial condition, results of operations, access to credit or the trading price of the Company s common stock.

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.

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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, 2008, real estate served as the principal source of collateral with respect to approximately 54% of the Company s loan portfolio. The Company s financial condition and operating results will be subject to changes in economic conditions in California. In the early to mid-1990s, California experienced a significant and prolonged downturn in its economy, which adversely affected financial institutions. The California economy is currently in a recession which may last for a prolonged period of time. 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. Many of the Company s loans are secured by collateral that includes real estate located in California. In 2007 and throughout 2008, much of the California and national real estate market experienced a decline in values of varying degrees. This decline is having an adverse impact on the businesses of some of the Company s borrowers and on the value of the collateral for many of the Company s loans.

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 a state which is prone to earthquakes, brush fires, flooding 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, 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.

As a financial services company, 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 commitments;

- 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.

- an increase in the number of delinquencies, bankruptcies or defaults could result in a higher level of nonperforming assets, net charge-offs, provision for loan losses, and valuation adjustments on loans held for sale.

The Company s Business May Be Adversely Affected by Conditions in the Financial Markets and Economic Conditions Generally

Since December 2007, the United States has been in a recession. Business activity across a wide range of industries and regions is greatly reduced and local governments and many businesses are in serious difficulty due to the lack of consumer spending and the lack of liquidity in the credit markets. Unemployment has increased significantly.

Since mid-2007, and particularly during the second half of 2008, the financial services industry and the securities markets generally were materially and adversely affected by significant declines in the values of nearly all asset classes and by a serious lack of liquidity. This was initially triggered by declines in home prices and the values of subprime mortgages, but spread to all mortgage and real estate asset classes, to leveraged bank loans and to nearly all asset classes, including equities. The global markets have been characterized by substantially increased volatility and short-selling and an overall loss of investor confidence, initially in financial institutions, but more recently in companies in a number of other industries and in the broader markets.

Market conditions have also led to the failure or merger of a number of prominent financial institutions. Financial institution failures or near-failures have resulted in further losses as a consequence of defaults on securities issued by them and defaults under contracts entered into with such entities as counterparties. Furthermore, declining asset values, defaults on mortgages and consumer loans, and the lack of market and investor confidence, as well as other factors, have all combined to increase credit default swap spreads, to cause rating agencies to lower credit ratings, and to otherwise increase the cost and decrease the availability of liquidity, despite very significant declines in Federal Reserve borrowing rates and other government actions. Some banks and other lenders have suffered significant losses and have become reluctant to lend, even on a secured basis, due to the increased risk of default and the impact of declining asset values on the value of collateral. The foregoing has significantly weakened the strength and liquidity of some financial institutions worldwide. In 2008, the U.S. government, the Federal Reserve and other regulators have taken numerous steps to increase liquidity and to restore investor confidence, including investing approximately $200 billion in the equity of other banking organizations, but asset values have continued to decline and access to liquidity continues to be very limited.

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, 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, business activity or investor or business confidence; limitations on the availability 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.

Overall, during 2008, the business environment has been adverse for many households and businesses in the United States and worldwide. It is expected that the business environment in the State of California, the United States and worldwide will continue to deteriorate for the foreseeable future. There can be no assurance that these conditions will improve in the near term. Such conditions could adversely affect the credit quality of the Company s loans, results of operations and financial condition.

The Value of Securities in the Company s Investment Securities Portfolio May be Negatively Affected by Continued Disruptions In Securities Markets

The market for some of the investment securities held in the Company s portfolio has become extremely volatile over the past twelve months. 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 associated with these disruptions 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. 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. This trend is likely to continue in the future. 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

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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, and (c) 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.

Federal and state governments could pass legislation responsive to current credit conditions.

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 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. Current economic conditions have increased expectations for bank failures, in which case the FDIC would take control of failed banks and ensure 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.

The Federal Reserve Bank has been providing vast amounts of liquidity into the banking system to compensate for weaknesses in short-term borrowing markets and other capital markets. A reduction in the Federal Reserve s activities or capacity could reduce liquidity in the markets, thereby increasing funding costs to the Bank or reducing the availability of funds to the Bank to finance its existing operations.

As discussed in Item 1. Business, on February 13, 2009, the Company utilized the CPP of the EESA issuing Treasury Preferred Stock and a TARP Warrant. The term of the CPP could reduce investment returns to participating banks shareholders by restricting dividends to common shareholders, diluting existing shareholders interest, and restricting capital management practices.

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 customer relationship management and systems. 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. 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.

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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. 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 difficulty integrating the branches and operations of the former County Bank.

On February 6, 2009, the Bank acquired approximately $1.6 billion in assets, including loans, and $1.2 billion in deposits of the former County Bank, of Merced, California, from the FDIC as its receiver. County Bank s loan portfolio had suffered substantial deterioration over the previous year, and the Company can provide no assurance that it will not continue to deteriorate now that it is part of the Bank s portfolio. If Management s estimates of the losses are too low, the recorded fair values for the loans may need to be reduced with a corresponding charge to earnings. In addition, integrating County Bank s 39 branches, employees and customers will require substantial expense and management efforts. If the Company consolidates branches, the Company risks attrition in deposits and customers.

Shares of Company common stock eligible for future sale 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 28.9 million were outstanding at December 31, 2008. Pursuant to its stock option plans, at December 31, 2008, the Company had exercisable options outstanding of 2.1 million. As of December 31, 2008, 3.1 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 repurchases and retires its common stock in accordance with Board of Directors approved share repurchase programs. At December 31, 2008, approximately 2.0 million shares remained available to repurchase under such plans.

The Agreement between the Company and the United States Treasury limits the Company s ability to pay dividends on and repurchase the Company s common stock.

The Securities Purchase Agreement between the Company and the Treasury pursuant to which the Company sold $83.7 million of the Company s Series A Preferred Stock (the Treasury Preferred Stock) and issued a warrant to purchase up to 246,640 shares of the Company s common stock (the TARP Warrant) provides that prior to the earlier of (i) February 13, 2012 and (ii) the date on which all of the shares of the Treasury Preferred Stock have been redeemed by the Company or transferred by the Treasury to third parties, the Company may not, without the consent of the Treasury, (a) increase the cash dividend on the Company s common stock above $0.35 per share, the amount of the last quarterly cash dividend per share declared prior to October 14, 2008 or (b) subject to limited exceptions, redeem, repurchase or otherwise acquire shares of the Company s common stock or preferred stock other than the Treasury Preferred Stock. In addition, the Company is unable to pay any dividends on the Company s common stock unless the Company is current in the Company s dividend payments on the Treasury Preferred Stock. These restrictions, together with the potentially dilutive impact of the TARP Warrant described in the next risk factor, could have a negative effect on the value of the Company s common stock. Moreover, 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 Treasury Preferred Stock impacts net income available to the Company s common stockholders and earnings per common share, and the TARP Warrant may be dilutive to holders of the Company s common stock.

The dividends declared and the accretion of the discount on the Treasury Preferred Stock will reduce the net income available to common stockholders and the Company s earnings per common share. The Treasury Preferred Stock will also receive preferential treatment in the event of liquidation, dissolution or winding up of the Company. Additionally, the ownership interest of the existing holders of the Company s common stock will be diluted to the extent the TARP Warrant is exercised. The shares of common stock underlying the TARP Warrant represent approximately 0.85% of the shares of the Company s common stock outstanding as of February 13, 2009 (including the shares issuable upon exercise of the TARP Warrant in total shares outstanding). Although the Treasury has agreed not to vote any of the shares of common stock it receives upon exercise of the TARP Warrant, a transferee of any portion of the TARP Warrant or of any shares of common stock acquired upon exercise of the TARP Warrant is not bound by this restriction.

Because of the Company s participation in the Troubled Asset Relief Program, the Company is subject to several restrictions including restrictions on compensation paid to the Company s executives.

Pursuant to the terms of the Securities Purchase Agreement, the Company adopted certain standards for executive compensation and corporate governance for the period during which the Initial Selling Shareholder holds the equity issued pursuant to the Securities Purchase Agreement, including the common stock which may be issued pursuant to the TARP Warrant. These standards generally apply to the Company s Chief Executive Officer, Chief Financial Officer and the three next most highly compensated senior executive officers. The standards include (1) ensuring that incentive compensation for senior executives does not encourage unnecessary and excessive risks that threaten the value of the financial institution; (2) required clawback of any bonus or incentive compensation paid to a senior executive based on statements of earnings, gains or other criteria that are later proven to be materially inaccurate; (3) prohibition on making golden parachute payments to senior executives; and (4) agreement not to deduct for tax purposes executive compensation in excess of $500,000 for each senior executive. In particular, the change to the deductibility limit on executive compensation will likely increase the overall cost of the Company s compensation programs in future periods. Since the TARP Warrant has a ten year term, the Company could potentially be subject to the executive compensation and corporate governance restrictions for a ten year time period. Pursuant to the American Recovery and Reinvestment Act of 2009, further compensation restrictions, including significant limitations on incentive compensation and golden parachute payments, have been imposed on the Company s most highly compensated employees, which may make it more difficult for the Company to retain and recruit qualified personnel.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None

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ITEM 2. PROPERTIES

Branch Offices and Facilities

WAB is engaged in the banking business through 86 offices in 21 counties in Northern and Central California including 13 offices in Fresno County, 11 each in Marin and Sonoma Counties, seven in Napa County, five each in Stanislaus, Lake, Contra Costa and Solano Counties, four in Kern, County, three each in Alameda and Sacramento Counties, two each in Mendocino, Nevada, Placer and Tulare Counties, and one each in Merced, San Francisco, Tuolumne, Kings, Madera, and Yolo Counties. WAB believes all of its offices are constructed and equipped to meet prescribed security requirements.

The Company owns 26 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, property taxes and maintenance.

On February 6, 2009, in connection with the acquisition of assets and deposits of County Bank, the Company acquired a short-term option to acquire its branch premises located in Merced and throughout the Central Valley. The Company has not yet determined the extent to which the Company will exercise this option.

ITEM 3. LEGAL PROCEEDINGS

During 2007, Visa announced that it completed restructuring transactions in preparation for an initial public offering planned for early 2008, and, as part of those transactions, the Bank s membership interest in Visa was exchanged for an equity interest in Visa Inc. In accordance with Visa s by-laws, the Bank and other Visa U.S.A. member banks are obligated to share in Visa s litigation obligations which existed at the time of the restructuring transactions. On November 7, 2007, Visa announced that it had reached a settlement with American Express related to an antitrust lawsuit. Visa has disclosed other antitrust lawsuits which existed at the time of the restructuring transactions. In consideration of the American Express settlement and other antitrust lawsuits filed against Visa, the Company recorded in the fourth quarter of 2007 a liability and corresponding expense of $2,338 thousand. In the first quarter 2008, Visa funded a litigation settlement escrow using proceeds from its initial public offering. Upon the escrow funding, the Company relieved its liability with a corresponding expense reversal in the amount of $2,338 thousand. On October 27, 2008, Visa announced that it had reached a settlement with Discover Financial Services related to an antitrust lawsuit that existed at the time of Visa s restructuring requiring the payment of the settlement to be funded from the litigation settlement escrow. On December 22, 2008, Visa announced that it had funded its litigation settlement escrow in an amount sufficient to meet such litigation obligation pursuant to Visa s amended and restated Certificate of Incorporation approved by Visa s shareholders on December 16, 2008. As such, the Company has not recorded a liability for this settlement.

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, 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. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

There were no matters submitted to a vote of the shareholders during the fourth quarter of 2008.

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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
2008:		
First quarter	$56.49	$39.00
Second quarter	61.49	50.55
Third quarter	69.00	35.50
Fourth quarter	60.00	41.17
2007:		
First quarter	$51.47	$46.43
Second quarter	48.61	44.23
Third quarter	50.49	39.77
Fourth quarter	53.29	42.11

As of February 2, 2009, there were approximately 8,000 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, 2008, $54 million was allowable 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.

As discussed in Note 8 to the consolidated financial statements, in December 1986, the Company declared a dividend distribution of one common share purchase right (the Right) for each outstanding share of common stock. The terms of the Rights were most recently amended and restated in 2004. The amended plan is very similar in purpose and effect to the plan as it existed prior to this amendment, aimed at helping the Board of Directors to maximize shareholder value in the event of a change of control of the Company and otherwise resist actions that the Board considers likely to injure the Company or its shareholders.

The Company also issued to Treasury a warrant to purchase 246,640 shares of its common stock at an exercise price of $50.92 per share.

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Stock performance

The following chart compares the cumulative return on the Company s stock during the ten years ended December 31, 2008 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, 1998 and reinvestment of all dividends.

	Period ending					
	1998	1999	2000	2001	2002	2003
Westamerica Bancorporation (WABC)	$100.00	$ 77.50	$122.67	$115.38	$119.73	$151.71
S&P 500 (SPX)	100.00	121.04	109.99	96.99	75.55	97.22
NASDAQ Bank Index (CBNK)	100.00	94.17	110.92	124.76	133.43	177.52

	Period ending				
	2004	2005	2006	2007	2008
Westamerica Bancorporation (WABC)	$181.40	$168.89	$165.34	$150.89	$177.66
S&P 500 (SPX)	107.77	113.08	130.99	138.18	87.17
NASDAQ Bank Index (CBNK)	201.71	197.80	225.21	180.38	141.61

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The following chart compares the cumulative return on the Company s stock during the five years ended December 31, 2008 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, 2003 and reinvestment of all dividends.

	Period ending					
	2003	2004	2005	2006	2007	2008
Westamerica Bancorporation (WABC)	$100.00	$119.57	$111.33	$108.98	$ 99.46	$117.11
S&P 500 (SPX)	100.00	110.85	116.30	134.73	142.13	89.66
NASDAQ Bank Index (CBNK)	100.00	113.63	111.43	126.87	101.61	79.78

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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, 2008 (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	12	$50.41	12	1,981
November 1 through November 30	1	51.77	1	1,980
December 1 through December 31	3	51.99	3	1,977
Total	16	$50.74	16	1,977

* Includes 12 thousand, 1 thousand and 3 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 2008 pursuant to a program approved by the Board of Directors on August 28, 2008 authorizing the purchase of up to 2 million shares of the Company s common stock from time to time prior to September 1, 2009.

On February 13, 2009, the Company utilized the Troubled Asset Relief Program and issued 83,726 preferred shares to the United States Treasury at $1,000 per share (Treasury Preferred Stock). Under the terms of the Treasury Preferred Stock, share repurchases are limited to repurchase related to employee benefit programs.

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ITEM 6. SELECTED FINANCIAL DATA

The following financial information for the five years ended December 31, 2008 has been derived from the Company s Consolidated Financial Statements. This information should be read in conjunction with the Consolidated Financial Statements and related notes thereto included elsewhere herein.

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

Year ended December 31:	*2008*	*2007*	*2006*	*2005**	*2004**
Interest income	$ 208,469	$ 235,872	$ 246,515	$ 242,797	$ 216,337
Interest expense	33,243	72,555	65,268	43,649	21,106
Net interest income	175,226	163,317	181,247	199,148	195,231
Provision for credit losses	2,700	700	445	900	2,700
Noninterest income:					
Net losses from securities	(56,955)			(4,903)	(5,011)
Loss on extinguishment of debt					(2,204)
Deposit service charges and other	54,899	59,278	55,347	59,443	45,798
Total noninterest income	(2,056)	59,278	55,347	54,540	38,583
Noninterest expense					
Visa Litigation	(2,338)	2,338			
Other noninterest expense	103,099	99,090	101,724	107,250	102,099
Total noninterest expense	100,761	101,428	101,724	107,250	102,099
Income before income taxes	69,709	120,467	134,425	145,538	129,015
Provision for income taxes	9,874	30,691	35,619	39,497	35,756
Net income	$ 59,835	$ 89,776	$ 98,806	$ 106,041	$ 93,259
Earnings per share:					
Basic	$ 2.07	$ 3.02	$ 3.17	$ 3.28	$ 2.93
Diluted	2.04	2.98	3.11	3.22	2.87
Per share:					
Dividends paid	$ 1.39	$ 1.36	$ 1.30	$ 1.22	$ 1.10
Book value at December 31	14.19	13.60	13.89	13.65	11.59
Average common shares outstanding	28,892	29,753	31,202	32,291	31,821
Average diluted common shares outstanding	29,273	30,165	31,739	32,897	32,461
Shares outstanding at December 31	28,880	29,018	30,547	31,882	31,640
At December 31:					
Loans, net	$2,337,956	$2,450,470	$2,476,404	$2,616,372	$2,246,078
Investments	1,237,779	1,578,109	1,780,617	1,999,604	2,192,542
Intangible assets and goodwill	136,907	140,148	143,801	148,077	21,890

Total assets	4,032,934	4,558,959	4,769,335	5,157,559	4,745,318
Total deposits	3,095,054	3,264,790	3,516,734	3,846,101	3,583,619
Short-term borrowed funds	457,275	798,599	731,977	775,173	735,423
Debt financing and notes payable	26,631	36,773	36,920	40,281	21,429
Shareholders equity	409,852	394,603	424,235	435,064	366,659
Financial Ratios:					
For the year:					
Return on assets	1.42%	1.93%	2.01%	2.09%	2.06%
Return on equity	14.77%	22.11%	23.38%	25.70%	28.23%
Net interest margin **	5.13%	4.40%	4.57%	4.82%	5.14%
Net loan losses to average loans	0.44%	0.14%	0.04%	0.03%	0.11%
Efficiency ratio ***	51.88%	41.46%	39.12%	38.52%	39.79%
At December 31:					
Equity to assets	10.16%	8.66%	8.90%	8.44%	7.73%
Total capital to risk-adjusted assets	11.76%	10.64%	11.09%	10.40%	12.46%
Allowance for loan losses to loans	1.87%	2.10%	2.19%	2.09%	2.35%

The above financial summary has been derived from the Company s audited consolidated financial statements. This information should be read in conjunction with those statements, notes and the other information included elsewhere herein.

* Adjusted to adopt Financial Accounting Standard 123 (revised 2004), Share-Based Payment. See Note 8.

** Yields on securities and certain loans have been adjusted upward to a fully taxable equivalent (FTE) basis 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 a tax-equivalent basis and noninterest income).

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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 51 through 83, 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 management 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. 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 to be the accounting areas that require the most subjective or complex judgments, and as such could be most subject to revision as new information becomes available.

The Allowance for Loan Losses represents management s estimate of the amount of loss in the loan portfolio that can be reasonably estimated as of the balance sheet date. Determining the amount of the Allowance for Loan Losses is considered a critical accounting estimate because it requires significant judgment and the use of estimates related to the amount and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, and interpretation of current economic trends, uncertainties and conditions, all of which may be susceptible to significant change. A discussion of the factors driving changes in the amount of the Allowance for Loan losses is included in the Credit Quality discussion below.

Acquisition

On February 6, 2009, the Bank entered a Purchase and Assumption Agreement (the Agreement) with the Federal Deposit Insurance Corporation) as Receiver (Receiver) of County Bank (County). At February 6, 2009, County s accounting records reflected total assets to be purchased by the Bank of approximately $1.6 billion, total loans to be purchased by the Bank of approximately $1.3 billion, and total deposits to be assumed by the Bank of approximately $1.2 billion. Under the terms of the Agreement, the Bank purchased substantially all assets of County, including loans, investment securities and other assets, excluding premises, equipment and company owned life insurance. The Bank has a short-term option to purchase certain premises and equipment from the Receiver. Under the terms of the Agreement, the Bank also assumed all the deposits, secured liabilities, and certain other liabilities of County. The Agreement also provided a loss sharing arrangement over certain assets, primarily loans and loan collateral received in satisfaction of loans receivable. Losses on covered assets up to $269 million are shared 80% by the Receiver and 20% by the Bank. Losses on covered assets exceeding $269 million are shared 95% by the Receiver and 5% by the Bank. The loss sharing agreement has a term of three years for all loans other than residential loans which have a term of ten years. The agreement covers only the assets and liabilities of County Bank. Assets, liabilities and trust preferred debt of County Bank s former parent company Capital Corp of the West have not been purchased or assumed by Westamerica Bank or the Company.

The Company will apply the mark-to-market provisions of FAS 141R to account for the purchase of assets and assumption of liabilities, including recognition of a core deposit intangible asset. Accounting rules also require recognition of the FDIC s estimated loss assistance with respect to the loans and other real estate owned.

Net Income

The Company reported net income for 2008 of $59.8 million or $2.04 diluted earnings per share, compared with $89.8 million or $2.98 diluted earnings per share for 2007. The 2008 results included a $62.7 million charge for securities losses and other than temporary impairment securities losses in the value of FHLMC and FNMA preferred stock and other common stock. At December 31, 2008, the recorded value of FHLMC and FNMA stock was $822 thousand. Additionally, results for 2008 included a $5.7 million gain on the sale of VISA common stock from Visa s initial public offering (IPO), $2.3 million in reduced expenses as known litigation contingencies were satisfied as a part of the VISA IPO, and approximately $1.0 million reduction in the tax provision primarily due to adjusting the estimated tax provision to actual amounts on the filed 2007 federal tax return. The securities gains and losses, satisfaction of litigation contingencies, and tax provision adjustment combined to reduce 2008 net income by $30.7 million or diluted earnings per share by $1.05. The 2007 results included a $2.3 million litigation expense for the Bank s proportionate share of Visa s litigation exposure for which Visa s members are responsible. The 2007 period also included $822 thousand in company-owned life insurance proceeds and a $700 thousand income tax refund, derived from an amended 2003 tax return, which reduced income tax expense. The expense for Visa litigation, insurance proceeds and the income tax refund combined to increase 2007 net income by $232 thousand.

Components of Net Income

Year ended December 31, ($ in thousands except per share amounts)	2008	2007	2006
Net interest and fee income *	$ 196,257	$ 185,348	$ 204,703
Provision for loan losses	(2,700)	(700)	(445)
Noninterest income	(2,056)	59,278	55,347
Noninterest expense	(100,761)	(101,428)	(101,724)
Income before income taxes *	90,740	142,498	157,881
Taxes *	(30,905)	(52,722)	(59,075)
Net income	$ 59,835	$ 89,776	$ 98,806
Net income per average fully-diluted share	$ 2.04	$ 2.98	$ 3.11
Net income as a percentage of average shareholders equity	14.77%	22.11%	23.38%
Net income as a percentage of average total assets	1.42%	1.93%	2.01%

* Fully taxable equivalent (FTE)

Comparing 2008 to the prior year, net income decreased $29.9 million, due to securities losses and other than temporary impairment charges on FHLMC and FNMA preferred stock and other common stock and a higher loan loss provision, partially offset by higher net interest income (FTE), a gain on sale of VISA common stock and lower tax provision (FTE). The higher net interest income (FTE) was mainly caused by lower funding costs, partially offset by a lower volume of average interest-earning assets and lower yields on loans. The provision for loan losses increased $2.0 million to reflect Management s assessment of increased credit risk and the appropriate level of the allowance for loan losses. Noninterest income in 2008 was a loss of $2.1 million compared with $59.3 million in 2007 mainly due to the losses and impairment charges on FHLMC and FNMA preferred stock and other common stock, $822 thousand gain from life insurance proceeds in 2007 and a $950 thousand decrease in fees on the issuance of official checks, partially offset by the $5.7 million gain on sale of VISA common stock. Noninterest expense decreased $667 thousand or 0.7%, primarily the net result of the reversal of a $2.3 million accrual for known Visa related litigation and lower amortization of identifiable intangible assets, partially offset by higher data processing and personnel costs and legal fees. The income tax provision (FTE) decreased $21.8 million largely due to lower pretax income and the $1 million tax adjustment for the filed 2007 federal income tax return.

Net income for 2007 decreased $9.0 million, or 9.1%, compared to net income for 2006 primarily due to lower net interest income (FTE) and an increased provision for credit losses, partially offset by higher noninterest income, lower noninterest expense and a lower tax provision. The lower net interest income (FTE) was mainly caused by a lower volume of average interest-earning assets and higher funding costs, partially offset by higher yields on earning assets. The provision for loan losses increased $255 thousand to reflect Management s assessment of credit risk for the loan portfolio. Noninterest income increased $3.9 million or 7.1% largely due to higher service charges on deposits, merchant credit card processing fees, debit card income and company-owned life insurance proceeds. Noninterest expense declined $296 thousand or 0.3% primarily due to lower personnel costs and intangible asset amortization, decreases in equipment costs, professional fees, a reduction in the reserve for unfunded commitments, partially offset by the $2.3 million Visa litigation charge and an increase in data processing costs. The tax provision (FTE) decreased $6.4 million primarily due to lower pretax income and a $700 thousand refund from an amended tax return.

The Company s return on average total assets was 1.42% in 2008, compared to 1.93% and 2.01% in 2007 and 2006, respectively. Return on average equity in 2008 was 14.77%, compared to 22.11% and 23.38% in 2007 and 2006, respectively.

Net Interest 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 on interest-bearing deposits and other borrowings. Net interest income (FTE) in 2008 increased $10.9 million or 5.9% from 2007, to $196.3 million. Comparing 2007 to 2006, net interest income (FTE) declined $19.4 million or 9.5%.

Components of Net Interest Income

Year ended December 31, (in thousands)	2008	2007	2006
Interest and fee income	$208,469	$235,872	$246,515
Interest expense	(33,243)	(72,555)	(65,268)
FTE adjustment	21,031	22,031	23,456
Net interest income (FTE)	$196,257	$185,348	$204,703
Net interest margin (FTE)	5.13%	4.40%	4.57%

The Company s net interest margin expanded in 2008 compared with 2007. The Federal Reserve s Open Market Committee (FOMC) reduced the target federal funds rate from 5.25% in August 2007 to between zero and 0.25% in December 2008 in ten increments. As a result, short-term interest rates declined and the Company managed to reduce the interest rates paid on deposits and other interest-bearing liabilities during 2008 compared with 2007. In 2008, the Company s loan and investment yields were less sensitive to changes in interest rates resulting in a lesser reduction in such yields compared with the rates paid on deposits and other funding sources. Offsetting some of the benefit of the expanding margin was the reduction in the level of average interest-earning assets and lower yields on loans resulting in a reduction of interest and fee income (FTE) of $28.4 million or 11.0% in 2008 relative to 2007.

Comparing 2008 with 2007, average earning assets decreased $390.8 million or 9.3% in 2008 compared with 2007, due to a $311.6 million decline in the investment portfolio and a $79.2 million decrease in the loan portfolio. Lower average investment balances were largely attributable to U.S. government sponsored entity obligations (down $138 million), mortgage backed securities and collateralized mortgage obligations (down $105 million), municipal securities (down $41 million) and corporate and other securities (down $30 million). The average balance of corporate and other securities declined largely due to sales and impairment of FHLMC and FNMA preferred stock. The loan portfolio decline was primarily due to decreases in the average balances of commercial real estate loans (down $44 million), residential real estate loans (down $25 million), tax-exempt commercial loans (down $17 million), partly offset by an $8 million increase in the average balance of consumer loans, primarily automobile loans.

The average yield on the Company s earning assets decreased from 6.12% in 2007 to 6.00% in 2008. The composite yield on loans fell 35 basis points (bp) to 6.30% due to decreases in yields on taxable commercial loans (down 155 bp), real estate construction loans (down 332 bp), consumer loans (down 21 bp) and commercial real estate loans (down 9 bp), partially offset by higher yields on tax-exempt commercial loans (up 10 bp) and residential real estate loans (up 10 bp). Real estate construction loans and commercial lines of credit have variable interest rates based on the prime lending rate. The prime lending rate averaged 8.11% in 2007 compared to 5.70% in 2008, reducing the yields earned on real estate construction loans and commercial lines of credit. The investment portfolio yield increased

14 bp to 5.48%, mainly due to higher yields on U.S. Government sponsored entity obligations (up 9 bp), mortgage backed securities and collateralized mortgage obligations (up 6 bp) and municipal securities (up 5 bp), partially offset by corporate and other securities (down 105 bp). Other securities yields declined mostly due to reduced dividends on FHLMC preferred stock. As investment portfolio balances have declined over the past year, municipal security balances have declined at a slower rate than the remainder of the investment portfolio. As a result, average municipal securities represented 52% of total average investment security balances during 2008, compared with 45% during 2007. This migration in the composition of the investment portfolio has improved the overall yield of the investment portfolio since municipal security yields exceed the yield of the overall investment portfolio.

In Management s opinion, current economic conditions are not conducive for generating profitable loan growth. Recent downward pressure on real estate values create a cautious view toward real estate lending, and economic pressure on consumers has reduced demand for automobile and other consumer loans. Additionally, yields available on the highest quality investment securities do not offer an adequate profit margin over the cost of funding. As a result, the Company has not taken an aggressive posture relative to current loan and investment portfolio growth.
Net interest income in 2008 included $2.1 million in dividends on FNMA and FHLMC preferred stock, however, there will be no dividend income from such preferred stock in 2009. Seventy percent of such dividends are excludable from taxable income for federal income tax purposes.
Interest expense in 2008 decreased $39.3 million or 54.2% compared with 2007. The decrease was attributable to lower rates paid on the interest-bearing liabilities and lower average balances of those liabilities. The average rate paid on interest-bearing liabilities decreased from 2.50% in 2007 to 1.29% in 2008. Rates paid on most interest-bearing liabilities moved with general market conditions. Rates on deposits decreased 72 bp to 1.07% primarily due to decreases in rates paid on CDs over $100 thousand (down 239 bp), preferred money market savings (down 121 bp) and retail CDs (down 62 bp). Rates on short-term borrowings also decreased 246 bp mostly due to lower rates on federal funds purchased (down 296 bp) and line of credit and repurchase facilities (down 189 bp). Interest-bearing liabilities declined $337.4 million or 11.6% in 2008 over 2007. Short-term borrowings declined $210 million primarily due to a $185 million decrease in federal funds purchased. Most categories of deposits declined including money market savings (down $68 million), money market checking accounts (down $28 million), regular savings (down $18 million), Retail CDs (down $16 million) and CDs over $100 thousand (down $14 million). The decline was partially offset by a $20 million increase in preferred money market savings.
Interest and fee income (FTE) decreased in 2007 by $12.1 million or 4.5% from 2006, the net result of a lower volume of average earning assets, partially mitigated by higher yields on earning assets. Average earning assets declined by $264 million. Management allowed the investment portfolio to liquidate in 2007 as, in Management s opinion, rates available on high quality securities did not provide yields adequate to support long-term profitability. Average investment security balances decreased $198 million due to declines in the average balances of mortgage backed securities and collateralized mortgage obligations (down $125 million), municipal securities (down $34 million), U.S. government sponsored entity obligations (down $22 million) and other securities (down $17 million). The decline in loans is due to heightened competition with reduced yields and liberalized underwriting standards. Management maintained more conservative underwriting standards and higher pricing relative to competitors, which limited loan origination volumes. The loan portfolio declined $65 million mainly due to decreases in the average volumes of commercial loans (down $51 million), commercial real estate loans (down $37 million), residential real estate loans (down $17 million) and consumer credit lines (down $10 million), offset in part by a $45 million increase in indirect automobile loans. Management grew indirect automobile loan volumes as rates on loan originations exceeded the average existing portfolio rates, causing the yield to increase on such loans.
The average yield on the Company s earning assets increased from 6.03% in 2006 to 6.12% in 2007. The composite yield on loans rose 5 bp to 6.65% due to increases in rates earned on indirect auto and other consumer loans (up 30 bp), residential real estate loans (up 11 bp) and construction loans (up 36 bp), partially offset by decreases in yields on taxable commercial loans (down 4 bp) and tax-exempt commercial loans (down 5 bp). The investment portfolio yield increased 8 bp to 5.34%, mainly caused by increases in the yield on US. Government sponsored entity obligations (up 16 bp) and mortgage backed securities and collateralized mortgage obligations (up 4 bp) and corporate and other securities (up 33 bp), partially offset by a 5 bp decline in municipal securities. The decline in the yield on municipal securities was attributable to yields on maturities, calls and serial payments exceeding yields on securities remaining in the portfolio.
Interest expense in 2007 increased $7.3 million or 11.2% compared 2006. The increase was attributable to higher rates paid on the interest- bearing liabilities, partially offset by lower average balances of interest-bearing deposits. Competition for deposits was heightened in 2007 due to loan growth exceeding deposit growth in the banking industry. The level of short-term interest rates also supported consumer demand for interest-bearing deposit products. Due to both of these general conditions, interest rates rose on deposits and banks competed fiercely for deposit balances. The average rate paid on interest-bearing liabilities increased from 2.11% in 2006 to 2.50% in 2007. Rates

on deposits increased 34 bp to 1.79% primarily due to increases in rates paid on preferred money market savings (up 169 bp), non-public CDs over $100 thousand (up 67 bp) and CDs less than $100 thousand (up 58 bp). Rates on short-term borrowings also increased 27 bp mostly due to higher rates on federal funds (up 11 bp) and line of credit and repurchase facilities (up 59 bp). Interest-bearing liabilities declined $186 million in 2007 compared with 2006. Interest- bearing deposits decreased $210 million primarily due to decreases in money market savings (down $132 million), regular savings (down $45 million), money market checking accounts (down $49 million), non-public CDs over $100 thousand (down $29 million). The decline was partially offset by increases in preferred money market savings (up $47 million) and public CDs (up $27 million).

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The following tables present information regarding the consolidated average assets, liabilities and shareholders equity, the amounts of interest income earned from average earning assets and the resulting yields, and the amount of interest expense paid on average interest-bearing liabilities and the resulting rates paid. 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. Yields on securities and certain 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, 2008		
(dollars in thousands)	Average Balance	Interest Income/ Expense	Rates Earned/ Paid
Assets			
Money market assets and funds sold	$ 817	$ 3	0.37%
Investment securities:			
Available for sale			
Taxable	205,138	8,854	4.32%
Tax-exempt (1)	196,993	13,795	7.00%
Held to maturity			
Taxable	436,041	19,237	4.41%
Tax-exempt (1)	551,120	34,328	6.23%
Loans:			
Commercial			
Taxable	318,075	22,341	7.02%
Tax-exempt (1)	208,155	13,575	6.52%
Commercial real estate	835,925	58,913	7.05%
Real estate construction	76,086	4,863	6.39%
Real estate residential	468,140	22,683	4.85%
Consumer	526,175	30,908	5.87%
Total Loans (1)	2,432,556	153,283	6.30%
Earning assets (1)	3,822,665	229,500	6.00%
Other assets	397,098		
Total assets	$ 4,219,763		
Liabilities and shareholders equity			
Deposits:			
Noninterest bearing demand	$ 1,181,679		
Savings and interest-bearing transaction	1,301,556	5,642	0.43%
Time less than $100,000	193,889	5,209	2.69%
Time $100,000 or more	489,326	10,331	2.11%
Total interest-bearing deposits	1,984,771	21,182	1.07%
Short-term borrowed funds	549,438	9,958	1.81%
Debt financing and notes payable	33,807	2,103	6.22%

Total interest-bearing liabilities	2,568,016	33,243	1.29%
Other liabilities	64,992		
Shareholders equity	405,076		
Total liabilities and shareholders equity	$ 4,219,763		
Net interest spread (2)			4.71%
Net interest income and interest margin (1)(3)		$ 196,257	5.13%

(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 paid on interest-bearing liabilities.

(3) Net interest margin is computed by dividing net interest income by total average earning assets.

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

	Year Ended December 31, 2007		
(dollars in thousands)	Average Balance	Interest Income/ Expense	Rates Earned/ Paid
Assets			
Money market assets and funds sold	$ 671	$ 7	1.04%
Investment securities:			
Available for sale			
Taxable	361,851	15,639	4.32%
Tax-exempt (1)	232,047	16,888	7.28%
Held to maturity			
Taxable	538,089	23,361	4.34%
Tax-exempt (1)	569,090	34,973	6.15%
Loans:			
Commercial			
Taxable	314,428	26,936	8.57%
Tax-exempt (1)	225,320	14,469	6.42%
Commercial real estate	879,952	62,833	7.14%
Real estate construction	81,093	7,878	9.71%
Real estate residential	493,126	23,422	4.75%
Consumer	517,844	31,497	6.08%
Total Loans (1)	2,511,763	167,035	6.65%
Earning assets (1)	4,213,511	257,903	6.12%
Other assets	427,949		
Total assets	$ 4,641,460		
Liabilities and shareholders equity			
Deposits:			
Noninterest bearing demand	$ 1,262,723		
Savings and interest-bearing transaction	1,395,622	8,237	0.59%
Time less than $100,000	210,039	6,956	3.31%
Time $100,000 or more	503,469	22,656	4.50%
Total interest-bearing deposits	2,109,130	37,849	1.79%
Short-term borrowed funds	759,390	32,393	4.27%
Debt financing and notes payable	36,850	2,313	6.28%
Total interest-bearing liabilities	2,905,370	72,555	2.50%
Other liabilities	67,339		
Shareholders equity	406,028		
Total liabilities and shareholders equity	$ 4,641,460		

Net interest spread (2)		3.62%
Net interest income and interest margin (1)(3)	$ 185,348	4.40%

(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 paid on interest-bearing liabilities.

(3) Net interest margin is computed by dividing net interest income by total average earning assets.

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

	Year Ended December 31, 2006		
(dollars in thousands)	Average Balance	Interest Income/ Expense	Rates Earned/ Paid
Assets			
Money market assets and funds sold	$ 853	$ 5	0.59%
Investment securities:			
Available for sale			
Taxable	394,070	16,844	4.27%
Tax-exempt (1)	251,783	18,312	7.27%
Held to maturity			
Taxable	671,475	28,809	4.29%
Tax-exempt (1)	582,075	35,987	6.18%
Loans:			
Commercial			
Taxable	347,163	29,407	8.47%
Tax-exempt (1)	243,232	15,729	6.47%
Commercial real estate	916,677	66,163	7.22%
Real estate construction	75,019	7,017	9.35%
Real estate residential	510,345	23,690	4.64%
Consumer	484,355	28,008	5.78%
Total Loans (1)	2,576,791	170,014	6.60%
Earning assets (1)	4,477,047	269,971	6.03%
Other assets	433,624		
Total assets	$ 4,910,671		
Liabilities and shareholders equity			
Deposits:			
Noninterest bearing demand	$ 1,329,107		
Savings and interest-bearing transaction	1,574,655	5,969	0.38%
Time less than $100,000	239,361	6,535	2.73%
Time $100,000 or more	504,980	21,043	4.17%
Total interest-bearing deposits	2,318,996	33,547	1.45%
Short-term borrowed funds	734,970	29,389	4.00%
Debt financing and notes payable	37,265	2,332	6.26%
Total interest-bearing liabilities	3,091,231	65,268	2.11%
Other liabilities	67,792		
Shareholders equity	422,541		
Total liabilities and shareholders equity	$ 4,910,671		

Net interest spread (2)		3.92%
Net interest income and interest margin (1)(3)	$ 204,703	4.57%

(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 paid on interest-bearing liabilities.

(3) Net interest margin is computed by dividing net interest income by total average earning assets.

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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 rates for the periods indicated. Changes not solely attributable to volume or rates have been allocated in proportion to the respective volume and rate components.

Summary of Changes in Interest Income and Expense

Years Ended December 31,	2008 Compared with 2007		
(dollars in thousands)	Volume	Rate	Total
Increase (decrease) in interest and fee income:			
Money market assets and funds sold	$ 1	($5)	($4)
Investment securities:			
Available for sale Taxable	(6,764)	(21)	(6,785)
Tax- exempt (1)	(2,466)	(627)	(3,093)
Held to maturity Taxable	(4,492)	368	(4,124)
Tax- exempt (1)	(1,088)	443	(645)
Loans:			
Commercial:			
Taxable	365	(4,960)	(4,595)
Tax- exempt (1)	(1,110)	216	(894)
Commercial real estate	(3,079)	(841)	(3,920)
Real estate construction	(449)	(2,566)	(3,015)
Real estate residential	(1,187)	448	(739)
Consumer	555	(1,144)	(589)
Total loans (1)	(4,905)	(8,847)	(13,752)
Total decrease in interest and fee income (1)	(19,714)	(8,689)	(28,403)
Decrease in interest expense:			
Deposits:			
Savings/ interest-bearing	(512)	(2,083)	(2,595)
Time less than $100,000	(495)	(1,252)	(1,747)
Time $100,000 or more	(592)	(11,733)	(12,325)
Total interest-bearing	(1,599)	(15,068)	(16,667)
Short-term borrowed funds	(7,262)	(15,173)	(22,435)
Notes and mortgages payable	(189)	(21)	(210)
Total decrease in interest expense	(9,050)	(30,262)	(39,312)
(Increase) decrease in net interest income (1)	($10,664)	$ 21,573	$ 10,909

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

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Summary of Changes in Interest Income and Expense

Years Ended December 31, (dollars in thousands)	2007 Compared with 2006 Volume	Rate	Total
Increase (decrease) in interest and fee income:			
Money market assets and funds sold	($1)	$ 3	$ 2
Investment securities:			
Available for sale Taxable	(1,391)	186	(1,205)
Tax- exempt (1)	(1,436)	12	(1,424)
Held to maturity Taxable	(5,787)	339	(5,448)
Tax- exempt (1)	(799)	(215)	(1,014)
Loans:			
Commercial:			
Taxable	(2,801)	330	(2,471)
Tax- exempt (1)	(1,151)	(109)	(1,260)
Commercial real estate	(2,628)	(702)	(3,330)
Real estate construction	583	278	861
Real estate residential	(810)	542	(268)
Consumer	1,994	1,495	3,489
Total loans (1)	(4,813)	1,834	(2,979)
Total (decrease) increase in interest and fee income (1)	(14,227)	2,159	(12,068)
Increase (decrease) in interest expense:			
Deposits:			
Savings/ interest-bearing	(743)	3,011	2,268
Time less than $100,000	(863)	1,284	421
Time $100,000 or more	(63)	1,676	1,613
Total interest-bearing	(1,669)	5,971	4,302
Short-term borrowed funds	998	2,006	3,004
Notes and mortgages payable	(26)	7	(19)
Total (decrease) increase in interest expense	(697)	7,984	7,287
Decrease in net interest income (1)	($13,530)	($5,825)	($19,355)

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

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Provision for Loan Losses

The Company manages credit costs by consistently enforcing conservative underwriting and administration procedures and aggressively pursuing collection efforts with troubled debtors. In 2008, the provision for loan losses was $2.7 million, compared to $700 thousand for 2007, and $445 thousand for 2006. The provision reflects management s assessment of credit risk in the loan portfolio for each of the periods presented. For further information regarding net loan losses and the allowance for credit losses, see the Credit Quality and Allowance for Credit Losses sections of this report.

Investment Portfolio

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

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. The held to maturity investment portfolio had a duration of 3.2 years at December 31, 2008 and, on the same date, those investments included $921.0 million in fixed-rate and $28.3 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.

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 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 recorded as a credit or charge to earnings and the equity adjustment is reversed. At December 31, 2008, the Company held $288.5 million in securities classified as investments available for sale with a duration of 2.3 years. At December 31, 2008, an unrealized gain of $1.4 million, net of taxes of $1 million, related to these securities, was included in shareholders equity.

The Company had no trading securities at December 31, 2008, 2007 and 2006.

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, (dollars in thousands)	2008	2007	2006
U.S. Treasury securities	$ 3,082	$	$
U.S. Government sponsored entities	11,077	123,062	151,147
Mortgage backed securities	41,240	68,393	45,145
States and political subdivisions	161,046	183,307	207,580
Collateralized mortgage obligations	59,851	90,986	127,971
Asset-backed securities	6,447	9,700	10,273
FHLMC and FNMA stock	821	49,671	65,948
Other	4,890	7,702	7,461
Total	$ 288,454	$ 532,821	$ 615,525

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, 2008. Yields on state and political subdivision securities have been calculated on a fully taxable equivalent basis using the current federal statutory rate.

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Available for Sale Maturity Distribution

At December 31, 2008, (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	$ 3,082	$	$	$	$	$	$ 3,082
Interest rate	2.77%	%	%	%	%	%	2.77%
U.S. Government sponsored entities	9,987		1,090				11,077
Interest rate	6.04%		5.59%				6.00%
States and political subdivisions	4,459	71,664	74,341	10,582			161,046
Interest rate (FTE)	7.28%	7.21%	7.16%	5.99%			7.16%
Asset-backed securities				6,447			6,447
Interest rate				2.25%			2.25%
Subtotal	17,528	71,664	75,431	17,029			181,652
Interest rate	5.79%	7.21%	7.14%	4.20%			6.74%
Mortgage backed securities					101,091		101,091
Interest rate					4.29%		4.29%
Other without set maturities						5,711	5,711
Interest rate						4.79%	4.79%
Total	$ 17,528	$ 71,664	$ 75,431	$ 17,029	$ 101,091	$ 5,711	$ 288,454
Interest rate	5.79%	7.21%	7.14%	4.20%	4.29%	4.79%	5.83%

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, (Dollars in thousands)	2008	2007	2006
U.S. Government sponsored entities	$ 110,000	$ 130,000	$ 160,000
Mortgage backed securities	85,676	107,162	131,137
States and political subdivisions	545,237	566,351	579,747
Collateralized mortgage obligations	208,412	241,775	294,208
Total	$ 949,325	$ 1,045,288	$ 1,165,092
Fair value	$ 950,210	$ 1,049,442	$ 1,155,736

The following table sets forth the relative maturities and contractual yields of the Company s held to maturity securities at December 31, 2008. Yields on state and political subdivision securities have been calculated on a fully taxable equivalent basis using the current federal statutory rate.

Held to Maturity Maturity Distribution

At December 31, 2008, (Dollars in thousands)	Within One year	After one but within five years	After five but within ten years	After ten years	Mortgage-backed	Total
U.S. Government sponsored entities	$ 110,000	$	$	$	$	$ 110,000
Interest rate	4.03%	%	%	%	%	4.03%
States and political subdivisions	5,593	39,972	396,275	103,396		545,236
Interest rate (FTE)	6.65%	6.49%	6.09%	6.25%		6.17%
Subtotal	115,593	39,972	396,275	103,396		655,236
Interest rate	4.16%	6.49%	6.09%	6.25%		5.81%
Mortgage backed					294,089	294,089
Interest rate					4.61%	4.61%
Total	$ 115,593	$ 39,972	$ 396,275	$ 103,396	$ 294,089	$ 949,325
Interest rate	4.16%	6.49%	6.09%	6.25%	4.61%	5.44%

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Loan Portfolio

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:

Loan Portfolio Distribution

At December 31, (dollars in thousands)	2008	2007	2006	2005	2004
Commercial and commercial real estate	$1,342,209	$1,389,231	$1,463,823	$1,594,925	$1,388,639
Real estate construction	52,664	97,464	70,650	72,095	29,724
Real estate residential	458,447	484,549	507,553	508,174	375,532
Consumer	529,106	531,732	489,708	497,027	506,335
Total loans	$2,382,426	$2,502,976	$2,531,734	$2,672,221	$2,300,230

The following table shows the maturity distribution and interest rate sensitivity of commercial, commercial real estate, and construction loans at December 31, 2008. Balances exclude residential real estate loans and consumer loans totaling $987.6 million. These types of loans are typically paid in monthly installments over a number of years.

Loan Maturity Distribution

At December 31, 2008 (dollars in thousands)	Within One Year	One to Five Years	After Five Years	Total
Commercial and commercial real estate *	$454,037	$706,033	$182,139	$1,342,209
Real estate construction	52,664	0	0	52,664
Total	$506,701	$706,033	$182,139	$1,394,873
Loans with fixed interest rates	$154,894	$212,329	$173,737	$ 540,960
Loans with floating or adjustable interest rates	351,807	493,704	8,402	853,913
Total	$506,701	$706,033	$182,139	$1,394,873

* Includes demand loans

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 and lines of credit typically mature within one year. For further information, see the notes accompanying the consolidated financial statements.

Credit Quality

The Company closely monitors the markets in which it conducts its lending operations and continues its strategy to control exposure to loans with high credit risk and to maintain broad diversification within the loan portfolio. Loan reviews are performed using grading standards and criteria similar to those employed by bank regulatory agencies. Loans receiving lesser grades fall under the classified category, which includes all nonperforming and potential problem loans, and receive an elevated level of attention to ensure collection. Foreclosed or repossessed loan collateral, other real estate owned (OREO), is adjusted to fair value less costs to sell upon transfer to OREO. Subsequently, OREO is recorded at the lower of cost or appraised value less disposal cost.

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Classified Loans, Loan Commitments and Other Real Estate Owned

The following summarizes the Company s classified loans, loan commitments and OREO for the periods indicated:

Classified Loans, Loan Commitments and OREO

At December 31, (dollars in thousands)	2008	2007
Classified loans and loan commitments	$34,028	$24,419
Other real estate owned	3,505	613
Total classified assets	$37,533	$25,032

Classified loans include loans graded substandard , doubtful and loss using regulatory guidelines. At December 31, 2008, $33.1 million of loans or 97.3% of total classified loans are graded substandard . Such substandard loans accounted for 1.39% of total gross loans at December 31, 2008. Classified assets at December 31, 2008, increased $12.5 million from a year ago. The increase is primarily attributable to two classified construction loan relationships. Portions of the loan collateral for one of the construction loans have been foreclosed and represent $2.2 million of other real estate owned at December 31, 2008. The remaining carrying value of the two construction loans is $5.5 million at December 31, 2008. Management aggressively pursues collection of all classified assets.

Nonperforming Loans and Other Real Estate Owned

Nonperforming loans include nonaccrual loans and loans 90 or more days past due and still accruing. Loans are placed on nonaccrual status upon becoming delinquent 90 days or more, unless the loan is well secured and in the process of collection. Interest previously accrued on loans placed on nonaccrual status is charged against interest income. In addition, some loans secured by real estate with temporarily impaired values and commercial loans to borrowers experiencing financial difficulties are placed on nonaccrual status even though the borrowers continue to repay the loans as scheduled. Such loans are classified by Management as performing nonaccrual and are included in total nonaccrual loans. When the ability to fully collect nonaccrual loan principal is in doubt, payments received are applied against the principal balance of the loans until such time as full collection of the remaining recorded balance is expected. Any additional interest payments received after that time are recorded as interest income on a cash basis. Nonaccrual loans are reinstated to accrual status when improvements in credit quality eliminate the doubt as to the full collectibility of both interest and principal.

The following table summarizes the nonperforming assets of the Company for the periods indicated:

Nonperforming Loans and OREO

At December 31, (dollars in thousands)	2008	2007	2006	2005	2004
Performing nonaccrual loans	$ 1,143	$1,688	$4,404	$4,256	$4,072
Nonperforming nonaccrual loans	8,883	3,164	61	2,068	2,970
Nonaccrual loans	10,026	4,852	4,465	6,324	7,042
Loans 90 or more days past due and still accruing	755	297	65	162	10
Other real estate owned	3,505	613	647	0	0
Total nonperforming loans and OREO	$14,286	$5,762	$5,177	$6,486	$7,052

As a percentage of total loans	0.60%	0.23%	0.20%	0.24%	0.31%

Nonaccrual loans increased $5.2 million during the twelve months ended December 31, 2008. Seventeen loans comprised the $10.0 million nonaccrual loans as of December 31, 2008. One of those loans was on nonaccrual status throughout 2008, while the remaining 16 loans were placed on nonaccrual status during the twelve months ended December 31, 2008. The increase in nonperforming nonaccrual loans is primarily due to placing the two construction loan relationships described in the Classified Assets section on nonaccrual status. The Company actively pursues full collection of nonaccrual loans.

The Company s residential real estate loan underwriting standards for first mortgages limit the loan amount to no more than 80% of the appraised value of the property serving as collateral for the loan, and require verification of income of the borrower(s). The Company had no sub-prime loans as of December 31, 2008 and December 31, 2007. Of the loans 90 days past due and still accruing at December 31, 2008, $-0- thousand and $569 thousand were residential real estate loans and automobile loans, respectively. Delinquent consumer loans on accrual status were as follows ($ in thousands):

	At December 31,	
	2008	2007
Residential real estate loans:		
30-89 days delinquent:		
Dollar amount	$3,273	$2,761
Percentage of total residential real estate loans	0.71%	0.57%
90 or more days delinquent:		
Dollar amount	$ -0-	$ -0-
Percentage of total residential real estate loans	0.00%	0.00%
Automobile loans:		
30-89 days delinquent:		
Dollar amount	$5,241	$2,872
Percentage of total automobile loans	1.12%	0.61%
90 or more days delinquent:		
Dollar amount	$ 569	$ 253
Percentage of total automobile loans	0.12%	0.05%

The Company had no restructured loans as of December 31, 2008, 2007 and 2006.

The amount of gross interest income that would have been recorded if all nonaccrual loans had been current in accordance with their original terms while outstanding during the period was $666 thousand in 2008, $428 thousand in 2007 and $502 thousand in 2006. The amount of interest income that was recognized on nonaccrual loans from cash payments made in 2008, 2007 and 2006 was $511 thousand, $474 thousand and $488 thousand, respectively. Yields on these cash payments were 4.72%, 9.80% and 8.60%, respectively, for the year ended December 31, 2008, December 31, 2007 and December 31, 2006. Cash payments received, which were applied against the book balance of performing and nonperforming nonaccrual loans outstanding at December 31, 2008, totaled $-0- thousand, compared with approximately $14 thousand and $50 thousand at December 31, 2007 and 2006, respectively.

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

Allowance for Credit Losses

The Company s allowance for credit losses is maintained at a level considered adequate 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 loans and classified loans, recommendations of regulatory authorities, prevailing economic conditions and other factors. A portion of the allowance is specifically allocated to impaired loans whose full collectibility is uncertain. Such allocations are determined by Management based on loan-by-loan analyses. A second allocation is based in part on quantitative analyses of historical credit loss experience, in which criticized and classified credit balances identified through an independent internal credit review process are analyzed using a linear regression model to determine standard loss rates. The results of this analysis are applied to current criticized and classified loan balances to allocate the reserve to the respective segments of the loan portfolio. In addition, loans with similar characteristics not usually criticized using regulatory guidelines are analyzed and reserves established based on the historical loss rates and delinquency trends, grouped by the number of days the payments on these loans are delinquent. Last, allocations are made to non-criticized and non-classified commercial loans and residential real estate loans based on historical loss rates, and other statistical data. 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. It 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 past loan charge-off history (external factors). The external factors evaluated by the Company include: economic and business conditions, external competitive issues, 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 include: loan review system, adequacy of lending Management and staff, loan policies and procedures, problem loan trends, concentrations of credit, 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. Management considers the $47.6 million allowance for credit losses to be adequate as a reserve against losses as of December 31, 2008.

The following table summarizes the loan loss experience of the Company for the periods indicated:

Allowance For Credit Losses, Chargeoffs & Recoveries

Year ended December 31, (dollars in thousands)	2008	2007	2006	2005	2004
Total loans outstanding	$2,382,426	$2,502,976	$2,531,734	$2,672,221	$2,300,230
Average loans outstanding during the period	2,432,556	2,511,763	2,576,791	2,576,363	2,258,482
Analysis of the Allowance					
Balance, beginning of period	$ 55,799	$ 59,023	$ 59,537	$ 54,152	$ 53,910
Provision for loan losses	2,700	700	445	900	2,700
Provision for unfunded credit commitments	(200)	(400)	5		
Allowance acquired through merger	0	0	0	5,213	0
Loans charged off:					
Commercial and commercial real estate	(1,296)	(1,648)	(1,176)	(673)	(2,154)
Real estate construction	(5,348)	0	0	0	0
Real estate residential	(131)	0	0	0	0
Consumer	(5,638)	(4,033)	(2,446)	(2,065)	(3,439)
Total chargeoffs	(12,413)	(5,681)	(3,622)	(2,738)	(5,593)
Recoveries of loans previously charged off:					
Commercial and commercial real estate	331	1,060	1,149	864	1,623
Real estate construction	0	0	0	0	0
Real estate residential	0	0	0	0	0
Consumer	1,346	1,097	1,509	1,146	1,512
Total recoveries	1,677	2,157	2,658	2,010	3,135
Net loan losses	(10,736)	(3,524)	(964)	(728)	(2,458)
Balance, end of period	$ 47,563	$ 55,799	$ 59,023	$ 59,537	$ 54,152

Components:					
Allowance for loan losses	$ 44,470	$ 52,506	$ 55,330	$ 55,849	$ 54,152
Reserve for unfunded credit commitments (1)	3,093	3,293	3,693	3,688	
Allowance for credit losses	$ 47,563	$ 55,799	$ 59,023	$ 59,537	$ 54,152
Net loan losses to average loans	0.44%	0.14%	0.04%	0.03%	0.11%
Allowance for loan losses as a percentage of loans outstanding	1.87%	2.10%	2.19%	2.09%	2.35%

(1) Effective December 31, 2005, the Company transferred the portion of the allowance for credit losses related to lending commitments and letters of credit to other liabilities.

Net credit losses rose in 2008 compared with 2007 due to higher chargeoffs on real estate construction and automobile loans and lower recoveries on commercial loans, partially offset by lower chargeoffs on commercial loans and higher recoveries on consumer loans. Annualized net loan losses to average loans rose to 0.44% in 2008, compared to 0.14% in 2007. No assurance can be given that higher levels of net charge-offs will not occur. Management continues to follow conservative credit underwriting policies and practices, and aggressively pursues collection of classified loans and recovery of recognized loan losses.

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Allocation of the Allowance for Credit Losses

The following table presents the allocation of the allowance for credit losses as of December 31 for the years indicated:

Allocation of the Allowance for Credit Losses

At December 31,	2008		2007		2006		2005		2004	
(dollars in thousands)	Allocation of the Allowance Balance	Loans as Percent of Total Loans	Allocation of the Allowance Balance	Loans as Percent of Total Loans	Allocation of the Allowance Balance	Loans as Percent of Total Loans	Allocation of the Allowance Balance	Loans as Percent of Total Loans	Allocation of the Allowance Balance	Loans as Percent of Total Loans
Commercial	$23,774	57%	$27,233	56%	$23,217	58%	$30,438	60%	$29,857	61%
Real estate construction	4,725	2%	5,403	4%	3,942	3%	3,346	3%	1,441	1%
Real estate residential	367	19%	388	19%	1,219	20%	1,230	19%	917	16%
Consumer	6,331	22%	4,626	21%	4,132	19%	5,291	18%	5,140	22%
Unallocated portion	12,366		18,149		26,513		19,232		16,797	
Total	$47,563	100%	$55,799	100%	$59,023	100%	$59,537	100%	$54,152	100%

The allocation to loan portfolio segments changed from December 31, 2007 to December 31, 2008. The decrease in allocation to commercial loans was primarily due to a reduction in allocations to agricultural and municipal loans based on re-evaluation and measurement of risk attributes. The decline in the allocation to real estate construction loans reflects a decrease in criticized real estate construction loans and the increase in allocation to consumer loans reflects delinquency trends.

The allocation to loan portfolio segments changed from December 31, 2006 to December 31, 2007. The increase in allocation for commercial loans reflects an increase in historical loss rates. The increase in allocation to real estate construction loans reflects an increase in criticized construction loans outstanding, which receive higher allocations due to higher risk attributes, offset in part by lower volumes of non-criticized construction loans and construction loan commitments. The reduced allocations for residential real estate loans reflects refinements to the statistical model used to apply historical loss rates to loan volumes. The increased allocation for consumer loans reflects higher delinquencies in automobile loans.

The unallocated portion of the allowance for credit losses declined $5.7 million from December 31, 2007 to December 31, 2008. The unallocated allowance is established to provide for probable losses that have been incurred, but not reflected in the allocated allowance. During 2008, classified loans, nonperforming loans and consumer loan delinquencies increased; as a result, the allocated allowance reflects probable losses related to these loans and the unallocated allowance has declined. At December 31, 2007 and December 31, 2008, Management s evaluations of the unallocated portion of the allowance for credit losses attributed significant risk levels to developing economic and business conditions ($4.0 million and $3.4 million, respectively), external competitive issues ($2.0 million and $1.2 million, respectively), internal credit administration considerations ($4.2 million and $1.4 million, respectively), and delinquency and problem loan trends ($4.2 million and $3.5 million, respectively). The change in the amounts allocated to the above qualitative risk factors was based upon Management s judgment, review of trends in its loan portfolio which includes a decline in loan balances and reduced real estate construction exposure, levels of the allowance allocated to portfolio segments, internal staffing considerations and current economic conditions in its marketplace including loan underwriting and pricing practices of competitors. Based on Management s analysis and judgment, the amount of the unallocated portion of the allowance for credit losses was $18.1 million at December 31, 2007, compared with $12.4 million at December 31, 2008.

The unallocated portion of the allowance for credit losses declined $8.4 million from December 31, 2006 to December 31, 2007. The unallocated allowance is established to provide for probable losses that have been incurred, but not reflected in the allocated allowance. At December 31, 2006 and December 31, 2007, Management s evaluations of the unallocated portion of the allowance for credit losses attributed significant risk levels to developing economic and business conditions ($4.6 million and $4.0 million, respectively), external competitive issues ($2.4 million and $2.0 million, respectively), internal credit administration considerations ($5.2 million and $4.2 million), and delinquency and problem loan trends ($4.3 million and $4.2 million, respectively). The change in the amounts allocated to the above qualitative risk factors was based upon Management s judgment, review of trends in its loan portfolio, levels of the allowance allocated to portfolio segments, and current economic conditions in its marketplace. Based on Management s analysis and judgment, the amount of the unallocated portion of the allowance for credit losses was $26.5 million at December 31, 2006, compared to $18.1 million at December 31, 2007.

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Impaired Loans

The Company considers a loan to be impaired when, based on current information and events, it is probable that it will be unable to collect all amounts due (principal and interest) according to the contractual terms of the loan agreement. The measurement of impairment may be based on (i) the present value of the expected cash flows of the impaired loan discounted at the loan s original effective interest rate, (ii) the observable market price of the impaired loan or (iii) the fair value of the collateral of a collateral-dependent loan. The Company does not apply this definition to smaller-balance loans that are collectively evaluated for credit risk. In assessing impairment, the Company reviews all nonaccrual commercial and construction loans with outstanding principal balances in excess of $250 thousand. Nonaccrual commercial and construction loans with outstanding principal balances less than $250 thousand, and large groups of smaller-balance homogeneous loans such as installment, personal revolving credit, residential real estate and student loans, are evaluated collectively for impairment under the Company s standard loan loss reserve methodology.

The following summarizes the Company s recorded investment in impaired loans for the dates indicated:

Impaired Loans

At December 31, (dollars in thousands)	2008	2007
Total impaired loans	$6,849	$317
Specific reserves	$1,936	$317

At December 31, 2008 and 2007, the Company measured impairment using the fair value of loan collateral. The average balance of the Company s impaired loans for the year ended December 31, 2008 was $7.0 million compared with $139 thousand and $234 thousand in 2007 and 2006, respectively. All impaired loans are on nonaccrual status.

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 reprice at different times. Assets and liabilities may reprice at the same time but by different amounts. Short-term and long-term market interest rates may change by different amounts. The remaining maturity of various assets or liabilities may shorten or lengthen as interest rates change. In addition, interest rates may have an impact on loan demand, credit losses, and other sources of earnings such as account analysis fees on commercial deposit accounts and correspondent bank service charges.

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 remains slightly liability sensitive, with a greater amount of interest-bearing liabilities subject to immediate and near-term interest rate changes relative to earning assets. As a result, the FOMC s recent reductions in the federal funds target rate (charged for short-term inter-bank borrowings) and the related decline in U.S. Treasury bill rates has improved the Company s net interest margin in the twelve months ended December 31, 2008. 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.

Management assesses interest rate risk by comparing the Company s most likely earnings plan with various earnings models using many interest rate scenarios that differ in the direction of interest rate changes, the degree of change over time, the speed of change and the projected shape of the yield curve. For example, using the current composition of the Company s balance sheet and assuming no change in the federal funds rate and an increase of 84 bp in the 10 year Constant Maturity Treasury Bond yield during the same period, earnings are not estimated to change by a meaningful amount compared to the Company s most likely net income plan for the twelve months ending December 31, 2009. Conversely, using the current composition of the Company s balance sheet and assuming an increase of 100 bp in the federal funds rate and an increase of 108 bp in the 10 year Constant Maturity Treasury Bond yield during the same period, estimated earnings at risk would be approximately 3.2% of the Company s most likely net income plan for the twelve months ending December 31, 2009. 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 is currently deploying tactics to reduce the liability sensitivity of the Company s balance sheet to a more neutral condition where changes in interest rates result in less significant changes in earnings. 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 for purposes of computing earnings per share. On February 13, 2009, the Company issued preferred stock to the Treasury: the terms of such issuance limits the Company s ability to repurchase stock. See Note 20 to the Consolidated Financial Statements for additional information. 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 chargeoffs and the provision for loan losses. 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 operating sources of liquidity are operating earnings, investment securities, consumer and other loans, deposits, and other borrowed funds. During 2008, investment securities provided $293.6 million in liquidity from paydowns and maturities, and loans provided $106.3 million in liquidity from scheduled payments and maturities, net of loan fundings. The Company projects $47.9 million in additional liquidity from investment security paydowns and maturities in the three months ending March 31, 2009.

At December 31, 2008, indirect automobile loans totaled $469.1 million, which were experiencing stable monthly principal payments of approximately $17.0 million during the last three month of 2008. During 2008, a portion of the liquidity provided by investment securities and loans provided funds to meet a net reduction in deposits totaling $169.7 million. The remaining liquidity was used to reduce higher cost borrowed funds, primarily subordinated debt which decreased $10 million and federal funds purchased which declined $286.0 million. During 2007, investment securities provided $193.1 million in liquidity from paydowns and maturities, and loans provided $26.2 million in liquidity from scheduled payments and maturities, net of loan fundings. During 2007, a portion of the liquidity provided by investment securities, loans and a $66.6 million increase in short term borrowings provided funds to meet a net reduction in deposits totaling $251.9 million.

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The Company held $1.2 billion in total investment securities at December 31, 2008. Under certain deposit, borrowing and other arrangements, the Company must hold investment securities as collateral. At December 31, 2008, such collateral requirements totaled approximately $1.1 billion. At December 31, 2008, $288.5 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.

At December 31, 2008, $395.2 million in collateralized mortgage obligations (CMOs) and mortgage backed securities (MBSs) were held in the Company s investment portfolios. None of the CMOs or MBSs are backed by sub-prime mortgages. All of the Non Agency CMOs are rated AAA based on their subordination structures without reliance on monoline insurance. Other than nominal amounts of FHLMC and FNMA MBSs purchased for Community Reinvestment Act investment purposes, the Company has not purchased a CMO or MBS since November 2005. The CMOs and MBSs have been experiencing stable principal paydowns of approximately $5.5 million per month during the last three months. In addition, at December 31, 2008, the Company had customary lines for overnight borrowings from other financial institutions in excess of $700 million, under which $335.0 million was outstanding. Additionally, the Company has access to borrowing from the Federal Reserve. The Company s short-term debt rating from Fitch Ratings is F1. The Company s long-term debt rating from Fitch Ratings is A with a stable outlook. 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. The FDIC adopted the Temporary Liquidity Guarantee Program (TLGP) because of disruptions in the credit markets. The TLGP guarantees newly issued senior unsecured debt of banks and certain holding companies in addition to providing full coverage of noninterest bearing deposit transaction accounts. Debt issuance is subject to a maximum acount, and fees for use of the program are assessed on a sliding scale. The Company did not opt out of this program. No senior unsecured debt has been issued by the Company under the TLGP.

The Company generates significant liquidity from its operating activities. The Company s profitability during 2008, 2007 and 2006 resulted in operating cash flows of $93.3 million, $108.4 million and $108.0 million, respectively. In 2008, profitability and retained earnings from prior years provided cash for $35.9 million of Company stock repurchases and $40.2 million in shareholder dividends. In 2007, operating activities provided a substantial portion of cash for $40.6 million in shareholder dividends and $87.1 million of share repurchase activity. In 2006, operating activities provided a substantial portion of cash for $40.7 million in shareholder dividends and $89.0 million of share repurchase activity.

It is anticipated that loan demand will be weak during 2009, although such demand 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 interest rates. The growth of deposit balances is subject to heightened competition, the success of the Company s sales efforts, delivery of superior customer service and market conditions. The recent series of reductions in the federal funds rate resulted in declining short-term interest rates, which could impact deposit volumes in the future. Depending on economic conditions, interest rate levels, and a variety of other conditions, deposit growth may be used to fund loans, to reduce short-term 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. Quarterly shareholder dividends are restricted to the quarterly per share amount prior to October 14, 2008 under the terms of the February 13, 2009 issuance of preferred stock to the Treasury. See Note 20 to the Consolidated Financial Statements for additional information.

The Parent Company s primary source of liquidity is dividends from the Bank. Dividends from the Bank are subject to certain regulatory limitations. During 2008, 2007 and 2006, the Bank declared dividends to the Company of $100 million, $109 million and $108 million, respectively.

The following table sets forth the known contractual obligations of the Company at December 31, 2008:

Contractual Obligations

At December 31, 2008 (dollars in thousands)	Within One Year	One to Three Years	Four to Five Years	After Five Years	Total
Long-Term Debt Obligations	$ 0	$ 0	$15,000	$11,631	$26,631
Operating Lease Obligations	5,993	8,852	5,893	886	21,624
Purchase Obligations	8,047	16,093	0	0	24,140
Total	$14,040	$24,945	$20,893	$12,517	$72,395

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 23.4% in 2006, 22.1% in 2007 and 14.8% in 2008. The Company also raises capital as employees exercise stock options, which are awarded as a part of the Company s executive compensation programs to reinforce shareholders interests in the Management of the Company. Capital raised through the exercise of stock options totaled $18.2 million in 2006, $14.6 million in 2007 and $25.8 million in 2008.

The Company paid dividends totaling $40.7 million in 2006, $40.6 million in 2007, and $40.2 million in 2008, which represent dividends per share of $1.30, $1.36, and $1.39, 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 1.8 million shares of common stock valued at $89.0 million in 2006, 1.9 million shares valued at $87.1 million in 2007, and 719 thousand shares valued at $35.9 million in 2008. Share repurchases are restricted to amounts conducted in coordination with employee benefit programs under the terms of the February 13, 2009 issuance of preferred stock to the Treasury. See Note 20 to the Consolidated Financial Statements for additional information.

The Company s primary capital resource is shareholders equity, which increased $15.2 million or 3.9% in 2008 from the previous year, primarily the net result of $59.8 million in profits earned during the year and $25.8 million in issuance of stock in connection with exercises of employee stock options, offset by $40.2 million in dividends paid and $35.9 million in stock repurchases.

The Company s ratio of equity to total assets increased from 8.66% at December 31, 2007 to 10.16% at December 31, 2008 because of a decline in total assets and an increase in shareholders equity.

Capital to Risk-Adjusted Assets

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

At December 31,	2008	2007	Minimum Regulatory Requirement	Well Capitalized
Tier I Capital	10.47%	9.33%	4.00%	6.00%
Total Capital	11.76%	10.64%	8.00%	10.00%
Leverage ratio	7.36%	6.32%	4.00%	5.00%

The Company s risk-based capital ratios increased at December 31, 2008, compared with December 31, 2007, due to a decline in risk-weighted assets.

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

At December 31,	2008	2007	Minimum Regulatory Requirement	Well Capitalized
Tier I Capital	9.31%	9.52%	4.00%	6.00%
Total Capital	10.78%	10.98%	8.00%	10.00%
Leverage ratio	6.52%	6.41%	4.00%	5.00%

The risk-based capital ratios declined at December 31, 2008, compared with December 31, 2007, due to a decrease in regulatory capital, offset in part by a decline in risk-weighted assets.

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The Company intends to maintain regulatory capital in excess of the highest regulatory standard, referred to as well capitalized . The Company routinely projects its 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 expects to maintain regulatory capital levels exceeding the well capitalized standard and pay quarterly dividends to shareholders. No assurance can be given that changes in capital management plans will not occur.

Financial Ratios

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

At and for the years ended December 31,	2008	2007	2006
Return on average total assets	1.42%	1.93%	2.01%
Return on average shareholders equity	14.77%	22.11%	23.38%
Average shareholders equity as a percentage of:			
Average total assets	9.60%	8.75%	8.60%
Average total loans	16.65%	16.17%	16.40%
Average total deposits	12.79%	12.04%	11.58%
Dividend payout ratio (diluted EPS)	68%	46%	42%

Deposit categories

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

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

	2008			2007			2006		
Years Ended December 31, (Dollars in thousands)	Average Balance	Percentage of Total Deposits	Rate	Average Balance	Percentage of Total Deposits	Rate	Average Balance	Percentage of Total Deposits	Rate
Noninterest bearing demand	$1,181,679	37.3%	%	$1,262,723	37.5%	%	$1,329,107	36.4%	%
Interest bearing:									
Transaction	541,727	17.1%	0.26%	569,286	16.9%	0.37%	617,956	16.9%	0.29%
Savings	759,829	24.0%	0.56%	826,336	24.5%	0.74%	956,698	26.3%	0.44%
Time less than $100 thousand	193,889	6.1%	2.69%	210,039	6.2%	3.31%	239,361	6.6%	2.73%
Time $100 thousand or more	489,326	15.5%	2.11%	503,469	14.9%	4.50%	504,980	13.8%	4.17%
Total	$3,166,450	100.0%	1.07%	$3,371,853	100.0%	1.79%	$3,648,102	100.0%	1.45%

Deposit competition remained elevated during 2008. The Company modified its deposit pricing practices to retain its profitable customers. During 2008, total average deposits declined by $205.4 million or 6.1% from 2007 due to an $81.0 million decrease in noninterest bearing demand deposits, a $66.5 million decrease in savings deposits, a $27.6 million decrease in interest bearing transaction deposits, a $16.2 million decrease in time deposits less than $100 thousand and a $14.1 million decrease in time deposits $100 thousand or more.

Deposit competition increased during 2006 due to rising short-term interest rates, and remained elevated during 2007. The Company modified its deposit pricing practices to retain its profitable customers. During 2007, total average deposits declined by $276.2 million or 7.6% from 2006 primarily due to a $130.4 million decrease in savings deposits, a $66.4 million decrease in noninterest bearing demand deposits, a $48.7 million decrease in interest bearing transaction deposits, and a $29.3 million decrease in time deposits less than $100 thousand.

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Total time deposits were $665.8 million and $714.9 million at December 31, 2008 and 2007, respectively. The following table sets forth, by time remaining to maturity, the Company s total domestic time deposits.

(In thousands)	December 31, 2008
2009	$ 619,392
2010	25,193
2011	8,429
2012	5,026
2013	5,006
Thereafter	2,727
Total	$ 665,773

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, 2008
Three months or less	$ 407,502
Over three through six months	34,457
Over six through twelve months	24,700
Over twelve months	9,945
Total	$ 476,604

Short-term Borrowings

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

Short-Term Borrowings Distribution

At December 31, (In thousands)	2008	2007	2006
Federal funds purchased	$335,000	$621,000	$551,000
Other borrowed funds:			
Sweep accounts	119,015	150,097	134,634
Securities sold under repurchase agreements	3,260	7,969	25,830
Line of credit	0	19,533	20,513
Total short term borrowings	$457,275	$798,599	$731,977

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

Years Ended December 31, (dollars in thousands)	2008	2007	2006
Federal Funds Purchased Balances and Rates Paid			
Outstanding amount:			

Average for the year	$411,488	$596,711	$525,068
Maximum month-end balance during the year	665,000	705,000	626,500
Interest rates:			
Average for the year	2.17%	5.13%	5.02%
Average at period end	0.16%	4.33%	5.23%
Other Borrowed Funds Balances and Rates Paid Outstanding amount:			
Average for the year	$137,950	$162,679	$209,902
Maximum month-end balance during the year	155,466	222,227	255,517
Interest rates:			
Average for the year	0.74%	1.08%	1.44%
Average at period end	0.55%	0.99%	1.33%

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Noninterest Income

Components of Noninterest Income

Years Ended December 31, (dollars in thousands)	2008	2007	2006
Service charges on deposit accounts	$ 29,762	$30,235	$28,414
Merchant credit card fees	10,525	10,841	9,860
Debit card fees	3,769	3,797	3,489
ATM fees and interchange	2,923	2,824	2,824
Other service charges	2,025	2,065	1,954
Financial services commissions	830	1,321	1,368
Trust fees	1,227	1,281	1,178
Official check fees	163	1,113	1,391
Life insurance proceeds		822	
Gain on sales of real property		230	239
Mortgage banking income	125	124	179
Securities losses and impairment	(62,653)		
Gain on sale of Visa common stock	5,698		
Other noninterest income	3,550	4,625	4,451
Total	$ (2,056)	$59,278	$55,347

In 2008, a $2.1 million loss was recorded from all sources of noninterest income compared with $59.3 million in noninterest income for 2007. The 2008 period included the $62.7 million in losses on sale and impairment charge of FHLMC and FNMA preferred stock and other common stock, $5.7 million in securities gains from the redemption of VISA Class B common stock as part of Visa s initial public offering. Noninterest income in 2007 included an $822 thousand gain on company-owned life insurance and a $230 thousand gain on sale of real property. During the second quarter of 2008, the Company began issuing its own official checks rather than use a vendor which paid the Company fees based on the availability of funds while the official checks remained outstanding (float). By issuing its own official checks, the Company uses the related float as a source of funding and reduces its interest expense. Such vendor fees were $950 thousand lower in 2008 compared with 2007. Financial services commissions fell $491 thousand or 37.2%. Service charges on deposits declined $473 thousand or 1.6%, due to declines in overdraft fees and returned item charges (down $492 thousand) and fees charged on business and retail checking and savings accounts (down $542 thousand), partially offset by a $562 thousand increase in deficit fees charged on analyzed accounts. Deficit fees are service charges collected from business customers that typically pay for such services with compensating balances. Merchant credit card fees declined $316 thousand or 2.9%. Other noninterest income decreased $1.1 million or 23.2% primarily due to a $292 thousand decline in interest recoveries on charged-off loans and lower customer check sales income and gains on sale of other assets in 2007.

Noninterest income for 2007 was $3.9 million or 7.1% higher than 2006 primarily due to higher service charges on deposit accounts and merchant credit card fees, and $822 thousand in company-owned life insurance proceeds. Service charges on deposit accounts increased $1.8 million or 6.4% mainly due to a $2.3 million increase in overdraft fees due to marketing initiatives, partially offset by declines in fees charged on retail and business checking accounts (down $296 thousand) and deficit fees charged on analyzed accounts (down $200 thousand). Merchant credit card fees increased $981 thousand or 9.9% due to increased processing volumes. Debit card fees increased $308 thousand or 8.8% mainly due to increased usage. Other service charges increased $111 thousand or 5.7%. Trust fees increased $103 thousand or 8.7%. Official check sales income declined $278 thousand or 20.0% mostly due to lower average investable balances.

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Noninterest Expense

Components of Noninterest Expense

Years Ended December 31, (dollars in thousands)	2008	2007	2006
Salaries and related benefits	$ 51,492	$ 50,142	$ 52,302
Occupancy	13,703	13,346	13,047
Data processing	8,440	7,069	6,097
Equipment	3,801	4,302	4,949
Courier Service	3,322	3,404	3,627
Professional fees	2,624	1,889	2,437
Postage	1,487	1,602	1,648
Telephone	1,368	1,398	1,634
Stationery and supplies	1,170	1,271	1,163
Customer checks	920	939	992
Correspondent service charges	634	869	778
Advertising and public relations	843	834	843
Operational losses	845	793	892
Loan expenses	911	750	882
FDIC insurance assessments	518	401	462
Amortization of intangible assets	3,221	3,653	4,087
Visa litigation	(2,338)	2,338	
Other	7,800	6,428	5,884
Total	$100,761	$101,428	$101,724
Noninterest expense to revenues (efficiency ratio)(FTE)	51.9%	41.5%	39.1%
Average full-time equivalent staff	891	887	909
Total average assets per full-time staff	$ 4,736	$ 5,233	$ 5,402

In 2008, noninterest expense decreased $667 thousand or 0.7% compared with 2007. The 2008 results included reversal of the $2.3 million accrual for known Visa related litigation, which was reversed with the funding of a litigation escrow as a part of the Visa IPO. Data processing service costs were higher by $1.4 million or 19.4% due to conversion of the Company s item processing function to an outside vendor. Salaries and related benefits increased $1.4 million or 2.7% mainly due to annual merit increases granted to continuing staff and increases in incentives, payroll taxes and workers compensation. Professional fees increased $735 thousand or 38.9% primarily due to higher legal fees, partially offset by lower audit fees. Occupancy costs increased $357 thousand or 2.7% primarily due to increases in net rent and miscellaneous occupancy expense, partially offset by lower depreciation costs. Loan expenses increased $161 thousand or 21.5%. FDIC insurance assessments increased $117 thousand or 29.2%. FDIC insurance assessments are expected to rise in 2009. See Premiums for Deposit Insurance and Assessments for Examinations contained in the Supervision and Regulation section of Part I, Item 1 of this report. Other noninterest expense rose by $1.4 million or 21.3% due to writedown of foreclosed property, higher insurance costs and amortization of low-income housing investments as tax benefits are realized and a lower reduction in the reserve for unfunded credit commitments. Other categories of expense decreased from 2007, offsetting the increases outlined above. Equipment expense declined $501 thousand or 11.6% mostly due to reduced depreciation costs and lower maintenance expenses. Amortization of intangible assets decreased $432 thousand or 11.8%. Correspondent service charges were lower by $235 thousand or 27.0%. Postage declined $115 thousand or 7.2%. Stationery and supplies expenses were lower by $101 thousand or 7.9%.

In 2007, noninterest expense declined $296 thousand or 0.3% compared with 2006. Salaries and related benefits declined $2.2 million or 4.1% mostly a result of fewer employees, partially offset by annual merit increases, and declines in stock based compensation (down $725 thousand), workers compensation (down $410 thousand), restricted performance shares (down $207 thousand) and incentives and bonuses (down $457 thousand). Equipment expense declined $647 thousand or 13.1% primarily due to lower repair, maintenance and depreciation expenses. Professional fees decreased $548 thousand or 22.5% mainly due to lower legal fees (down $474 thousand). Amortization of deposit intangibles decreased $434 thousand or 10.6%. Telephone expense declined $236 thousand or 14.4% largely due to lower rates contained in a new vendor contract. Courier service expense decreased $223 thousand or 6.1%. Loan expense fell $132 thousand or 15.0% largely due to lower repossession expenses. Declines were partially offset by the $2.3 million Visa litigation expense and increases in data processing (up $972 thousand or 15.9%), other noninterest expense (up $483 thousand or 7.6%), occupancy expense (up $299 thousand or 2.3%) and stationery and supplies (up $108 thousand or 9.3%). The higher data processing expenses and a portion of the lower personnel costs, lower full-time equivalent staff levels and lower equipment expenses were due to conversion of the Company s item processing function to an outside vendor. Other noninterest expense rose mostly due to increases in debit card and ATM network fees, travel costs, internet banking expenses, and amortization of low-income housing investments as tax benefits are realized. The increase was partially offset by a $400 thousand reduction in the reserve for unfunded credit commitments due to a reduction in commitments under construction credit facilities. Occupancy expense increased primarily due to increases in maintenance and insurance costs, partly offset by lower depreciation charges.

Provision for Income Tax

In 2008, the Company filed its 2007 federal income tax return. Amounts included in that filed return were reconciled to estimates of such amounts used to recognize the 2007 federal income tax provision. As a result, a reduction in the tax provision in the amount of $877 thousand was recognized in 2008 to adjust the 2007 tax estimates to amounts included in the filed tax return. The adjustment primarily resulted from higher than anticipated tax credits earned on limited partnership investments providing low-income housing and housing for the elderly in our Northern and Central California communities. In 2008, the Company further reduced its tax provision by $114 thousand to reflect a reduction in its unrecognized tax benefits due to a lapse in the statute of limitations.

The income tax provision (FTE) was $30.9 million for 2008 compared with $52.7 million for 2007. The effective tax rate (FTE) of 34.1% for 2008 compared with 37.0% for 2007. The tax provision for 2007 reflected the tax-free nature of $822 thousand in life insurance proceeds, higher dividend received deductions and lower non-deductible life insurance premiums.

The Troubled Asset Relief Program, signed into law on October 3, 2008, provided ordinary tax treatment to losses on FHLMC and FNMA preferred stock held on September 6, 2008 or sold on or after January 1, 2008. As a result, the Company s losses on FNMA and FHLMC preferred stock receive ordinary tax treatment.

The income tax provision (FTE) decreased by $6.4 million or 10.8% in 2007 compared to 2006 primarily due to lower earnings. The 2007 provision (FTE) of $52.7 million reflects an effective tax rate of 37.0% compared to a provision of $59.1 million in 2006, representing an effective tax rate of 37.4%. The tax provision in 2007 reflected $700 thousand in tax refunds in connection with the acceptance of amended returns and the tax-exempt nature of $822 thousand in life insurance proceeds, which reduced the effective tax rate from 37.7% to 37.0%.

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.

Interest rate risk is the most significant market risk affecting the Company, and equity price risk can also affect the Company s financial results, both of which are described in the preceding sections regarding Asset and Liability Management and Liquidity. 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

INDEX TO FINANCIAL STATEMENTS

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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, 2008. 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, 2008 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, 2008 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 26, 2009

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders
Westamerica Bancorporation:

We have audited Westamerica Bancorporation and Subsidiaries (the Company) internal control over financial reporting as of December 31, 2008, 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, 2008, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of the Company as of December 31, 2008 and 2007, and the related consolidated statements of income, changes in shareholders equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2008, and our report dated February 26, 2009 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP
KPMG LLP

San Francisco, California
February 26, 2009

CONSOLIDATED BALANCE SHEETS
(In thousands)

Balances as of December 31,	***2008***	***2007***
Assets		
Cash and cash equivalents	$ 138,883	$ 209,764
Money market assets	341	333
Investment securities available for sale	288,454	532,821
Investment securities held to maturity; market values of $950,210 in 2008 and $1,049,422 in 2007	949,325	1,045,288
Loans, net of an allowance for loan losses of: $44,470 in 2008 and $52,506 in 2007	2,337,956	2,450,470
Other real estate owned	3,505	613
Premises and equipment, net	27,351	28,380
Identifiable intangibles	15,208	18,429
Goodwill	121,699	121,719
Interest receivable and other assets	150,212	151,142
Total Assets	$4,032,934	$4,558,959
Liabilities		
Deposits:		
Noninterest bearing	$1,158,632	$1,245,500
Interest bearing:		
Transaction	525,153	544,411
Savings	745,496	760,006
Time	665,773	714,873
Total deposits	3,095,054	3,264,790
Short-term borrowed funds	457,275	798,599
Debt financing and notes payable	26,631	36,773
Liability for interest, taxes and other expenses	44,122	64,194
Total Liabilities	3,623,082	4,164,356
Shareholders Equity		
Common Stock (no par value)		
Authorized 150,000 shares		
Issued and outstanding 28,880 in 2008 and 29,018 in 2007	352,265	334,211
Deferred compensation	2,409	2,990
Accumulated Other Comprehensive Income (Loss)	1,040	(4,520)
Retained earnings	54,138	61,922
Total Shareholders Equity	409,852	394,603

Total Liabilities and Shareholders Equity	$4,032,934	$4,558,959

See accompanying notes to consolidated financial statements.

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CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share data)

For the years ended December 31,	***2008***	***2007***	***2006***
Interest and Fee Income			
Loans	$148,659	$162,242	$164,756
Money market assets and funds sold	3	7	5
Investment securities:			
Available for sale			
Taxable	8,854	15,639	16,844
Tax-exempt	9,357	11,566	12,519
Held to maturity Taxable	19,237	23,361	28,809
Tax-exempt	22,359	23,057	23,582
Total Interest and Fee Income	208,469	235,872	246,515
Interest Expense			
Transaction deposits	1,397	2,093	1,771
Savings deposits	4,245	6,144	4,198
Time deposits	15,540	29,612	27,578
Short-term borrowed funds	9,958	32,393	29,389
Debt financing and notes payable	2,103	2,313	2,332
Total Interest Expense	33,243	72,555	65,268
Net Interest Income	175,226	163,317	181,247
Provision for Loan Losses	2,700	700	445
Net Interest Income After Provision for Loan Losses	172,526	162,617	180,802
Noninterest Income			
Service charges on deposit accounts	29,762	30,235	28,414
Merchant credit card income	10,525	10,841	9,860
Debit card income	3,769	3,797	3,489
Financial services commissions	830	1,321	1,368
Trust fees	1,227	1,281	1,178
Net losses from equity securities	(56,955)		
Other	8,786	11,803	11,038
Total Noninterest (Loss) Income	(2,056)	59,278	55,347
Noninterest Expense			
Salaries and related benefits	51,492	50,142	52,302
Occupancy	13,703	13,346	13,047
Data processing	8,440	7,069	6,097
Furniture and equipment	3,801	4,302	4,949
Amortization of intangibles	3,221	3,653	4,087
Courier Service	3,322	3,404	3,627

Professional fees	2,624	1,889	2,437
Visa litigation	(2,338)	2,338	
Other	16,496	15,285	15,178
Total Noninterest Expense	100,761	101,428	101,724
Income Before Income Taxes	69,709	120,467	134,425
Provision for income taxes	9,874	30,691	35,619
Net Income	$ 59,835	$ 89,776	$ 98,806
Average Shares Outstanding	28,892	29,753	31,202
Diluted Average Shares Outstanding	29,273	30,165	31,739
Per Share Data			
Basic earnings	$ 2.07	$ 3.02	$ 3.17
Diluted earnings	2.04	2.98	3.11
Dividends paid	1.39	1.36	1.30

See accompanying notes to consolidated financial statements.

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CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY AND COMPREHENSIVE INCOME
(In thousands)

	Shares	*Common Stock*	*Deferred Compensation*	*Accumulated Other Comprehensive Income (Loss)*	*Retained Earnings*	*Total*
December 31, 2005*	31,882	$343,035	$ 2,423	$ 1,882	$ 87,724	$435,064
Adjustment to initially apply SAB Statement No. 108, net of tax					1,756	1,756
Balance at January 1, 2006	31,882	343,035	2,423	1,882	89,480	436,820
Comprehensive income						
Net income for the year 2006					98,806	98,806
Other comprehensive income, net of tax:						
Increase in net unrealized gains on securities available for sale				362		362
Total comprehensive income						99,168
Post-retirement benefit transition obligation, net of tax				(394)		(394)
Exercise of stock options	409	12,755				12,755
Stock option tax benefits		1,867				1,867
Restricted stock activity	20	727	311			1,038
Stock based compensation		2,504				2,504
Stock awarded to employees	3	154				154
Purchase and retirement of stock	(1,767)	(19,513)			(69,468)	(88,981)
Dividends					(40,696)	(40,696)
December 31, 2006	30,547	341,529	2,734	1,850	78,122	424,235
Comprehensive income						
Net income for the year 2007					89,776	89,776

Other comprehensive income, net of tax:						
Increase in net unrealized losses on securities available for sale				(6,406)		(6,406)
Post-retirement benefit transition obligation amortization				36		36
Total comprehensive income						83,406
Exercise of stock options	342	11,908				11,908
Stock option tax benefits		306				306
Restricted stock activity	12	302	256			558
Stock based compensation		1,779				1,779
Stock awarded to employees	3	161				161
Purchase and retirement of stock	(1,886)	(21,774)			(65,329)	(87,103)
Dividends					(40,647)	(40,647)
December 31, 2007	29,018	334,211	2,990	(4,520)	61,922	394,603
Comprehensive income						
Net income for the year 2008					59,835	59,835
Other comprehensive income, net of tax:						
Increase in net unrealized gains on securities available for sale				5,524		5,524
Post-retirement benefit transition obligation amortization				36		36
Total comprehensive income						65,395
Exercise of stock options	567	22,830				22,830
Stock option tax benefits		1,130				1,130
Restricted stock activity	11	1,261	(581)			680
Stock based compensation		1,193				1,193
Stock awarded to employees	3	171				171
	(719)	(8,531)			(27,383)	(35,914)

Purchase and retirement of stock						
Dividends					(40,236)	(40,236)
December 31, 2008	28,880	$352,265	$ 2,409	$ 1,040	$ 54,138	$409,852

See accompanying notes to consolidated financial statements.

* Adjusted to adopt Financial Accounting Standard 123 (revised 2004), Share-Based Payment. See Note 8.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

For the years ended December 31,	*2008*	*2007*	*2006*
Operating Activities:			
Net income	$ 59,835	$89,776	$98,806
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	9,581	9,489	10,221
Loan loss provision	2,700	700	445
Net amortization of deferred loan cost (fees)	124	(955)	(414)
Decrease in interest income receivable	3,480	2,870	1,327
Increase in other assets	(17,633)	(7,073)	(5,712)
Stock option compensation expense	1,193	1,779	