WESTAMERICA BANCORPORATION
Form 10-K
February 28, 2019

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

(Mark one)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2018

or

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: 001-09383

WESTAMERICA BANCORPORATION

(Exact name of the registrant as specified in its charter)

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

1108 FIFTH AVENUE, SAN RAFAEL, CALIFORNIA 94901

(Address of principal executive offices) (zip code)

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

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

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

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

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

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 NO

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 NO

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

Indicate by check mark if disclosure of delinquent filers pursuant to item 405 of Regulation S-K (section 229.405 of this chapter) 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.

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

Large accelerated filer   Accelerated filer   Non-accelerated filer

Smaller reporting company   Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The aggregate market value of the Common Stock held by non-affiliates of the registrant as of June 30, 2018 as reported on the NASDAQ Global Select Market, was $1,072,647,598.47 . Shares of Common Stock held by each executive officer and director and by each person who owns 10% 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 20, 2019: 26,889,495 Shares

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement relating to registrant's Annual Meeting of Shareholders, to be held on April 25, 2019, are incorporated by reference in Items 10, 11, 12, 13 and 14 of Part III to the extent described therein.

TABLE OF CONTENTS

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, future credit quality and performance, the appropriateness of the allowance for loan losses, loan growth or reduction, mitigation of risk in the Company’s loan and investment securities portfolios, 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", “estimates”, "intends", "targeted", "projected", “forecast”, "continue", "remain", "will", "should", "may" and other similar expressions are intended to identify forward-looking statements but are not the exclusive means of identifying such statements.

These forward-looking statements are based on Management’s current knowledge and belief and include information concerning the Company’s possible or assumed future financial condition and results of operations. A number of factors, some of which are beyond the Company’s ability to predict or control, could cause future results to differ materially from those contemplated. These factors include but are not limited to (1) the length and severity of any difficulties in the global, national and California economies and the effects of government efforts to address those difficulties; (2) liquidity levels in capital markets; (3) fluctuations in asset prices including, but not limited to stocks, bonds, real estate, and commodities; (4) the effect of acquisitions and integration of acquired businesses; (5) economic uncertainty created by terrorist threats and attacks on the United States, the actions taken in response, and the uncertain effect of these events on the national and regional economies; (6) changes in the interest rate environment; (7) changes in the regulatory environment; (8) competitive pressure in the banking industry; (9) operational risks including a failure or breach in data processing or security systems or those of third party vendors and other service providers, including as a result of cyber attacks or fraud; (10) volatility of interest rate sensitive loans, deposits and investments; (11) asset/liability management risks and liquidity risks; (12) the effect of natural disasters, including earthquakes, hurricanes, fire, flood, drought, and other disasters, on the uninsured value of the Company’s assets and of loan collateral, the financial condition of debtors and issuers of investment securities, the economic conditions affecting the Company’s market place, and commodities and asset values; (13) changes in the securities markets and (14) the outcome of contingencies, such as legal proceedings. However, the reader should not consider the above-mentioned factors to be a complete set of all potential risks or uncertainties.

Forward-looking statements speak only as of the date they are made. The Company undertakes no obligation to update any forward-looking statements in this report to reflect circumstances or events that occur after the date forward looking statements are made, except as may be required by law. 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 commercial customers in Northern and Central California through its subsidiary bank, Westamerica Bank (“WAB” or the “Bank”). The principal communities served are located in Northern and Central California, from Mendocino, Lake and Nevada Counties in the north to Kern County in the south. The Company’s strategic focus is on the banking needs of small businesses. In addition, the Bank owns 100% of the capital stock of Community Banker Services Corporation (“CBSC”), a company engaged in providing the Company and its subsidiaries with data processing services and other support functions.

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

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

During the period 2000 through 2005, the Company acquired three additional banks. These acquisitions were accounted for using the purchase accounting method.

On February 6, 2009, Westamerica Bank acquired the banking operations of County Bank ("County") from the Federal Deposit Insurance Corporation ("FDIC"). On August 20, 2010, Westamerica Bank acquired assets and assumed liabilities of the former Sonoma Valley Bank ("Sonoma") from the FDIC. The County and Sonoma acquired assets and assumed liabilities were measured at estimated fair values, as required by FASB ASC 805, Business Combinations.

At December 31, 2018, the Company had consolidated assets of approximately $5.6 billion, deposits of approximately $4.9 billion and shareholders' equity of approximately $616 million. The Company and its subsidiaries employed 762 full-time equivalent staff as of December 31, 2018.

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

Westamerica Bancorporation

Corporate Secretary A-2M

Post Office Box 1200

Suisun City, California 94585-1200

Supervision and Regulation

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

Regulation and Supervision of Bank Holding Companies

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

The FRB has significant supervisory and regulatory authority over the Company and its affiliates. The FRB requires the Company to maintain certain levels of capital. See "Capital Standards." The FRB also has the authority to take enforcement action against any bank holding company that commits any unsafe or unsound practice, or violates certain laws, regulations or conditions imposed in writing by the FRB. Under the BHCA, the Company is required to obtain the prior approval of the FRB before it acquires, merges or consolidates with any bank or bank holding company. Any company seeking to acquire, merge or consolidate with the Company also would be required to obtain the prior approval of the FRB.

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

The FRB generally prohibits a bank holding company from declaring or paying a cash dividend that would impose undue pressure on the capital of subsidiary banks or would be funded only through borrowing or other arrangements which might adversely affect a bank holding company's financial position. Under the FRB policy, a bank holding company should not continue its existing rate of cash dividends on its common stock unless its net income is sufficient to fully fund each dividend and its prospective rate of earnings retention appears consistent with its capital needs, asset quality and overall financial condition. See the section entitled "Restrictions on Dividends and Other Distributions" for additional restrictions on the ability of the Company and the Bank to pay dividends.

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

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

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

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

Regulation and Supervision of Banks

The Bank is a California state-chartered Federal Reserve member bank and its deposits are insured by the FDIC. The Bank is subject to regulation, supervision and regular examination by the California Department of Business Oversight (“DBO”) and the FRB. 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.

In addition, the Federal Deposit Insurance Corporation Improvement Act (“FDICIA”) imposes limitations on the activities and equity investments of state chartered, federally insured banks. FDICIA also prohibits a state bank from making an investment or engaging in any activity as a principal that is not permissible for a national bank, unless the Bank is adequately capitalized and the FDIC approves the investment or activity after determining that such investment or activity does not pose a significant risk to the deposit insurance fund.

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

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

Provisions in the legislation that affect the payment of interest on demand deposits and interchange fees may increase the costs associated with deposits as well as place limitations on certain revenues those deposits may generate.

Capital Standards

The federal banking agencies have risk-based capital adequacy guidelines intended to provide a measure of capital adequacy that reflects the degree of risk associated with a banking organization's operations for both transactions resulting in assets being recognized on the balance sheet as assets, and the extension of credit facilities such as letters of credit and recourse arrangements, which are recorded as off balance sheet items. Under these guidelines, nominal dollar amounts of assets and credit equivalent amounts of off balance sheet items are multiplied by one of several risk adjustment percentages, which range from 0% for assets with low credit risk, such as certain U.S. government securities, to 1250% for assets with relatively higher credit risk, such as certain securitizations. 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, 2018, 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 minimum capital requirements and for the Bank the standards for well capitalized depository institutions.

On July 2, 2013, the Federal Reserve Board approved a final rule that implements changes to the regulatory capital framework for all banking organizations over a transitional period 2015 through 2018.

See the sections entitled "Capital Resources and Capital to Risk-Adjusted Assets" in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations for additional information.

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

FDICIA has implemented certain specific restrictions on transactions and required federal banking regulators to adopt overall safety and soundness standards for depository institutions related to internal control, loan underwriting and documentation, and asset growth. Among other things, FDICIA limits the interest rates paid on deposits by undercapitalized institutions, restricts the use of brokered deposits, limits the aggregate extensions of credit by a depository institution to an executive officer, director, principal shareholder or related interest, and reduces deposit insurance coverage for deposits offered by undercapitalized institutions for deposits by certain employee benefits accounts. The federal banking agencies may require an institution to submit an acceptable compliance plan as well as have the flexibility to pursue other more appropriate or effective courses of action given the specific circumstances and severity of an institution’s noncompliance with one or more standards.

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

Restrictions on Dividends and Other Distributions

The Company's ability to pay dividends to its shareholders is subject to the restrictions set forth in the California General Corporation Law ("CGCL"). The CGCL provides that a corporation may make a distribution to its shareholders if (i) the corporation's retained earnings equal or exceed the amount of the proposed distribution plus unpaid accrued dividends (if any) on securities with a dividend preference, or (ii) immediately after the dividend, the corporation's total assets equal or exceed total liabilities plus unpaid accrued dividends (if any) on securities with a dividend preference.

The Company's ability to pay dividends depends in part on the Bank's ability to pay cash dividends to the Company. 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 or its holding company 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. The Federal Reserve Board has issued guidance indicating its expectations that a bank holding company will inform and consult with Federal Reserve supervisory staff sufficiently in advance of (i) declaring and paying a dividend that could raise safety and soundness concerns (e.g., declaring and paying a dividend that exceeds earnings for the period for which the dividend is being paid); (ii) redeeming or repurchasing regulatory capital instruments when the bank holding company is experiencing financial weaknesses; or (iii) redeeming or repurchasing common stock or perpetual preferred stock that would result in a net reduction as of the end of the quarter in the amount of such equity instruments outstanding compared with the beginning of the quarter in which the redemption or repurchase occurred.

Premiums for Deposit Insurance

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

In July 2010, Congress in the Dodd-Frank Act increased the minimum for the DIF reserve ratio, the ratio of the amount in the fund to insured deposits, from 1.15% to 1.35% and required that the ratio reach that level by September 30, 2020. Further, the Dodd-Frank Act made banks with $10 billion or more in assets responsible for the increase from 1.15% to 1.35%, among other provisions.

In October 2010, the FDIC adopted a new DIF restoration plan to ensure the DIF reaching 1.35% by September 30, 2020. In assessing its progress in restoring the reserves, at least semi-annually, the FDIC updates its loss and income projections for the fund and, if needed, increases or decreases assessment rates, following notice-and-comment rulemaking, if required.

In February 2011, the FDIC adopted a final rule effective April 1, 2011 to:

(1) Redefine the deposit insurance assessment base from total domestic deposits to average total assets minus average tangible equity as required by the Dodd-Frank Act;

(2) Change the deposit insurance assessment rates (which provide for progressively lower assessment rate schedules that will take effect when the reserve ratio exceeds 1.15%, 2%, and 2.5%) ;

(3) Implement the Dodd-Frank Act DIF dividend provisions; and

(4) Revise the risk-based assessment system for all “large” and “highly complex” insured depository institutions. “Large” depository institutions are defined generally as having more than $10 billion in assets and "highly complex" institutions have over $50 billion in assets and are fully owned by a parent with over $500 billion in assets. The Bank is neither a “large” nor “highly complex” institution.

In March, 2016, the FDIC issued a final rule to increase the DIF reserve ratio to the statutory minimum level of 1.35%, effective July 1, 2016, if the reserve ratio reached 1.15% before that date.

In August, 2016, the FDIC announced the DIF reserve ratio surpassed the 1.15% reserve ratio target, triggering three major changes:

(1) The decline in the range of initial assessment rates for all banks from 5-35 basis points to 3-30 basis points;

(2) The assessment of a quarterly surcharge on large banks equal to an annual rate of 4.5 basis points in addition to regular assessments; and

(3) A revised method to calculate risk-based assessment rates for established small banks (under $1 billion in assets) pursuant to an FDIC final rule issued April, 2016.

In September 2018, the FDIC issued a Financial Institutions Letter stating the Deposit Insurance Fund Reserve Ratio reached 1.36%, exceeding the statutorily required minimum reserve ratio of 1.35% ahead of the September 30, 2020, deadline required under the Dodd-Frank Act. FDIC regulations provide for two changes to deposit insurance assessments upon reaching the minimum: (1) surcharges on insured depository institutions with total consolidated assets of $10 billion or more (large banks) will cease; and (2) small banks will receive assessment credits for the portion of their assessments that contributed to the growth in the reserve ratio from between 1.15% and 1.35%, to be applied when the reserve ratio is at or above 1.38%. In January 2019, the Bank, which meets the definition of a “small Bank”, was advised by the FDIC its assessment credit to be applied when the reserve ratio is at or above 1.38% is $1.4 million which will reduce future assessment expenses. The Company cannot provide any assurance as to the effect of any future changes in its deposit insurance premium rates.

Community Reinvestment Act and Fair Lending Developments

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

Financial Privacy Legislation and Customer Information Security

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

U.S.A. PATRIOT Act

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

Sarbanes-Oxley Act of 2002

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

Sarbanes-Oxley includes very specific additional disclosure requirements and corporate governance rules, required the SEC and securities exchanges to adopt extensive additional disclosure, corporate governance and other related rules and mandates further studies of certain issues. Sarbanes-Oxley represents significant federal involvement in matters traditionally left to state regulatory systems, such as the regulation of the accounting profession, and to state corporate law, such as the relationship between a board of directors and management and between a board of directors and its committees and public company shareholders. Sarbanes-Oxley addresses, among other matters: (i) independent audit committees for reporting companies whose securities are listed on national exchanges or automated quotation systems 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 blackout periods; (v) disclosure of off-balance sheet transactions; (vi) a prohibition on personal loans to directors and officers under most circumstances with exceptions for certain normal course transactions by regulated financial institutions; (vii) expedited electronic filing requirements related to trading by insiders in an issuer's securities on Form 4; (viii) disclosure of a code of ethics and filing a Form 8-K for a change or waiver of such code; (ix) accelerated filing of periodic reports; (x) the formation of the Public Company Accounting Oversight Board ("PCAOB") to regulate public accounting firms and the audit of public companies that are subject to the securities laws; (xi) auditor independence; (xii) internal control evaluation and reporting; and (xiii) various increased criminal penalties for violations of securities laws.

Programs To Mitigate Identity Theft

In November 2007, federal banking agencies together with the National Credit Union Administration and Federal Trade Commission adopted regulations under the Fair and Accurate Credit Transactions Act of 2003 to require financial institutions and other creditors to develop and implement a written identity theft prevention program to detect, prevent and mitigate identity theft in connection with certain new and existing accounts. Covered accounts generally include consumer accounts and other accounts that present a reasonably foreseeable risk of identity theft. Each institution's program must include policies and procedures designed to: (i) identify indicators, or "red flags," of possible risk of identity theft; (ii) detect the occurrence of red flags; (iii) respond appropriately to red flags that are detected; and (iv) ensure that the program is updated periodically as appropriate to address changing circumstances. The regulations include guidelines that each institution must consider and, to the extent appropriate, include in its program.

Pending Legislation

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

Competition

The Bank’s principal competitors for deposits and loans are major banks and smaller community banks, savings and loan associations and credit unions. To a lesser extent, competitors include 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 offer investment vehicles that also compete with banks for deposit business. Federal legislation in recent years has encouraged competition between different types of financial institutions and fostered new entrants into the financial services market.

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

ITEM 1A. RISK FACTORS

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

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

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

Market and Interest Rate Risk

Changes in interest rates could reduce income and cash flow.

The Company’s income and cash flow depend to a great extent on the difference between the interest earned on loans and investment securities and the interest paid on deposits and other borrowings, and the Company’s success in competing for loans and deposits. The Company cannot control or prevent changes in the level of interest rates which fluctuate in response to general economic conditions, the policies of various governmental and regulatory agencies, in particular, the Federal Open Market Committee of the FRB, and pricing practices of the Company’s competitors. Changes in monetary policy, including changes in interest rates, will influence the origination of loans, the purchase of investments, the generation of deposits and other borrowings, and the rates received on loans and investment securities and paid on deposits and other liabilities. The discussion in this Report under “Item 7 Management’s Discussion and Analysis of Financial Condition and Results of Operations – Asset, Liability and Market Risk Management” and “- Liquidity and Funding” and “Item 7A Quantitative and Qualitative Disclosures About Market Risk” is incorporated by reference in this paragraph.

Changes in capital market conditions could reduce asset valuations.

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

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

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

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

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

Shares of Company common stock eligible for future sale or grant of stock options and other equity awards 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 26.7 million shares of common stock were outstanding at December 31, 2018. Pursuant to its stock option plans, at December 31, 2018, the Company had outstanding options for 946 thousand shares of common stock, of which 457 thousand were currently exercisable. As of December 31, 2018, 713 thousand shares of Company common stock remained available for grants under the Company's equity incentive plans. Sales of substantial amounts of Company common stock in the public market could adversely affect the market price of its common stock.

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

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

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

The Company repurchases and retires its common stock in accordance with Board of Directors-approved share repurchase programs. At December 31, 2018, approximately 1.8 million shares remained available to repurchase under such plans. The Company has been active in repurchasing and retiring shares of its common stock when alternative uses of excess capital, such as acquisitions, have been limited. The Company could repurchase shares of its common stock at price levels considered excessive, thereby spending more cash on such repurchases as deemed reasonable and effectively retiring fewer shares than would be retired if repurchases were effected at lower prices.

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

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

The risk that borrowers may not pay interest or repay their loans as agreed is an inherent risk of the banking business. The company mitigates this risk by adhering to sound and proven underwriting practices, managed by experienced and knowledgeable credit professionals. Nonetheless, the Company may incur losses on loans that meet its underwriting criteria, and these losses may exceed the amounts set aside as reserves. 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 or its results of operations.

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, 2018, real estate served as the principal source of collateral with respect to approximately 55% of the Company's loan portfolio. The Company's financial condition and operating results will be subject to changes in economic conditions in California. The California economy was severely affected by the recessionary period of 2008 to 2009. Much of the California real estate market experienced a decline in values of varying degrees. This decline had an adverse impact on the business of some of the Company's borrowers and on the value of the collateral for many of the Company's loans. Generally, the counties surrounding and near San Francisco Bay have recovered more soundly from the recent recession than counties in the California "Central Valley," from Sacramento in the north to Bakersfield in the south. Approximately 22% of the Company's loans are to borrowers in the California "Central Valley." Economic conditions in California's diverse geographic markets can be vastly different and are subject to various uncertainties, including the condition of the construction and real estate sectors, the effect of drought on the agricultural sector and its infrastructure, and the California state and municipal governments' budgetary and fiscal conditions. The Company can provide no assurance that conditions in any sector or geographic market of the California economy will not deteriorate in the future and that such deterioration will not adversely affect the

Company.

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

All of the properties of the Company are located in California. Also, most of the real and personal properties which currently secure a majority of the Company's loans are located in California. Further, the Company invests in securities issued by companies and municipalities operating throughout the United States, and in mortgage-backed securities collateralized by real property located throughout the United States. California and other regions of the United States are prone to earthquakes, brush and wildfires, flooding, drought and other natural disasters. In addition to possibly sustaining uninsured damage to its own properties, if there is a major earthquake, flood, drought, fire or other natural disaster, the Company faces the risk that many of its debtors may experience uninsured property losses, or sustained business or employment interruption and/or loss which may materially impair their ability to meet the terms of their debt obligations. A major earthquake, flood, prolonged drought, fire or other natural disaster in California or other regions of the United States could have a material adverse effect on the Company's business, financial condition, results of operations and cash flows.

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

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

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

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

The 2008 - 2009 financial crisis led to the failure or merger of a number of financial institutions. Financial institution failures can result in further losses as a consequence of defaults on securities issued by them and defaults under contracts entered into with such entities as counterparties. The failure of institutions with FDIC insured deposits can cause the DIF reserve ratio to decline, resulting in increased deposit insurance assessments on surviving FDIC insured institutions. Weak economic conditions can significantly weaken the strength and liquidity of financial institutions.

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

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

Regulatory Risks

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

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

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

The Company is subject to significant federal and state regulation and supervision, which is primarily for the benefit and protection of the Company's customers and not for the benefit of investors. In the past, the Company's business has been materially affected by these regulations.

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. Among the instruments of monetary policy available to the FRB are (a) conducting open market operations in U.S. government securities, (b) changing the discount rates of borrowings by depository institutions, (c) changing interest rates paid on balances financial institutions deposit with the FRB, and (d) imposing or changing reserve requirements against certain borrowings by banks and their affiliates. These methods are used in varying degrees and combinations to directly affect the availability of bank loans and deposits, as well as the interest rates charged on loans and paid on deposits. The policies of the FRB may have a material effect on the Company's business, results of operations and financial condition. Under long- standing policy of the FRB, a BHC is expected to act as a source of financial strength for its subsidiary banks. As a result of that policy, the Company may be required to commit financial and other resources to its subsidiary bank in circumstances where the Company might not otherwise do so.

Following the recessions of 2008 and 2009, the FRB provided vast amounts of liquidity into the banking system. The FRB purchased large quantities of U.S. government securities, including agency-backed mortgage securities, increasing the demand for such securities thereby reducing interest rates. Interest rates remained historically low through 2016 as the monetary policy of the Federal Open Market Committee (the "FOMC") was highly accommodative. The FRB began reducing these asset purchase activities in the fourth quarter 2013 and the FOMC began removing monetary stimulus in December 2016 and has increased the federal funds rate by 2.00 percent to 2.50 percent through December 2018. The raised target range for the federal funds rate could reduce liquidity in the markets and cause interest rates to rise, thereby increasing funding costs to the Bank, reducing the availability of funds to the Bank to finance its existing operations, and causing fixed-rate investment securities and loans to decline in value.

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

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

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. The FDIC may increase premium assessments to maintain adequate funding of the Deposit Insurance Fund.

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

Systems, Accounting and Internal Control Risks

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

The discussion under "Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Policies" in this Report and the information referred to in that discussion is incorporated by reference in this paragraph. The Company makes certain estimates and judgments in preparing its financial statements.

The quality and accuracy of those estimates and judgments will have an impact on the Company's operating results and financial condition.

A new accounting standard will significantly change the manner in which the Company recognizes credit losses and may have a material impact on the Company's results of operations, financial condition or liquidity.

In June 2016, the Financial Accounting Standards Board ("FASB") issued a new accounting update, FASB ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.* The ASU changes the accounting for estimates for credit losses related to financial assets measured at amortized cost and certain other contracts. The ASU replaces the currently incurred loss model with model based on current expected credit loss ("CECL"), which will accelerate recognition of credit losses. Additionally credit losses relating to debt securities available-for-sale will be recorded through an allowance for credit losses under the new standard. The Company will be required to adopt the ASU provisions on January 1, 2010. The ASU will significantly change the manner in which the Company determines the adequacy of its allowance for loan losses. The Company is evaluating the impact the CECL model will have, but the Company may recognize a one-time cumulative-effect adjustment to its allowance for loan losses as of the beginning of the first reporting period in which the new standard is effective. Any required adjustment to the allowance for loan losses resulting from this change in methodology will be accomplished through an offsetting after-tax-adjustment to shareholders' equity. Moreover, the CECL model may create more volatility in the level of the allowance for loan losses after adoption. If the Company is required to materially increase the level of its allowance for loan losses for any reason, such increase could adversely affect its business, financial condition and results of operations.

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

The Company relies heavily on communications and information systems, including those of third party vendors and other service providers, to conduct its business. Any failure, interruption or breach in security of these systems could result in failures or disruptions in the Company's data processing, accounting, customer relationship management and other systems. Communication and information systems failures can result from a variety of risks including, but not limited to, events that are wholly or partially out of the Company's control, such as telecommunication line integrity, weather, terrorist acts, natural disasters, accidental disasters, unauthorized breaches of security systems, energy delivery systems, cyber attacks, and other events. Although the Company devotes significant resources to maintain and regularly upgrade its systems and processes that are designed to protect the security of the Company's computer systems, software, networks and other technology assets and the confidentiality, integrity and availability of information belonging to the Company and its customers, there is no assurance that any such failures, interruptions or security breaches will not occur or, if they do occur, that they will be adequately corrected by the Company or its vendors. The occurrence of any such failures, interruptions or security breaches could damage the Company's reputation, result in a loss of customer business, subject the Company to additional regulatory scrutiny, or expose the Company to litigation and possible financial liability, any of which could have a material adverse effect on the Company's financial condition and results of operations.

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

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

ITEM 1B. UNRESOLVED STAFF COMMENTS

None

ITEM 2. PROPERTIES

Branch Offices and Facilities

Westamerica Bank is engaged in the banking business through 80 branch offices in 21 counties in Northern and Central California. WAB believes all of its offices are constructed and equipped to meet prescribed security requirements.

The Company owns 28 banking office locations and one centralized administrative service center facility and leases 58 facilities. Most of the leases contain renewal options and provisions for rental increases, principally for changes in the cost of living index, and for changes in other operating costs such as property taxes and maintenance.

ITEM 3. LEGAL PROCEEDINGS

Due to the nature of its business, the Company is subject to various threatened or filed legal cases. Based on the advice of legal counsel, the Company does not expect such cases will have a material, adverse effect on its financial position or results of operations. Legal liabilities are accrued when obligations become probable and the amount can be reasonably estimated. In the third quarter 2018, the Company achieved a mediated settlement to dismiss a lawsuit, subject to court approval, and accrued a liability for $3,500 thousand.

The Company has determined that it will be obligated to provide refunds of revenue recognized in years prior to 2017 to some customers. The Company estimates the probable amount of these obligations will be $5,542 thousand and accrued a liability for such amount in 2017; the estimated liability is subject to revision.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable

PART II

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

The Company's common stock is traded on the NASDAQ Stock 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
2018:		
First quarter	$62.52	$55.72
Second quarter	60.68	55.81
Third quarter	64.52	57.56
Fourth quarter	63.20	52.75
2017:		
First quarter	$64.07	$54.12
Second quarter	57.78	51.31
Third quarter	59.54	49.54
Fourth quarter	63.03	53.96

As of January 31, 2019, there were approximately 5,500 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. See Item 8, Financial Statements and Supplementary Data, Note 20 to the consolidated financial statements for recent quarterly dividend information. 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."

The notes to the consolidated financial statements included in this Report contain additional information regarding the Company's capital levels, capital structure, 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.

[The remainder of this page intentionally left blank]

Stock performance

The following chart compares the cumulative return on the Company’s stock during the ten years ended December 31, 2018 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, 2008 and reinvestment of all dividends.

	December 31,					
	2008	2009	2010	2011	2012	2013
Westamerica Bancorporation (WABC)	$100.00	$111.42	$114.64	$93.54	$93.76	$128.29
S&P 500 (SPX)	100.00	126.47	145.55	148.59	172.34	228.11
NASDAQ Bank Index (CBNK)	100.00	83.71	95.57	85.53	101.55	143.89

	December 31,				
	2014	2015	2016	2017	2018
Westamerica Bancorporation (WABC)	$114.86	$109.95	$152.39	$143.47	$134.59
S&P 500 (SPX)	259.26	257.61	288.10	343.35	322.05
NASDAQ Bank Index (CBNK)	150.96	161.07	221.80	228.93	188.40

[The remainder of this page intentionally left blank]

The following chart compares the cumulative return on the Company's stock during the five years ended December 31, 2018 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, 2013 and reinvestment of all dividends.

	December 31,					
	2013	2014	2015	2016	2017	2018
Westamerica Bancorporation (WABC)	$100.00	$89.53	$85.71	$118.79	$111.83	$104.91
S&P 500 (SPX)	100.00	113.65	112.93	126.30	150.52	141.18
NASDAQ Bank Index (CBNK)	100.00	104.91	111.94	154.15	159.10	130.93

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, 2018 (in thousands, except per share data).

	2018			
Period	(a) Total Number of shares Purchased	(b) Average Price Paid per Share	(c) 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
	(In thousands, except exercise price)			
October 1 through October 31	-	$ -	-	1,750
November 1 through November 30	-	-	-	1,750
December 1 through December 31	-	-	-	1,750
Total	-	$ -	-	1,750

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 under stock option plans, and other ongoing requirements.

No shares were repurchased during the period from October 1, 2018 through December 31, 2018. A program approved by the Board of Directors on July 26, 2018 authorizes the purchase of up to 1,750 thousand shares of the Company's common stock from time to time prior to September 1, 2019.

[The remainder of this page intentionally left blank]

ITEM 6. SELECTED FINANCIAL DATA

The following financial information for the five years ended December 31, 2018 has been derived from the Company's audited consolidated financial statements. This information should be read in conjunction with those statements, notes and other information included elsewhere herein.

WESTAMERICA BANCORPORATION

FINANCIAL SUMMARY

	For the Years Ended December 31,				
	2018	2017	2016	2015	2014
	(In thousands, except per share data and ratios)				
Interest and loan fee income	$151,723	$138,312	$135,919	$136,529	$140,209
Interest expense	1,959	1,900	2,116	2,424	3,444
Net interest and loan fee income	149,764	136,412	133,803	134,105	136,765
(Reversal of) provision for loan losses	-	(1,900)	(3,200)	-	2,800
Noninterest income:					
Equity securities (losses) gains	(52)	7,955	-	-	-
Other noninterest income	48,201	48,673	46,574	47,867	51,787
Total noninterest income	48,149	56,628	46,574	47,867	51,787
Noninterest expense:					
Loss contingency	3,500	5,542	3	-	-
Other noninterest expense	103,416	102,226	103,617	105,300	106,799
Total noninterest expense	106,916	107,768	103,620	105,300	106,799
Income before income taxes	90,997	87,172	79,957	76,672	78,953
Income tax provision	19,433	37,147	21,104	17,919	18,307
Net income	$71,564	$50,025	$58,853	$58,753	$60,646
Average common shares outstanding	26,649	26,291	25,612	25,555	26,099
Average diluted common shares outstanding	26,756	26,419	25,678	25,577	26,160
Common shares outstanding at December 31,	26,730	26,425	25,907	25,528	25,745
Per common share:					
Basic earnings	$2.69	$1.90	$2.30	$2.30	$2.32
Diluted earnings	2.67	1.89	2.29	2.30	2.32
Book value at December 31,	23.03	22.34	21.67	20.85	20.45
Financial ratios:					
Return on assets	1.27%	0.92%	1.12%	1.16%	1.22%
Return on common equity	11.35%	8.39%	10.85%	11.32%	11.57%

Net interest margin (FTE)[1]	2.98 %	2.95 %	3.03 %	3.36 %	3.70 %
Net loan losses to average loans	0.14 %	0.08 %	0.04 %	0.11 %	0.17 %
Efficiency ratio[2]	52.52 %	52.51 %	53.55 %	53.69 %	52.24 %
Equity to assets	11.05 %	10.71 %	10.46 %	10.30 %	10.46 %
Period end balances:					
Assets	$5,568,526	$5,513,046	$5,366,083	$5,168,875	$5,035,724
Loans	1,207,202	1,287,982	1,352,711	1,533,396	1,700,290
Allowance for loan losses	21,351	23,009	25,954	29,771	31,485
Investment securities	3,641,026	3,352,371	3,237,070	2,886,291	2,639,439
Deposits	4,866,839	4,827,613	4,704,741	4,540,659	4,349,191
Identifiable intangible assets and goodwill	123,602	125,523	128,600	132,104	135,960
Short-term borrowed funds	51,247	58,471	59,078	53,028	89,784
Federal Home Loan Bank advances	-	-	-	-	20,015
Shareholders' equity	615,591	590,239	561,367	532,205	526,603
Capital ratios at period end:					
Total risk based capital	17.03 %	16.17 %	15.95 %	13.39 %	14.54 %
Tangible equity to tangible assets	9.04 %	8.63 %	8.26 %	7.94 %	7.97 %
Dividends paid per common share	$1.60	$1.57	$1.56	$1.53	$1.52
Common dividend payout ratio	60 %	83 %	68 %	67 %	66 %

(1) 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.

(2) The efficiency ratio is defined as noninterest expense divided by total revenue (net interest income on an FTE basis and noninterest income).

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

The following discussion addresses information pertaining to the financial condition and results of operations of Westamerica Bancorporation and subsidiaries (the "Company") that may not be otherwise apparent from a review of the consolidated financial statements and related footnotes. It should be read in conjunction with those statements and notes found on pages 48 through 90, as well as with the other information presented throughout this Report.

Critical Accounting Policies

The Company's consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America and follow general practices within the banking industry. Application of these principles requires the Company to make certain estimates, assumptions, and judgments that affect the amounts reported in the financial statements and accompanying notes. These estimates, assumptions, and judgments are based on information available as of the date of the financial statements; accordingly, as this information changes, the financial statements could reflect different estimates, assumptions, and judgments. Certain accounting policies inherently have a greater reliance on the use of estimates, assumptions and judgments and as such have a greater possibility of producing results that could be materially different than originally reported. Estimates, assumptions and judgments are necessary when assets and liabilities are required to be recorded at fair value, when a decline in the value of an asset not carried on the financial statements at fair value warrants an impairment writedown or valuation reserve to be established, or when an asset or liability needs to be recorded contingent upon a future event. Carrying assets and liabilities at fair value inherently results in more financial statement volatility. The fair values and the information used to record valuation adjustments for certain assets and liabilities are based either on quoted market prices or are provided by other third-party sources, when available.

The 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 area requiring the most subjective or complex judgments, and as such could be most subject to revision as new information becomes available. A discussion of the factors affecting accounting for the allowance for loan losses and purchased loans is included in the "Loan Portfolio Credit Risk" discussion below.

Financial Overview

Westamerica Bancorporation and subsidiaries' (collectively, the "Company") reported net income of $71.6 million or $2.67 diluted earnings per common share ("EPS") in 2018. The 2018 results include a $585 thousand tax-exempt life insurance policy gain and a $3.5 million loss contingency settlement, which on an aggregate basis reduced EPS $0.07. In 2018, the Company achieved a mediated settlement to dismiss a lawsuit, subject to court approval, and accrued a liability for such amount. The 2018 results compare to net income of $50.0 million or $1.89 EPS for the year ended December 31, 2017 and net income of $58.9 million or $2.29 EPS for the year ended December 31, 2016. The 2017 results include $12.3 million in adjustments to net deferred tax asset values triggered by enactment of the Tax Cuts and Jobs Act of 2017 (the "Act") which reduced EPS $0.48, recognition of a $5.5 million loss contingency, which reduced EPS $0.12, and securities gains of $8.0 million, which increased EPS $0.18.

The Company's principal source of revenue is net interest and loan fee income, which represents interest and fees earned on loans and investment securities ("earning assets") reduced by interest paid on deposits and other borrowings ("interest-bearing liabilities"). Market interest rates declined considerably following the recession of 2008 and 2009. Interest rates remained historically low through 2016 as the monetary policy of the Federal Open Market Committee (the "FOMC") was highly accommodative. During this period, Management avoided originating long-dated, low-yielding loans given the potential impact of such assets on forward earning potential; as a result, loans declined and investment securities increased. The changed composition of the earning assets and low market interest rates pressured the net interest margin to lower levels. The FOMC began removing monetary stimulus in December 2016 and has increased the federal funds rate by 2.00 percent to 2.50 percent through December 2018, although longer-term rates have not increased by a similar magnitude. This recent increase in market interest rates has begun benefiting the Company's earning asset yields. However, the rising market rates have not resulted in higher rates paid on deposits. The funding source of the Company's earning assets is primarily customer deposits. The Company's long-term strategy includes maximizing checking and savings deposits as these types of deposits are lower-cost and less sensitive to changes in interest rates compared to time deposits. The 2018 average volume of checking and savings deposits was 95 .6 percent of average total deposits.

Credit quality remained solid with nonperforming assets totaling $5.8 million at December 31, 2018 and net chargeoffs of $1.7 million in 2018. The Company did not recognize a provision for loan losses in 2018.

The Company presents its net interest margin and net interest income on an FTE basis using the current statutory federal tax rate. Management believes the FTE basis is valuable to the reader because the Company's loan and investment securities portfolios contain a relatively large portion of municipal loans and securities that are federally tax exempt. The Company's tax exempt loans and securities composition may not be similar to that of other banks, therefore in order to reflect the impact of the federally tax exempt loans and securities on the net interest margin and net interest income for comparability with other banks, the Company presents its net interest margin and net interest income on an FTE basis. Yields on tax-exempt securities and loans have been adjusted upward to reflect the effect of income exempt from federal income taxation at the federal statutory tax rate of 35% for 2017 and 2016. Due to the Act, the federal tax rate became 21% for 2018; as such, the upward adjustment to reflect the effect of income exempt from federal taxation is lower in 2018.

The Company's significant accounting policies (see Note 1 "Summary of Significant Accounting Policies" to the Consolidated Financial Statements below) are fundamental to understanding the Company's results of operations and financial condition. The Company adopted the FASB ASU 2016-09, *Improvements to Employee Share-Based Payment Accounting* effective January 1, 2017. The 2018 and 2017 results reflect the Company's prospective adoption of ASU 2016-09; the 2018 and 2017 income tax provision was $737 thousand and $698 thousand, respectively, lower than would have been under accounting standards prior to the adoption of ASU 2016-09.

Net Income

Following is a summary of the components of net income for the periods indicated:

	For the Years Ended December 31,		
	2018	2017	2016
	($ in thousands, except per share data)		
Net interest and loan fee income	$149,764	$136,412	$133,803
FTE adjustment	5,646	12,182	13,142
Net interest and loan fee income (FTE)	155,410	148,594	146,945
Reversal of (provision for) loan losses	-	1,900	3,200
Noninterest income	48,149	56,628	46,574
Noninterest expense	(106,916)	(107,768)	(103,620)
Income before income taxes (FTE)	96,643	99,354	93,099
Income taxes (FTE)	(25,079)	(49,329)	(34,246)
Net income	$71,564	$50,025	$58,853
Net income per average fully-diluted common share	$2.67	$1.89	$2.29

Net income as a percentage of average shareholders' equity	11.35 %	8.39 %	10.85 %
Net income as a percentage of average total assets	1.27 %	0.92 %	1.12 %

Comparing 2018 with 2017, net income increased $21.5 million. Net interest and loan fee income increased in 2018 compared with 2017 mostly attributable to higher average balances of investments and higher yields on earning assets as market interest rates rose. The increase was offset by lower average balances of loans. Net interest and loan fee income (FTE) in 2018 included a lower FTE adjustment than in 2017 due to the reduced federal corporate tax as a result of enactment of the Act. The provision for loan losses remained zero, reflecting Management's evaluation of losses inherent in the loan portfolio. In 2018, noninterest income decreased $8.5 million compared with 2017 because 2017 results included $8.0 million in gains of sale of securities. The non-FTE book tax provision for 2018, which reflected the tax-exempt nature of a $585 thousand life insurance policy gain, was $19.4 million compared with $37.1 million for 2017, representing effective tax rates of 21.4% and 42.6%, respectively. The non-FTE book tax provision for 2017 includes $12.3 million in adjustments to net deferred tax asset values triggered by enactment of the Act. The federal statutory tax rate was reduced from 35% in 2017 to 21% in 2018 due to the Act. The non-FTE book tax provisions for 2018 and 2017 include tax benefits of $737 thousand and $698 thousand, respectively, for tax deductions from the exercise of employee stock options which exceed related compensation expenses recognized in the financial statements.

Comparing 2017 with 2016, net income decreased $8.8 million. Net interest and loan fee income increased in 2017 compared with 2016 mostly attributable to higher average balances of investments and higher net yield on taxable investments and interest-bearing cash, offset by lower average balances of loans and lower yields on those loans. The Company recorded a $1.9 million reversal of provision for loan losses in 2017 and a $3.2 million reversal of provision for loan losses in 2016, reflecting Management's evaluation of losses inherent in the loan portfolio. Noninterest income increased in 2017 compared with 2016 because 2017 included $8.0 million in gains on sale of securities and higher income from merchant processing services, partially offset by lower service charges on deposit accounts. Noninterest expense increased due to a $5.5 million loss contingency and an impairment charge of tax credit investments, partially offset by reductions in professional fees. The non-FTE tax book provision for 2017 was higher than in 2016 primarily due to a $12.3 million charge to re-measure the Company’s net deferred tax asset triggered by enactment of the Act. The 2017 income tax provision was $698 thousand lower than it would have been under accounting standards prior to the adoption of ASU 2016-09.

Net Interest and Loan Fee Income (FTE)

The Company's primary source of revenue is net interest income, or the difference between interest income earned on loans and investment securities and interest expense paid on interest-bearing deposits and other borrowings.

Components of Net Interest and Loan Fee Income (FTE)

	For the Years Ended December 31,		
	2018	2017	2016
	($ in thousands)		
Interest and loan fee income	$151,723	$138,312	$135,919
Interest expense	(1,959)	(1,900)	(2,116)
Net interest and loan fee income	149,764	136,412	133,803
FTE adjustment	5,646	12,182	13,142
Net interest and loan fee income (FTE)	$155,410	$148,594	$146,945
Net interest margin (FTE)	2.98 %	2.95 %	3.03 %

Comparing 2018 with 2017, net interest and loan fee income increased $13.4 million due to higher average balances of investments (up $270 million) and higher yield on interest earning assets (up 0.03%), offset by lower average balances of loans (down $106 million). The FTE adjustment was lower in 2018 compared with 2017 mainly due to the reduced federal corporate tax rate as a result of enactment of the Act.

Comparing 2017 with 2016, net interest and loan fee income increased $2.6 million mostly due to higher average balances of investments (up $255 million) and higher yield on taxable investments (up 0.13%) and interest-bearing cash (up 0.59%), offset by lower average balances of loans (down $109 million) and lower net yield on those loans (down 0.16%).

The yield on earning assets (FTE) was 3.02% in 2018 and 2.99% in 2017, 3.08% in 2016. The 2018 yield on earning assets (FTE) reflected higher market interest rates which offset the impact of the reduced FTE adjustment.

The Company’s funding cost was 0.04% in 2018 compared with 0.04% in 2017 and 0.05% in 2016. Average balances of time deposits declined $58 million from 2016 to 2018 while lower-cost checking and savings deposits grew 8% in the same period. Average balances of checking and saving deposits accounted for 95.6% of average total deposits in 2018 compared with 94.8% in 2017 and 94.1% in 2016.

[The remainder of this page intentionally left blank]

Summary of Average Balances, Yields/Rates and Interest Differential

The following tables present information regarding the consolidated average assets, liabilities and shareholders' equity, the amounts of interest income earned from average interest earning assets and the resulting yields, and the amounts of interest expense incurred on average interest-bearing liabilities and the resulting rates. Average loan balances include nonperforming loans. Interest income includes reversal of previously accrued interest on loans placed on non-accrual status during the period and proceeds from loans on nonaccrual status only to the extent cash payments have been received and applied as interest income and accretion of purchased loan discounts. Yields on tax-exempt securities and loans have been adjusted upward to reflect the effect of income exempt from federal income taxation at the federal statutory tax rate of 35 percent for 2016 and 2017. Due to the Tax Cuts and Jobs Act of 2017, the federal tax rate is 21 percent for 2018; as such, the upward adjustment to reflect the effect of income exempt from federal taxation is lower in 2018.

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

	For the Year Ended December 31, 2018		
	Average Balance	Interest Income/ Expense	Yields/ Rates
	($ in thousands)		
Assets			
Investment securities:			
Taxable	$2,830,075	$65,330	2.31%
Tax-exempt (1)	747,522	24,610	3.29%
Total investments (1)	3,577,597	89,940	2.51%
Loans:			
Taxable	1,153,549	57,240	4.96%
Tax-exempt (1)	55,618	2,264	4.07%
Total loans (1)	1,209,167	59,504	4.92%
Total interest bearing cash	425,871	7,925	1.86%
Total interest-earning assets (1)	5,212,635	157,369	3.02%
Other assets	407,983		
Total assets	$5,620,618		
Liabilities and shareholders' equity			
Noninterest-bearing demand	$2,209,924	$-	- %
Savings and interest-bearing transaction	2,447,652	1,275	0.05%
Time less than $100,000	119,586	279	0.23%
Time $100,000 or more	94,919	368	0.39%
Total interest-bearing deposits	2,662,157	1,922	0.07%
Short-term borrowed funds	59,992	37	0.06%
Total interest-bearing liabilities	2,722,149	1,959	0.07%

Other liabilities	57,848		
Shareholders' equity	630,697		
Total liabilities and shareholders' equity	$5,620,618		
Net interest spread [1] [2]			2.95%
Net interest and fee income and interest margin [1] [3]		$155,410	2.98%

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

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

(3) Net interest margin is computed by calculating the difference between interest income and expense, divided by the average balance of interest-earning assets. The net interest margin is greater than the net interest spread due to the benefit of noninterest-bearing demand deposits.

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

	For the Year Ended December 31, 2017		
	Average Balance	Interest Income/ Expense	Yields/ Rates
	($ in thousands)		
Assets			
Investment securities:			
Taxable	$2,498,001	$51,445	2.06%
Tax-exempt (1)	809,136	31,737	3.92%
Total investments (1)	3,307,137	83,182	2.52%
Loans:			
Taxable	1,252,474	59,700	4.77%
Tax-exempt (1)	62,728	3,136	5.00%
Total loans (1)	1,315,202	62,836	4.78%
Total interest bearing cash	406,034	4,476	1.10%
Total interest-earning assets (1)	5,028,373	150,494	2.99%
Other assets	411,309		
Total assets	$5,439,682		
Liabilities and shareholders' equity			
Noninterest-bearing demand	$2,095,522	$-	- %
Savings and interest-bearing transaction	2,380,841	1,123	0.05%
Time less than $100,000	136,324	318	0.23%
Time $100,000 or more	109,563	415	0.38%
Total interest-bearing deposits	2,626,728	1,856	0.07%
Short-term borrowed funds	69,671	44	0.06%
Total interest-bearing liabilities	2,696,399	1,900	0.07%
Other liabilities	51,405		
Shareholders' equity	596,356		
Total liabilities and shareholders' equity	$5,439,682		
Net interest spread (1) (2)			2.92%
Net interest and fee income and interest margin (1) (3)		$148,594	2.95%

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

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

(3) Net interest margin is computed by calculating the difference between interest income and expense, divided by the average balance of interest-earning assets. The net interest margin is greater than the net interest spread due to the benefit of noninterest-bearing demand deposits.

[The remainder of this page intentionally left blank]

-24-

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

	For the Year Ended December 31, 2016		
	Average Balance	Interest Income/ Expense	Yields/ Rates
	($ in thousands)		
Assets			
Investment securities:			
Taxable	$2,212,234	$42,718	1.93%
Tax-exempt [1]	840,262	34,103	4.06%
Total investments [1]	3,052,496	76,821	2.52%
Loans:			
Taxable	1,356,417	66,842	4.93%
Tax-exempt [1]	67,842	3,530	5.20%
Total loans [1]	1,424,259	70,372	4.94%
Total interest bearing cash	365,243	1,868	0.51%
Total interest-earning assets [1]	4,841,998	149,061	3.08%
Other assets	404,146		
Total assets	$5,246,144		
Liabilities and shareholders' equity			
Noninterest-bearing demand	$2,026,939	$-	- %
Savings and interest-bearing transaction	2,290,640	1,166	0.05%
Time less than $100,000	154,022	402	0.26%
Time $100,000 or more	118,750	509	0.43%
Total interest-bearing deposits	2,563,412	2,077	0.08%
Short-term borrowed funds	61,276	39	0.06%
Total interest-bearing liabilities	2,624,688	2,116	0.08%
Other liabilities	52,216		
Shareholders' equity	542,301		
Total liabilities and shareholders' equity	$5,246,144		
Net interest spread [1] [2]			3.00%
Net interest and fee income and interest margin [1] [3]		$146,945	3.03%

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

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

(3) Net interest margin is computed by calculating the difference between interest income and expense, divided by the average balance of interest-earning assets. The net interest margin is greater than the net interest spread due to the benefit of noninterest-bearing demand deposits.

[The remainder of this page intentionally left blank]

-25-

Summary of Changes in Interest Income and Expense due to Changes in Average Asset & Liability Balances and Yields Earned & Rates Paid

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

Summary of Changes in Interest Income and Expense

	For the Year Ended December 31, 2018 Compared with For the Year Ended December 31, 2017		
	Volume	Yield/Rate	Total
	(In thousands)		
Increase (decrease) in interest and loan fee income:			
Investment securities:			
Taxable	$6,839	$ 7,046	$13,885
Tax-exempt [(1)]	(2,417)	(4,710)	(7,127)
Total investments [(1)]	4,422	2,336	6,758
Loans:			
Taxable	(4,715)	2,255	(2,460)
Tax-exempt [(1)]	(355)	(517)	(872)
Total loans [(1)]	(5,070)	1,738	(3,332)
Total interest bearing cash	219	3,230	3,449
Total (decrease) in interest and loan fee income [(1)]	(429)	7,304	6,875
Increase (decrease) in interest expense:			
Deposits:			
Savings and interest-bearing transaction	32	120	152
Time less than $100,000	(39)	-	(39)
Time $100,000 or more	(55)	8	(47)
Total interest-bearing deposits	(62)	128	66
Short-term borrowed funds	(7)	-	(7)
Total (decrease) increase in interest expense	(69)	128	59
(Decrease) increase in net interest and loan fee income [(1)]	$(360)	$ 7,176	$6,816

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

[The remainder of this page intentionally left blank]

-26-

Summary of Changes in Interest Income and Expense

	For the Year Ended December 31, 2017 Compared with For the Year Ended December 31, 2016		
	Volume	Yield/Rate	Total
	(In thousands)		
Increase (decrease) in interest and loan fee income:			
Investment securities:			
Taxable	$5,518	$ 3,209	$8,727
Tax-exempt [1]	(1,263)	(1,103)	(2,366)
Total investments [1]	4,255	2,106	6,361
Loans:			
Taxable	(5,118)	(2,024)	(7,142)
Tax-exempt [1]	(266)	(128)	(394)
Total loans [1]	(5,384)	(2,152)	(7,536)
Total interest bearing cash	209	2,399	2,608
Total (decrease) increase in interest and loan fee income [1]	(920)	2,353	1,433
Increase (decrease) in interest expense:			
Deposits:			
Savings and interest-bearing transaction	46	(89)	(43)
Time less than $100,000	(46)	(38)	(84)
Time $100,000 or more	(39)	(55)	(94)
Total interest-bearing deposits	(39)	(182)	(221)
Short-term borrowed funds	5	-	5
Total decrease in interest expense	(34)	(182)	(216)
(Decrease) increase in net interest and loan fee income [1]	$(886)	$ 2,535	$1,649

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

Provision for Loan Losses

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

The Company provided no provision for loan losses in 2018. The Company recorded a reversal of the provision for loan losses of $1.9 million in 2017 and $3.2 million in 2016. Classified loans declined $9.3 million (which included nonperforming loans of $4.9 million) in 2018. The provision for loan losses was zero in 2018, reflecting Management's evaluation of losses inherent in the loan portfolio. At December 31, 2018, the Company had $5.7 million in residential real estate secured loans which are indemnified from loss by the FDIC up to eighty percent of principal; the indemnification expired February 6, 2019. For further information regarding credit risk, net credit losses and the allowance for loan losses, see the "Loan Portfolio Credit Risk" and "Allowance for Loan Losses" sections of this Report.

[The remainder of this page intentionally left blank]

Noninterest Income

Components of Noninterest Income

	For the Years Ended December 31,		
	2018	2017	2016
	(In thousands)		
Service charges on deposit accounts	$18,508	$19,612	$20,854
Merchant processing services	9,630	8,426	6,377
Debit card fees	6,643	6,421	6,290
Trust fees	2,938	2,875	2,686
ATM processing fees	2,752	2,610	2,411
Other service fees	2,567	2,584	2,571
Life insurance gains	585	-	-
Financial services commissions	499	639	568
Equity securities (losses) gains	(52)	7,955	-
Other noninterest income	4,079	5,506	4,817
Total Noninterest Income	$48,149	$56,628	$46,574

In 2018, noninterest income decreased $8.5 million compared with 2017 primarily because 2017 results included $8.0 million in gains on sale of securities. Service charges on deposit accounts decreased $1.1 million due to declines in fees for overdrafts, checking accounts and analyzed accounts. The decreases in other noninterest income were partially offset by an increase in merchant processing services fees of $1.2 million due to successful sales efforts and higher transaction volumes and a $585 thousand life insurance gain in 2018.

In 2017, noninterest income increased $10.1 million compared with 2016 mainly due to $8.0 million in gains on sale of securities. Merchant processing services fees increased $2.0 million due to successful sales efforts and higher transaction volumes. ATM processing fees and debit card fees increased $199 thousand and $131 thousand, respectively, primarily due to increased transaction volumes. Trust fees increased $189 thousand due to successful sales efforts. Offsetting the increase were service charges on deposits which decreased $1.2 million due to declines in fees charged on overdrawn and insufficient funds accounts (down $1.0 million) and lower fees on analyzed accounts (down $220 thousand).

Noninterest Expense

Components of Noninterest Expense

	For the Years Ended December 31,		
	2018	2017	2016
	(In thousands)		
Salaries and related benefits	$53,007	$51,519	$51,507
Occupancy and equipment	19,679	19,430	19,017
Outsourced data processing services	9,229	9,035	8,505
Loss contingency	3,500	5,542	3
Professional fees	2,842	2,161	3,980
Amortization of identifiable intangibles	1,921	3,077	3,504
Courier service	1,779	1,732	1,952
Impairment of tax credit investments	-	625	-
Other noninterest expense	14,959	14,647	15,152
Total Noninterest Expense	$106,916	$107,768	$103,620

In 2018, noninterest expense decreased $852 thousand compared with 2017. The 2018 noninterest expense included a $3.5 million mediated settlement to dismiss a lawsuit, subject to court approval. The 2017 noninterest expense included a $5.5 million loss contingency and a $625 thousand impairment of low income housing limited partnership investments due to enactment of the Act. The 2017 loss contingency represents the Company’s estimated refunds to customers of revenue recognized in prior years. Salaries and related benefits increased $1.5 million primarily due to the annual merit increase cycle and higher incentives and employee benefit costs. Professional fees increased $681 thousand due to higher legal and consulting fees. Amortization of intangibles decreased $1.2 million as assets are amortized on a declining balance method.

In 2017, noninterest expense increased $4.1 million compared with 2016. The 2017 noninterest expense included a $5.5 million loss contingency and a $625 thousand impairment of low income housing limited partnership investments due to enactment of the Act. The loss contingency represents the Company's estimated refunds to customers of revenue recognized in prior years. Expenses for occupancy and equipment increased $413 thousand due to technology upgrades. Outsourced data processing services expense increased $530 thousand primarily due to additional processing services. Professional fees decreased $1.8 million due to lower legal fees associated with nonperforming assets. Amortization of intangibles decreased $427 thousand as assets are amortized on a declining balance method. Other noninterest expense decreased $505 thousand primarily due to lower insurance premiums.

Provision for Income Tax

The Company's income tax provision was $19.4 million in 2018 compared with $37.1 million in 2017 and $21.1 million in 2016, representing effective tax rates of 21.4%, 42.6% and 26.4%, respectively. The 2017 income tax provision included a $12.3 million charge to re-measure the Company's net deferred tax asset triggered by enactment of the Tax Cuts and Jobs Act of 2017. The book tax provisions for 2018 and 2017 include tax benefits of $737 thousand and $698 thousand, respectively, for tax deductions from the exercise of employee stock options which exceed related compensation expenses recognized in the financial statements. The lower effective tax rate for 2018 reflects a reduction in the federal corporate tax rate as a result of enactment of the Act and the tax-exempt nature of a $585 thousand life insurance policy gain.

Investment Securities Portfolio

The Company maintains an investment securities portfolio consisting of securities issued by the U.S. Treasury, U.S. Government sponsored entities, agency and non-agency mortgage backed securities, state and political subdivisions, corporations, and other securities.

Management has increased the investment securities portfolio in response to deposit growth and loan volume declines. The average carrying value of the Company's investment securities portfolio was $3.6 billion for the year ended December 31, 2018 compared with $3.4 billion for the year ended December 31, 2017.

Management continually evaluates the Company's investment securities portfolio in response to established asset/liability management objectives, changing market conditions that could affect profitability, liquidity, and the level of interest rate risk to which the Company is exposed. These evaluations may cause Management to change the level of funds the Company deploys into investment securities and change the composition of the Company's investment securities portfolio. In the year ended December 31, 2018, Management increased the holdings of corporate securities in order to improve yields without extending the duration of the bond portfolio.

At December 31, 2018, substantially all of the Company's investment securities continue to be investment grade rated by one or more major rating agencies. In addition to monitoring credit rating agency evaluations, Management performs its own evaluations regarding the credit worthiness of the issuer or the securitized assets underlying asset-backed securities. The Company's procedures for evaluating investments in securities are in accordance with guidance issued by the Board of Governors of the Federal Reserve System, "Investing in Securities without Reliance on Nationally Recognized Statistical Rating Agencies" (SR 12-15) and other regulatory guidance. There have been no significant differences in the Company's internal analyses compared with the ratings assigned by the third party credit rating agencies.

During the third quarter 2018, the Atlantic hurricane season caused severe damage within many U.S. states. Management evaluated investment security exposures within the counties receiving disaster designations. The Company's exposures are limited to municipal bond and utility provider corporate debt from issuers within South Carolina counties, the state of North Carolina and the Florida panhandle, and has determined that the storms had no material impact on the valuation of its investment securities.

Effective January 1, 2018, upon adoption of ASU 2016-01, equity securities included in the Company's available for sale portfolio of $1,800 thousand were reclassified to equity securities. The reclassification of equity securities resulted in recording a cumulative effect adjustment to decrease retained earnings by $142 thousand, net of tax.

At December 31, 2018, the market value of equity securities was $1,747 thousand. During the year ended December 31, 2018, the Company recognized gross unrealized holding losses of $52 thousand in earnings.

The following table shows the fair value carrying amount of the Company's equity securities and debt securities available for sale as of the dates indicated:

	At December 31,		
	2018	2017	2016
	(In thousands)		
Equity securities:			
Mutual funds	$1,747	$1,800	$1,815
FHLMC[1] and FNMA stock[2]	-	-	10,869
Other securities	-	-	656
Total equity securities	1,747	1,800	13,340
Debt securities available for sale:			
U.S. Treasury securities	139,574	-	-
Securities of U.S. Government sponsored entities	164,018	119,319	138,660
Agency residential mortgage-backed securities (MBS)	853,871	767,706	691,499
Non-agency residential MBS	114	154	271
Agency commercial MBS	1,842	2,219	-
Securities of U.S. Government entities	1,119	1,590	2,025
Obligations of states and political subdivisions	179,091	185,221	183,411
Asset-backed securities	-	-	695
Corporate securities	1,315,041	1,115,498	860,857
Total debt securities available for sale	2,654,670	2,191,707	1,877,418
Total	$2,656,417	$2,193,507	$1,890,758

(1) Federal Home Loan Mortgage Corporation

(2) Federal National Mortgage Association

The following table sets forth the relative maturities and contractual yields of the Company's debt securities available for sale (stated at fair value) at December 31, 2018. Yields on state and political subdivision securities have been calculated on a fully taxable equivalent basis using the current federal statutory rate. Mortgage-backed securities are shown separately because they are typically paid in monthly installments over a number of years.

Debt Securities Available for Sale Maturity Distribution

	At December 31, 2018					
	Within one year	After one but within five years	After five but within ten years	After ten years	Mortgage-backed	Total

	($ in thousands)					
U.S. Treasury securities	$139,574	$-	$-	$-	$-	$139,574
Interest rate	2.33 %	- %	- %	- %	- %	2.33 %
Securities of U.S. Government sponsored entities	990	163,028	-	-	-	164,018
Interest rate	2.00 %	2.28 %	- %	- %	- %	2.28 %
Securities of U.S. Government entities	-	-	1,119	-	-	1,119
Interest rate	- %	- %	3.49 %	- %	- %	3.49 %
Obligations of states and political subdivisions	17,774	39,589	84,758	36,970	-	179,091
Interest rate	2.61 %	4.27 %	4.34 %	2.91 %	- %	3.74 %
Corporate securities	103,638	1,211,403	-	-	-	1,315,041
Interest rate	2.28 %	2.72 %	- %	- %	- %	2.69 %
Subtotal	261,976	1,414,020	85,877	36,970	-	1,798,843
Interest rate	2.33 %	2.71 %	4.33 %	2.91 %	- %	2.73 %
MBS	-	-	-	-	855,827	855,827
Interest rate	- %	- %	- %	- %	2.28 %	2.28 %
Total	$261,976	$1,414,020	$85,877	$36,970	$855,827	$2,654,670
Interest rate	2.33 %	2.71 %	4.33 %	2.91 %	2.28 %	2.55 %

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

	At December 31,		
	2018	2017	2016
	(In thousands)		
Securities of U.S. Government sponsored entities	$-	$-	$581
Agency residential MBS	447,332	545,883	668,235
Non-agency residential MBS	3,387	4,462	5,370
Agency commercial MBS	-	9,041	9,332
Obligations of states and political subdivisions	533,890	599,478	662,794
Total	$984,609	$1,158,864	$1,346,312
Fair value	$971,445	$1,155,342	$1,340,741

The following table sets forth the relative maturities and contractual yields of the Company's debt securities held to maturity at December 31, 2018. Yields on state and political subdivision securities have been calculated on a fully taxable equivalent basis using the current federal statutory rate. Mortgage-backed securities are shown separately because they are typically paid in monthly installments over a number of years.

Debt Securities Held to Maturity Maturity Distribution

	At December 31, 2018					
	Within one year	After one but within five years	After five but within ten years	After ten years	Mortgage-backed	Total
	($ in thousands)					
Obligations of states and political subdivisions	$86,172	$214,137	$232,544	$1,037	$-	$533,890
Interest rate	2.15 %	2.73 %	3.62 %	3.53 %	- %	3.00 %
MBS	-	-	-	-	450,719	450,719
Interest rate	- %	- %	- %	- %	2.07 %	2.07 %
Total	$86,172	$214,137	$232,544	$1,037	$450,719	$984,609
Interest rate	2.15 %	2.73 %	3.62 %	3.53 %	2.07 %	2.58 %

The following table summarizes total corporate securities by the industry sector in which the issuing companies operate:

	At December 31, 2018		2017	
	Market value	As a percent of total corporate securities	Market value	As a percent of total corporate securities
	($ in thousands)			
Basic materials	$30,410	2 %	$35,219	3 %
Communications	49,642	4 %	50,763	5 %
Consumer, cyclical	58,430	5 %	12,592	1 %
Consumer, non-cyclical	169,851	13 %	133,476	12 %
Energy	19,668	1 %	-	0 %
Financial	531,512	40 %	525,932	47 %
Industrial	152,636	12 %	129,989	12 %
Technology	105,324	8 %	71,708	6 %
Utilities	197,568	15 %	155,819	14 %
Total corporate securities	$1,315,041	100 %	$1,115,498	100 %

The following tables summarize the total general obligation and revenue bonds issued by states and political subdivisions held in the Company's investment securities portfolios as of the dates indicated, identifying the state in which the issuing government municipality or agency operates.

At December 31, 2018, the Company's investment securities portfolios included securities issued by 583 state and local government municipalities and agencies located within 43 states. None of the Company's investment securities were issued by Puerto Rican government entities. The largest exposure to any one municipality or agency was $9.3 million (fair value) represented by eight general obligation bonds.

	At December 31, 2018	
	Amortized Cost	Fair Value
	(In thousands)	
Obligations of states and political subdivisions:		
General obligation bonds:		
California	$104,607	$105,730
Texas	56,653	56,286
New Jersey	35,501	35,527
Minnesota	29,609	29,593
Other (35 states)	267,402	266,136
Total general obligation bonds	$493,772	$493,272
Revenue bonds:		
California	$35,164	$35,399
Kentucky	19,320	19,328
Colorado	14,564	14,539
Washington	13,034	13,228
Iowa	13,202	13,052
Indiana	12,007	12,034
Other (28 states)	113,047	112,805
Total revenue bonds	$220,338	$220,385
Total obligations of states and political subdivisions	$714,110	$713,657

[The remainder of this page intentionally left blank]

At December 31, 2017, the Company’s investment securities portfolios included securities issued by 647 state and local government municipalities and agencies located within 44 states. None of the Company’s investment securities were issued by Puerto Rican government entities. The largest exposure to any one municipality or agency was $10.0 million (fair value) represented by nine general obligation bonds.

	At December 31, 2017	
	Amortized Cost	Fair Value
	(In thousands)	
Obligations of states and political subdivisions:		
General obligation bonds:		
California	$104,330	$106,311
Texas	66,636	66,699
New Jersey	39,387	39,612
Minnesota	30,485	30,707
Other (36 states)	292,102	294,779
Total general obligation bonds	$532,940	$538,108
Revenue bonds:		
California	$38,838	$39,660
Kentucky	21,731	21,958
Iowa	17,304	17,287
Colorado	14,956	15,086
Washington	13,506	13,963
Indiana	12,914	13,054
Other (29 states)	130,196	131,301
Total revenue bonds	$249,445	$252,309
Total obligations of states and political subdivisions	$782,385	$790,417

At December 31, 2018 and 2017, the revenue bonds in the Company’s investment securities portfolios were issued by state and local government municipalities and agencies to fund public services such as water utility, sewer utility, recreational and school facilities, and general public and economic improvements. The revenue bonds were payable from 22 revenue sources at December 31, 2018 and at December 31, 2017. The revenue sources that represent 5% or more individually of the total revenue bonds are summarized in the following tables.

	At December 31, 2018	
	Amortized Cost	Fair Value
	(In thousands)	
Revenue bonds by revenue source:		
Water	$46,326	$46,671
Sales tax	28,264	28,517

Sewer	28,335	28,502
Lease (renewal)	17,013	17,051
College & University	13,919	13,714
Other (17 sources)	86,481	85,930
Total revenue bonds by revenue source	$220,338	$220,385

[The remainder of this page intentionally left blank]

	At December 31, 2017	
	Amortized Cost	Fair Value
	(In thousands)	
Revenue bonds by revenue source:		
Water	$50,737	$51,854
Sewer	30,427	31,030
Sales tax	30,233	30,777
Lease (renewal)	20,007	20,235
College & University	17,230	17,087
Other (17 sources)	100,811	101,326
Total revenue bonds by revenue source	$249,445	$252,309

See Note 2 to the consolidated financial statements for additional information related to the investment securities.

Loan Portfolio

The Company originates loans with the intent to hold such assets until principal is repaid. Management follows written loan underwriting policies and procedures which are approved by the Bank's Board of Directors. Loans are underwritten following approved underwriting standards and lending authorities within a formalized organizational structure. The Board of Directors also approves independent real estate appraisers to be used in obtaining estimated values for real property serving as loan collateral. Prevailing economic trends and conditions are also taken into consideration in loan underwriting practices.

All loan applications must be for clearly defined legitimate purposes with a determinable primary source of repayment, and as appropriate, secondary sources of repayment. All loans are supported by appropriate documentation such as current financial statements, tax returns, credit reports, collateral information, guarantor asset verification, title reports, appraisals, and other relevant documentation.

Commercial loans represent term loans used to acquire durable business assets or revolving lines of credit used to finance working capital. Underwriting practices evaluate each borrower's cash flow as the principal source of loan repayment. Commercial loans are generally secured by the borrower's business assets as a secondary source of repayment. Commercial loans are evaluated for credit-worthiness based on prior loan performance and borrower financial information including cash flow, borrower net worth and aggregate debt.

Commercial real estate loans represent term loans used to acquire or refinance real estate to be operated by the borrower in a commercial capacity. Underwriting practices evaluate each borrower's global cash flow as the principal source of loan repayment, independent appraisal of value of the property, and other relevant factors. Commercial real estate loans are generally secured by a first lien on the property as a secondary source of repayment.

Real estate construction loans represent the financing of real estate development. Loan principal disbursements are controlled through the use of project budgets, and disbursements are approved based on construction progress, which is validated by project site inspections. A first lien on the real estate serves as collateral to secure the loan.

Residential real estate loans generally represent first lien mortgages used by the borrower to purchase or refinance a principal residence. For interest-rate risk purposes, the Company offers only fully-amortizing, adjustable-rate mortgages. In underwriting first lien mortgages, the Company evaluates each borrower’s ability to repay the loan, an independent appraisal of the value of the property, and other relevant factors. The Company does not offer riskier mortgage products, such as non-amortizing “interest-only” mortgages and “negative amortization” mortgages.

For loans secured by real estate, the Bank requires title insurance to insure the status of its lien and each borrower is obligated to insure the real estate collateral, naming the Company as loss payee, in an amount sufficient to repay the principal amount outstanding in the event of a property casualty loss.

Consumer installment and other loans are predominantly comprised of indirect automobile loans with underwriting based on credit history and scores, personal income, debt service capacity, and collateral values.

Loan volumes have declined due to payoffs and problem loan workout activities, particularly with purchased loans, and reduced volumes of loan originations. The Company did not take an aggressive posture relative to loan portfolio growth during the post-recession period of historically low interest rates. Management increased investment securities as loan volumes declined.

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

	At December 31,				
	2018	2017	2016	2015	2014
	(In thousands)				
Commercial	$275,080	$335,996	$354,697	$382,748	$391,815
Commercial real estate	580,480	568,584	542,171	637,456	718,604
Construction	3,982	5,649	2,555	3,951	13,872
Residential real estate	44,866	65,183	87,724	120,091	149,827
Consumer installment and other	302,794	312,570	365,564	389,150	426,172
Total loans	$1,207,202	$1,287,982	$1,352,711	$1,533,396	$1,700,290

The following table shows the maturity distribution and interest rate sensitivity of commercial, commercial real estate, and construction loans at December 31, 2018. Balances exclude residential real estate loans and consumer loans totaling $347.7 million. These types of loans are typically paid in monthly installments over a number of years.

Loan Maturity Distribution

	At December 31, 2018			
	Within One Year	One to Five Years	After Five Years	Total
	(In thousands)			
Commercial and Commercial real estate	$105,197	$186,315	$564,048	$855,560
Construction	3,982	-	-	3,982
Total	$109,179	$186,315	$564,048	$859,542
Loans with fixed interest rates	$42,082	$75,003	$42,152	$159,237
Loans with floating or adjustable interest rates	67,097	111,312	521,896	700,305
Total	$109,179	$186,315	$564,048	$859,542

Commitments and Letters of Credit

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

Loan Portfolio Credit Risk

The Company extends loans to commercial and consumer customers which expose the Company to the risk borrowers will default, causing loan losses. The Company's lending activities are exposed to various qualitative risks. All loan segments are exposed to risks inherent in the economy and market conditions. Significant risk characteristics related to the commercial loan segment include the borrowers' business performance and financial condition, and the value of collateral for secured loans. Significant risk characteristics related to the commercial real estate segment include the borrowers' business performance and the value of properties collateralizing the loans. Significant risk characteristics related to the construction loan segment include the borrowers' performance in successfully developing the real estate into the intended purpose and the value of the property collateralizing the loans. Significant risk characteristics related to the residential real estate segment include the borrowers' financial wherewithal to service the mortgages and the value of the property collateralizing the loans. Significant risk characteristics related to the consumer loan segment include the financial condition of the borrowers and the value of collateral securing the loans.

The preparation of the financial statements requires Management to estimate the amount of losses inherent in the loan portfolio and establish an allowance for credit losses. The allowance for credit losses is maintained by assessing or reversing a provision for loan losses through the Company's earnings. In estimating credit losses, Management must exercise judgment in evaluating information deemed relevant, such as financial information regarding individual borrowers, overall credit loss experience, the amount of past due, nonperforming and classified loans, recommendations of regulatory authorities, prevailing economic conditions and other information. The amount of ultimate losses on the loan portfolio can vary from the estimated amounts. Management follows a systematic methodology to estimate loss potential in an effort to reduce the differences between estimated and actual losses.

The Company closely monitors the markets in which it conducts its lending operations and follows a strategy to control exposure to loans with high credit risk. The Bank's organization structure separates the functions of business development and loan underwriting; Management believes this segregation of duties avoids inherent conflicts of combining business development and loan approval functions. In measuring and managing credit risk, the Company adheres to the following practices.

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

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

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

Nonperforming Assets

	At December 31,				
	2018	2017	2016	2015	2014
	(In thousands)				
Nonperforming nonaccrual loans	$998	$1,641	$3,956	$14,648	$17,494
Performing nonaccrual loans	3,870	4,285	4,429	350	110
Total nonaccrual loans	4,868	5,926	8,385	14,998	17,604
Accruing loans 90 or more days past due	551	531	497	295	502
Total nonperforming loans	5,419	6,457	8,882	15,293	18,106
Other real estate owned	350	1,426	3,095	9,264	6,374
Total nonperforming assets	$5,769	$7,883	$11,977	$24,557	$24,480

Nonperforming assets have declined during 2018 due to payoffs, chargeoffs and sale of Other Real Estate Owned. At December 31, 2018, one loan secured by commercial real estate with a balance of $3.9 million was on nonaccrual status. The remaining four nonaccrual loans held at December 31, 2018 had an average carrying value of $250 thousand and the largest carrying value was $516 thousand.

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

Allowance for Credit Losses

The Company’s allowance for loan losses represents Management’s estimate of loan losses inherent in the loan portfolio. In evaluating credit risk for loans, Management measures loss potential of the carrying value of loans. As described above, payments received on nonaccrual loans may be applied against the principal balance of the loans until such time as full collection of the remaining recorded balance is expected.

The following table summarizes the allowance for loan losses, chargeoffs and recoveries for the periods indicated:

	For the Years Ended December 31,				
	2018	2017	2016	2015	2014
	($ in thousands)				
Analysis of the Allowance for Loan Losses					
Balance, beginning of period	$23,009	$25,954	$29,771	$31,485	$31,693
(Reversal of) provision for loan losses	-	(1,900)	(3,200)	-	2,800
Loans charged off:					
Commercial	(513)	(961)	(2,023)	(756)	(2,152)
Commercial real estate	(240)	-	-	(449)	(1,022)
Construction	-	-	-	(431)	-
Residential real estate	-	-	-	-	(30)
Consumer and other installment	(4,124)	(4,957)	(4,749)	(3,493)	(4,214)
Total chargeoffs	(4,877)	(5,918)	(6,772)	(5,129)	(7,418)
Recoveries of loans previously charged off:					
Commercial	1,447	762	4,028	1,174	2,275
Commercial real estate	-	88	554	290	213
Construction	-	1,899	-	45	53
Consumer and other installment	1,772	2,124	1,573	1,906	1,869
Total recoveries	3,219	4,873	6,155	3,415	4,410
Net loan losses	(1,658)	(1,045)	(617)	(1,714)	(3,008)
Balance, end of period	$21,351	$23,009	$25,954	$29,771	$31,485
Net loan losses as a percentage of average loans	0.14 %	0.08 %	0.04 %	0.11 %	0.17 %

The Company's allowance for loan losses is maintained at a level considered appropriate to provide for losses that can be estimated based upon specific and general conditions. These include conditions unique to individual borrowers, as well as overall loan loss experience, the amount of past due, nonperforming and classified loans, recommendations of regulatory authorities, prevailing economic conditions and other factors. A portion of the allowance is individually allocated to impaired loans whose full collectability of principal is uncertain. Such allocations are determined by Management based on loan-by-loan analyses. The Company evaluates for impairment all loans with outstanding principal balances in excess of $500 thousand which are classified or on nonaccrual status and all “troubled debt restructured” loans. The remainder of the loan portfolio is collectively evaluated for impairment based in part on quantitative analyses of historical loan loss experience of loan portfolio segments to determine standard loss rates for each segment. The loss rate for each loan portfolio segment reflects both the historical loss experience during a look-back period and a loss emergence period. Liquidating purchased consumer installment loans are evaluated separately by applying historical loss rates to forecasted liquidating principal balances to measure losses inherent in this portfolio segment. The loss rates are applied to segmented loan balances to allocate the allowance to the segments of the loan portfolio.

The remainder of the allowance is considered to be unallocated. The unallocated allowance is established to provide for probable losses that have been incurred as of the reporting date but not reflected in the allocated allowance. The unallocated allowance addresses additional qualitative factors consistent with Management's analysis of the level of risks inherent in the loan portfolio, which are related to the risks of the Company's general lending activity. Included in the unallocated allowance is the risk of losses that are attributable to national or local economic or industry trends which have occurred but have not yet been recognized in loan chargeoff history (external factors). The primary external factor evaluated by the Company and the judgmental amount of unallocated reserve assigned by Management as of December 31, 2018 is economic and business conditions $0.4 million. Also included in the unallocated allowance is the risk of losses attributable to general attributes of the Company's loan portfolio and credit administration (internal factors). The internal factors evaluated by the Company and the judgmental amount of unallocated reserve assigned by Management are: loan review system $0.9 million, adequacy of lending Management and staff $0.8 million and concentrations of credit $1.0 million.

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

	At December 31,									
	2018		2017		2016		2015		2014	
	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
	($ in thousands)									
Commercial	$6,311	23 %	$7,746	26 %	$8,327	26 %	$9,559	25 %	$5,460	23 %
Commercial real estate	3,884	48 %	3,849	44 %	3,330	40 %	4,212	42 %	4,245	42 %
Construction	1,465	- %	335	1 %	152	- %	235	- %	654	1 %
Residential real estate	869	4 %	995	5 %	1,330	7 %	1,801	8 %	2,241	9 %
Consumer installment and other	5,645	25 %	6,418	24 %	7,980	27 %	8,001	25 %	9,827	25 %
Unallocated portion	3,177	- %	3,666	- %	4,835	- %	5,963	- %	9,058	- %
Total	$21,351	100 %	$23,009	100 %	$25,954	100 %	$29,771	100 %	$31,485	100 %

The portion of the allowance for loan losses ascribed to loan segments changed from December 31, 2017 to December 31, 2018 based on Management's evaluation of credit risk. The allowance for loan losses ascribed to commercial loans declined due to the improved financial performance of a specific borrower. The allowance for loan losses ascribed to construction loans increased based on an increased level of credit exposure relative to real property values. The allowance for loan losses ascribed to consumer installment loans declined due to Management's measurement of a shortened loss emergence period.

	Allowance for Loan Losses For the Year Ended December 31, 2018						
	Commercial	Commercial Real Estate	Construction	Residential Real Estate	Consumer Installment and Other	Unallocated	Total
	(In thousands)						
Allowance for loan losses:							
Balance at beginning of period	$7,746	$ 3,849	$ 335	$ 995	$ 6,418	$ 3,666	$23,009
(Reversal) provision	(2,369)	275	1,130	(126)	1,579	(489)	-
Chargeoffs	(513)	(240)	-	-	(4,124)	-	(4,877)
Recoveries	1,447	-	-	-	1,772	-	3,219
Total allowance for loan losses	$6,311	$ 3,884	$ 1,465	$ 869	$ 5,645	$ 3,177	$21,351

	Allowance for Loan Losses and Recorded Investment in Loans Evaluated for Impairment At December 31, 2018			
	Commercial	Construction	Unallocated	Total

		Commercial Real Estate		Residential Real Estate	Consumer Installment and Other		
	(In thousands)						
Allowance for loan losses:							
Individually evaluated for impairment	$2,752	$ -	$ -	$ -	$ -	$ -	$2,752
Collectively evaluated for impairment	3,559	3,884	1,465	869	5,645	3,177	18,599
Purchased loans with evidence of credit deterioration	-	-	-	-	-	-	-
Total	$6,311	$ 3,884	$ 1,465	$ 869	$ 5,645	$ 3,177	$21,351
Carrying value of loans:							
Individually evaluated for impairment	$9,921	$ 8,217	$ -	$ 717	$ -	$ -	$ 18,855
Collectively evaluated for impairment	265,136	572,042	3,982	44,149	302,651	-	1,187,960
Purchased loans with evidence of credit deterioration	23	221	-	-	143	-	387
Total	$275,080	$ 580,480	$ 3,982	$ 44,866	$ 302,794	$ -	$ 1,207,202

Management considers the $21.4 million allowance for loan losses to be adequate as a reserve against probable incurred loan losses in the loan portfolio as of December 31, 2018.

See Note 3 to the consolidated financial statements for additional information related to the loan portfolio, loan portfolio credit risk, and allowance for loan losses.

[The remainder of this page intentionally left blank]

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. Many factors affect the Company’s exposure to interest rates, such as general economic and financial conditions, customer preferences, historical pricing relationships, and re-pricing characteristics of financial instruments. Financial instruments may mature or re-price at different times. Financial instruments may re-price at the same time but by different amounts. Short-term and long-term market interest rates may change by different amounts. The timing and amount of cash flows of various financial instruments may change as interest rates change. In addition, the changing levels of interest rates may have an impact on loan demand and demand for various deposit products.

The Company’s earnings are affected not only by general economic conditions, but also by the monetary and fiscal policies of the United States government and its agencies, particularly the FOMC. The monetary policies of the FOMC can influence the overall growth of loans, investment securities, and deposits and the level of interest rates earned on loans and investment securities and paid for deposits and other borrowings. The nature and impact of future changes in monetary policies are generally not predictable.

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 market 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. 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.

Management monitors the Company’s interest rate risk using a purchased simulation model, which is periodically validated using supervisory guidance issued by the Board of Governors of the Federal Reserve System, SR 11-7 “Guidance on Model Risk Management.” Management measures its exposure to interest rate risk using both a static and dynamic composition of financial instruments. Within the static composition simulation, cash flows are assumed redeployed into like financial instruments at prevailing rates and yields. Within the dynamic composition simulation, Management makes assumptions regarding the expected change in the volume of financial instruments given the assumed change in market interest rates. Both simulations are used to measure expected changes in net interest income assuming various levels of change in market interest rates.

The Company's asset and liability position was slightly "asset sensitive" at December 31, 2018, depending on the interest rate assumptions applied to each simulation model. An "asset sensitive" position results in a slightly larger change in interest income than in interest expense resulting from application of assumed interest rate changes.

At December 31, 2018, Management's measurements of estimated changes in net interest income were:

Static Simulation:			
Assumed Immediate Parallel Shift in Interest Rates	-1.00%	0.00%	+1.00%
First Year Change in Net Interest Income	-7.50%	0.00%	+5.30%
Dynamic Simulation:			
Assumed Change in Interest Rates Over 1 Year	-1.00%	0.00%	+1.00%
First Year Change in Net Interest Income	-3.60%	0.00%	+2.80%

Simulation estimates depend on, and will change with, the size and mix of the actual and projected composition of financial instruments at the time of each simulation.

The Company does not currently engage in trading activities or use derivative instruments to manage 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. Preferred or common stock holdings, as permitted by banking regulations, can fluctuate in value. Changes in value of preferred or common stock holdings are recognized 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 at times repurchased and retired its common stock; the market price paid to retire the Company's common stock affects the level of the Company's shareholders' equity, cash flows and shares outstanding. Second, the Company's common stock price impacts the number of dilutive equivalent shares used to compute diluted earnings per share. Third, fluctuations in the Company's common stock price can motivate holders of options to purchase Company common stock through the exercise of such options thereby increasing the number of shares outstanding and potentially adding volatility to the book tax provision. Finally, the amount of compensation expense and tax deductions 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. The financial condition and liquidity of debtors issuing bonds and debtors whose mortgages or other obligations are securitized can directly impact the credit quality of the Company’s investment securities portfolio requiring the Company to recognize other than temporary impairment charges. Other types of market risk, such as foreign currency exchange risk, are not significant in the normal course of the Company's business activities.

Liquidity and Funding

The objective of liquidity management is to manage cash flow and liquidity reserves so that they are adequate to fund the Company's operations and meet obligations and other commitments on a timely basis and at a reasonable cost. The Company achieves this objective through the selection of asset and liability maturity mixes that it believes best meet its needs. The Company's liquidity position is enhanced by its ability to raise additional funds as needed in the wholesale markets.

In recent years, the Company's deposit base has provided the majority of the Company's funding requirements. This relatively stable and low-cost source of funds, along with shareholders' equity, provided 98 percent of funding for average total assets in the year ended December 31, 2018 and 2017. The stability of the Company’s funding from customer deposits is in part reliant on the confidence clients have in the Company. The Company places a very high priority in maintaining this confidence through conservative credit and capital management practices and by maintaining an appropriate level of liquidity.

Liquidity is further provided by assets such as balances held at the Federal Reserve Bank, investment securities, and amortizing loans. The Company's investment securities portfolio provides a substantial secondary source of liquidity. The Company held $3.6 billion in total investment securities at December 31, 2018. Under certain deposit, borrowing and other arrangements, the Company must hold and pledge investment securities as collateral. At December 31, 2018, such collateral requirements totaled approximately $728 million.

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

Management continually monitors the Company’s cash levels. Loan demand from credit worthy borrowers will be dictated by economic and competitive conditions. The Company aggressively solicits non-interest bearing demand deposits and money market checking deposits, which are the least sensitive to changes in interest rates. The growth of these deposit balances is subject to heightened competition, the success of the Company's sales efforts, delivery of superior customer service, new regulations and market conditions. The Company does not aggressively solicit higher-costing time deposits; as a result, Management anticipates such deposits will decline. Changes in interest rates, most notably rising interest rates, could impact deposit volumes. Depending on economic conditions, interest rate levels, liquidity management and a variety of other conditions, deposit growth may be used to fund loans or purchase investment securities. However, due to possible volatility in economic conditions, 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.

Westamerica Bancorporation ("Parent Company") is a separate entity apart from the Bank and must provide for its own liquidity. In addition to its operating expenses, the Parent Company is responsible for the payment of dividends declared for its shareholders, and interest and principal on any outstanding debt. The Parent Company currently has no debt. Substantially all of the Parent Company's revenues are obtained from subsidiary dividends and service fees.

The Bank's dividends paid to the Parent Company, proceeds from the exercise of stock options, and Parent Company cash balances provided adequate cash for the Parent Company to pay shareholder dividends of $43 million in 2018 and $41 million in 2017, and retire common stock in the amount of $524 thousand in 2018 and $314 thousand in 2017. Payment of dividends to the Parent Company by the Bank is limited under California and Federal laws. The Company believes these regulatory dividend restrictions will not have an impact on the Parent Company's ability to meet its ongoing cash obligations.

Contractual Obligations

Deposits and sort-term borrowings are detailed on pages 43 and 44. The following table sets forth the known contractual obligations, except deposits, short-term borrowing arrangements and post-retirement benefit plans, of the Company:

	At December 31, 2018				
	Within One Year	Over One to Three Years	Over Three to Five Years	After Five Years	Total
	(In thousands)				
Operating Lease Obligations	$5,996	$7,150	$3,144	$1,044	$17,334
Purchase Obligations	8,301	16,991	-	-	25,292
Total	$14,297	$24,141	$3,144	$1,044	$42,626

Operating lease obligations have not been reduced by minimum sublease rentals of $1 million due in the future under noncancelable subleases. 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 liabilities under contracts with third-party automation services providers .

Capital Resources

The Company has historically generated high levels of earnings, which provide a means of accumulating capital. The Company's net income as a percentage of average shareholders' equity (“return on equity” or “ROE”) has been 11.3% in 2018, 8.4% in 2017 and 10.9% in 2016. The Company also raises capital as employees exercise stock options. Capital raised through the exercise of stock options was $13 million in 2018, $25 million in 2017 and $24 million in 2016.

The Company paid common dividends totaling $43 million in 2018, $41 million in 2017 and $40 million in 2016, which represent dividends per common share of $1.60, $1.57 and $1.56, respectively. The Company's earnings have historically exceeded dividends paid to shareholders. The amount of earnings in excess of dividends provides the Company resources to finance growth and maintain appropriate levels of shareholders' equity. In the absence of profitable growth opportunities, the Company has at times repurchased and retired its common stock as another means to return earnings to shareholders. The Company repurchased and retired 9 thousand shares valued at $524 thousand in 2018, 6 thousand shares valued at $314 thousand in 2017 and 137 thousand shares valued at $6 million in 2016.

The Company's primary capital resource is shareholders' equity, which was $616 million at December 31, 2018 compared with $590 million at December 31, 2017. The Company's ratio of equity to total assets was 11.05% at December 31, 2018 and 10.71% at December 31, 2017.

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

Capital to Risk-Adjusted Assets

On July 2, 2013, the Federal Reserve Board approved a final rule that implements changes to the regulatory capital framework for all banking organizations. The rule's provisions which most affected the regulatory capital requirements of the Company and the Bank:

- Introduced a new "Common Equity Tier 1" capital measurement,
- Established higher minimum levels of capital,
- Introduced a "capital conservation buffer,"
- Increased the risk-weighting of certain assets, and
- Established limits on the amount of deferred tax assets with any excess treated as a deduction from Tier 1 capital.

Under the final rule, a banking organization that is not subject to the "advanced approaches rule" may make a one-time election not to include most elements of Accumulated Other Comprehensive Income, including net-of-tax unrealized gains and losses on debt securities available for sale, in regulatory capital. Neither the Company nor the Bank is subject to the "advanced approaches rule" and both made the election not to include most elements of Accumulated Other Comprehensive Income in regulatory capital.

Banking organizations that are not subject to the "advanced approaches rule" began complying with the final rule on January 1, 2015; on such date, the Company and the Bank became subject to the revised definitions of regulatory capital, the new minimum regulatory capital ratios, and various regulatory capital adjustments and deductions according to transition provisions and timelines. All banking organizations began calculating standardized total risk-weighted assets on January 1, 2015. The transition period for the capital conservation buffer for all banking organizations began on January 1, 2016 and ended January 1, 2019, when the 2.5% capital conservation buffer was fully implemented. Any bank subject to the rule which is unable to maintain its "capital conservation buffer" above the minimum regulatory capital ratios will be restricted in the payment of discretionary executive compensation and shareholder distributions, such as dividends and share repurchases.

The final rule did not supersede provisions of the Federal Deposit Insurance Corporation Improvement Act (FDICIA) requiring federal banking agencies to take prompt corrective action (PCA) to resolve problems of insured depository institutions. The final rule revised the PCA thresholds to incorporate the higher minimum levels of capital, including the "common equity tier 1" ratio.

The capital ratios for the Company and the Bank under the new capital framework are presented in the tables below, on the dates indicated.

	At December 31, 2018		Required for Capital Adequacy Purposes		To Be Well-capitalized Under Prompt Corrective Action Regulations (Bank)
	Company	Bank	Effective January 1, 2018	Effective January 1, 2019	
Common Equity Tier I Capital	16.30 %	13.01 %	6.375 %[1]	7.00 %[2]	6.50 %
Tier I Capital	16.30 %	13.01 %	7.875 %[1]	8.50 %[2]	8.00 %
Total Capital	17.03 %	13.94 %	9.875 %[1]	10.50 %[2]	10.00 %
Leverage Ratio	9.51 %	7.55 %	4.000 %	4.00 %	5.00 %

(1) Includes 1.875% capital conservation buffer.

(2) Includes 2.5% capital conservation buffer.

	At December 31, 2017		Required for Capital Adequacy Purposes		To Be Well-capitalized Under Prompt Corrective Action Regulations (Bank)
	Company	Bank	Effective January 1, 2017	Effective January 1, 2019	
Common Equity Tier I Capital	15.36 %	12.50 %	5.75 %[3]	7.00 %[4]	6.50 %
Tier I Capital	15.36 %	12.50 %	7.25 %[3]	8.50 %[4]	8.00 %
Total Capital	16.17 %	13.52 %	9.25 %[3]	10.50 %[4]	10.00 %
Leverage Ratio	8.86 %	7.16 %	4.00 %	4.00 %	5.00 %

(3) Includes 1.25% capital conservation buffer.

(4) Includes 2.5% capital conservation buffer.

In June 2016, the Financial Accounting Standards Board issued an update to the accounting standards for credit losses known as the "Current Expected Credit Losses" (CECL) methodology, which replaces the existing incurred loss methodology for certain financial assets. The Company intends to timely adopt the CECL methodology January 1, 2020, which involves an implementing accounting entry to retained earnings. In December 2018, the federal bank regulatory agencies approved a final rule which will be effective April 1, 2019 modifying their regulatory capital rules and providing an option to phase in over a period of three years the day-one regulatory capital effects of implementing the CECL methodology. The Company has not determined whether it will elect the three year phase in period for the day-one regulatory capital effects. See Note 1 to the consolidated financial statements, “Summary of Significant Accounting Policies: Recently Issued Accounting Standards” for more information on the CECL methodology.

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

Deposit Categories

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

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

Deposit Distribution and Average Rates Paid

	For the Years Ended December 31,								
	2018			2017			2016		
	Average Balance	Percentage of Total Deposits	Rate	Average Balance	Percentage of Total Deposits	Rate	Average Balance	Percentage of Total Deposits	Rate
	($ In thousands)								
Noninterest-bearing demand	$2,209,924	45.4 %	- %	$2,095,522	44.4 %	- %	$2,026,939	44.1 %	- %
Interest bearing:									
Transaction	928,277	19.0 %	0.04%	888,116	18.8 %	0.03%	862,581	18.8 %	0.03%

Savings	1,519,375	31.2	%	0.06	%	1,492,725	31.6	%	0.02	%	1,428,059	31.1	%	0.06	%
Time less than $100 thousand	119,586	2.5	%	0.23	%	136,324	2.9	%	0.17	%	154,022	3.4	%	0.26	%
Time $100 thousand or more	94,919	1.9	%	0.39	%	109,563	2.3	%	0.38	%	118,750	2.6	%	0.43	%
Total [(1)]	$4,872,081	100.0	%	0.04	%	$4,722,250	100.0	%	0.04	%	$4,590,351	100.0	%	0.05	%

(1) The rates for total deposits reflect the value of noninterest-bearing deposits.

The Company's strategy includes building the value of its deposit base by building balances of lower-costing deposits and avoiding reliance on higher-costing time deposits. From 2016 to 2018 higher costing time deposits declined from 6% to 4% of total deposits. The Company's average balances of checking and savings accounts represented 96% of average balances of total deposits in 2018 compared with 95% in 2017 and 94% in 2016.

Total time deposits were $195 million and $232 million at December 31, 2018 and 2017, respectively. The following table sets forth, by time remaining to maturity, the Company's total domestic time deposits. The Company has no foreign time deposits.

Time Deposits Maturity Distribution

	At December 31, 2018 (In thousands)
2019	$ 144,482
2020	26,229
2021	13,574
2022	5,463
2023	5,473
Thereafter	30
Total	$ 195,251

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

Time Deposits $100,000 or more Maturity Distribution

	At December 31, 2018 (In thousands)
Three months or less	$ 27,718
Over three through six months	14,785
Over six through twelve months	21,932
Over twelve months	28,162
Total	$ 92,597

Short-term Borrowings

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

Short-Term Borrowings Distribution

	At December 31,		
	2018	2017	2016
	(In thousands)		
Securities sold under agreements to repurchase the securities	$51,247	$58,471	$59,078
Total short-term borrowings	$51,247	$58,471	$59,078

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

	For the Years Ended December 31,		
	2018	2017	2016
	($ in thousands)		
Federal funds purchased balances and rates paid on outstanding amount:			
Average balance for the year	$1	$5	$5
Maximum month-end balance during the year	-	-	-
Average interest rate for the year	- %	1.53 %	0.77 %
Average interest rate at period end	- %	- %	- %
Securities sold under agreements to repurchase the securities balances and rates paid on outstanding amount:			
Average balance for the year	$59,991	$69,666	$61,271
Maximum month-end balance during the year	68,894	82,126	74,815
Average interest rate for the year	0.06 %	0.06 %	0.06 %
Average interest rate at period end	0.06 %	0.06 %	0.06 %

Financial Ratios

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

	At and For the Years Ended December 31,		
	2018	2017	2016
Return on average total assets	1.27 %	0.92 %	1.12 %
Return on average common shareholders' equity	11.35 %	8.39 %	10.85 %
Average shareholders' equity as a percentage of:			
Average total assets	11.22 %	10.96 %	10.34 %
Average total loans	52.16 %	45.34 %	38.08 %
Average total deposits	12.95 %	12.63 %	11.81 %
Common dividend payout ratio	60 %	83 %	68 %

[The remainder of this page intentionally left blank]

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

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

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

INDEX TO FINANCIAL STATEMENTS

-46-

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, 2018. 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, 2018 based upon criteria in Internal Control — Integrated Framework (2013) 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, 2018 based on the criteria in Internal Control - Integrated Framework (2013) issued by COSO.

The Company's independent registered public accounting firm has issued an attestation report on the Company's internal control over financial reporting. Their opinion and attestation on internal control over financial reporting appear on page 91.

Dated: February 28, 2019

WESTAMERICA BANCORPORATION

CONSOLIDATED BALANCE SHEETS

	At December 31,	
	2018	2017
	(In thousands)	
Assets:		
Cash and due from banks	$420,284	$575,002
Equity securities	1,747	1,800
Debt securities available for sale	2,654,670	2,191,707
Debt securities held to maturity, with fair values of: $971,445 at December 31, 2018 and $1,155,342 at December 31, 2017	984,609	1,158,864
Loans	1,207,202	1,287,982
Allowance for loan losses	(21,351)	(23,009)
Loans, net of allowance for loan losses	1,185,851	1,264,973
Other real estate owned	350	1,426
Premises and equipment, net	34,507	35,301
Identifiable intangibles, net	1,929	3,850
Goodwill	121,673	121,673
Other assets	162,906	158,450
Total Assets	$5,568,526	$5,513,046
Liabilities:		
Noninterest-bearing deposits	$2,243,251	$2,197,526
Interest-bearing deposits	2,623,588	2,630,087
Total deposits	4,866,839	4,827,613
Short-term borrowed funds	51,247	58,471
Other liabilities	34,849	36,723
Total Liabilities	4,952,935	4,922,807
Contingencies (Note 13)		
Shareholders' Equity:		
Common stock (no par value), authorized - 150,000 shares Issued and outstanding: 26,730 at December 31, 2018 and 26,425 at December 31, 2017	448,351	431,734
Deferred compensation	1,395	1,533
Accumulated other comprehensive loss	(39,996)	(16,832)
Retained earnings	205,841	173,804
Total Shareholders' Equity	615,591	590,239
Total Liabilities and Shareholders' Equity	$5,568,526	$5,513,046

See accompanying notes to consolidated financial statements.

WESTAMERICA BANCORPORATION

CONSOLIDATED STATEMENTS OF INCOME

	For the Years Ended December 31,		
	2018	2017	2016
	(In thousands, except per share data)		
Interest and Loan Fee Income:			
Loans	$59,030	$61,740	$69,139
Equity securities	354	293	267
Debt securities available for sale	60,383	44,371	34,009
Debt securities held to maturity	24,031	27,432	30,636
Interest bearing cash	7,925	4,476	1,868
Total Interest and Loan Fee Income	151,723	138,312	135,919
Interest Expense:			
Deposits	1,922	1,856	2,077
Short-term borrowed funds	37	44	39
Total Interest Expense	1,959	1,900	2,116
Net Interest and Loan Fee Income	149,764	136,412	133,803
Reversal of Provision for Loan Losses	-	(1,900)	(3,200)
Net Interest and Loan Fee Income After Reversal of Provision For Loan Losses	149,764	138,312	137,003
Noninterest Income:			
Service charges on deposit accounts	18,508	19,612	20,854
Merchant processing services	9,630	8,426	6,377
Debit card fees	6,643	6,421	6,290
Trust fees	2,938	2,875	2,686
ATM processing fees	2,752	2,610	2,411
Other service fees	2,567	2,584	2,571
Life insurance gains	585	-	-
Financial services commissions	499	639	568
Equity securities (losses) gains	(52)	7,955	-
Other noninterest income	4,079	5,506	4,817
Total Noninterest Income	48,149	56,628	46,574
Noninterest Expense:			
Salaries and related benefits	53,007	51,519	51,507
Occupancy and equipment	19,679	19,430	19,017
Outsourced data processing services	9,229	9,035	8,505
Loss contingency	3,500	5,542	3
Professional fees	2,842	2,161	3,980
Amortization of identifiable intangibles	1,921	3,077	3,504
Courier service	1,779	1,732	1,952
Impairment of tax credit investments	-	625	-
Other noninterest expense	14,959	14,647	15,152
Total Noninterest Expense	106,916	107,768	103,620
Income Before Income Taxes	90,997	87,172	79,957

Provision for income taxes	19,433	37,147	21,104
Net Income	$71,564	$50,025	$58,853
Average Common Shares Outstanding	26,649	26,291	25,612
Diluted Average Common Shares Outstanding	26,756	26,419	25,678
Per Common Share Data:			
Basic earnings	$2.69	$1.90	$2.30
Diluted earnings	2.67	1.89	2.29
Dividends paid	1.60	1.57	1.56

See accompanying notes to consolidated financial statements.

WESTAMERICA BANCORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	For the Years Ended December 31,		
	2018	2017	2016
	(In thousands)		
Net Income	$71,564	$50,025	$58,853
Other comprehensive loss:			
Changes in net unrealized losses on debt securities available for sale	(27,939)	(3,767)	(18,610)
Deferred tax benefit	8,258	1,585	7,825
Reclassification of gains included in net income	-	(7,955)	-
Deferred tax expense on gains included in net income	-	3,345	-
Changes in unrealized losses on debt securities available for sale, net of tax	(19,681)	(6,792)	(10,785)
Post-retirement benefit transition obligation amortization	-	59	61
Deferred tax expense	-	(25)	(25)
Post-retirement benefit transition obligation amortization, net of tax	-	34	36
Total Other Comprehensive Loss	(19,681)	(6,758)	(10,749)
Total Comprehensive Income	$51,883	$43,267	$48,104

See accompanying notes to consolidated financial statements.

WESTAMERICA BANCORPORATION

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

	Common Shares Outstanding	Common Stock	Deferred Compensation	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total
	(In thousands, except per share data)					
Balance, December 31, 2015	25,528	$378,858	$ 2,578	$ 675	$150,094	$532,205
Net income for the year 2016					58,853	58,853
Other comprehensive loss				(10,749)		(10,749)
Exercise of stock options	499	24,031				24,031
Tax benefit increase upon exercise and expiration of stock options		394				394
Restricted stock activity	15	1,798	(1,045)			753
Stock based compensation		1,494				1,494
Stock awarded to employees	2	90				90
Retirement of common stock	(137)	(2,059)			(3,721)	(5,780)
Dividends ($1.56 per share)					(39,924)	(39,924)
Balance, December 31, 2016	25,907	404,606	1,533	(10,074)	165,302	561,367
Net income for the year 2017					50,025	50,025
Other comprehensive loss				(6,758)		(6,758)
Exercise of stock options	509	24,583				24,583
Restricted stock activity	13	707				707
Stock based compensation		1,824				1,824
Stock awarded to employees	2	104				104
Retirement of common stock	(6)	(90)			(224)	(314)
Dividends ($1.57 per share)					(41,299)	(41,299)
Balance, December 31, 2017	26,425	431,734	1,533	(16,832)	173,804	590,239
Cumulative effect of equity securities losses reclassified				142	(142)	-
Adjusted Balance, January 1, 2018	26,425	431,734	1,533	(16,690)	173,662	590,239
Reclass stranded tax effects resulting from the Tax Cuts and Jobs Act of 2017				(3,625)	3,625	-
Net income for the year 2018					71,564	71,564
Other comprehensive loss				(19,681)		(19,681)
Exercise of stock options	292	13,373				13,373
Restricted stock activity	20	1,281	(138)			1,143
Stock based compensation		1,988				1,988
Stock awarded to employees	2	124				124
Retirement of common stock	(9)	(149)			(375)	(524)
Dividends ($1.60 per share)					(42,635)	(42,635)
Balance, December 31, 2018	26,730	$448,351	$ 1,395	$ (39,996)	$205,841	$615,591

See accompanying notes to consolidated financial statements.

WESTAMERICA BANCORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Years Ended December 31,		
	2018	2017	2016
Operating Activities:	(In thousands)		
Net income	$71,564	$50,025	$58,853
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization/accretion	24,402	26,082	19,939
Reversal of provision for loan losses	-	(1,900)	(3,200)
Net amortization of deferred loan fees	(203)	(46)	(340)
Increase in interest income receivable	(2,277)	(2,068)	(1,316)
(Increase) decrease in net deferred tax asset	(943)	27,018	4,380
Increase in other assets	(4,017)	(1,732)	(3,321)
Stock option compensation expense	1,988	1,824	1,494
Tax benefit increase upon exercise and expiration of stock options	-	-	(394)
Increase (decrease) in income taxes payable	7,554	(6,650)	(40)
Decrease in interest expense payable	(27)	(31)	(52)
(Decrease) increase in other liabilities	(580)	(3,016)	2,026
Life insurance gains	(585)	-	-
Equity securities losses	52	-	-
Gain on sale of other assets	-	(1,004)	-
Gain on sale of securities	-	(7,955)	-
(Gain) loss on disposal of premises and equipment	(216)	60	30
Net (gain) loss on sale of or write-down of foreclosed assets	(83)	147	(422)
Net Cash Provided by Operating Activities	96,629	80,754	77,637
Investing Activities:			
Net repayments of loans	80,985	66,065	183,506
Net payments under FDIC[1] indemnification agreements	-	(63)	(127)
Proceeds from life insurance	1,169	-	-
Purchases of debt securities available for sale	(854,555)	(635,814)	(1,080,959)
Proceeds from sale/maturity/calls of debt securities available for sale	353,327	319,324	737,625
Purchases of debt securities held to maturity	-	-	(246,956)
Proceeds from maturity/calls of debt securities held to maturity	167,029	178,429	204,054
Purchases of premises and equipment	(3,123)	(2,720)	(1,818)
Proceeds from sale of premises and equipment	446	-	-
Proceeds from sale of foreclosed assets	1,159	1,521	7,412
Net Cash Used in Investing Activities	(253,563)	(73,258)	(197,263)
Financing Activities:			
Net change in deposits	39,226	122,872	164,082
Net change in short-term borrowings	(7,224)	(607)	6,050
Exercise of stock options	13,373	24,583	24,031
Taxes paid by withholding shares for tax purposes	-	-	(356)
Tax benefit increase upon exercise and expiration of stock options	-	-	394
Retirement of common stock	(524)	(314)	(5,424)

Common stock dividends paid	(42,635)	(41,299)	(39,924)
Net Cash Provided by Financing Activities	2,216	105,235	148,853
Net Change In Cash and Due from Banks	(154,718)	112,731	29,227
Cash and Due from Banks at Beginning of Period	575,002	462,271	433,044
Cash and Due from Banks at End of Period	$420,284	$575,002	$462,271
Supplemental Cash Flow Disclosures:			
Supplemental disclosure of noncash activities:			
Loan collateral transferred to other real estate owned	$-	$-	$821
Supplemental disclosure of cash flow activities:			
Interest paid for the period	1,932	1,931	2,202
Income tax payments for the period	13,627	17,351	19,264

See accompanying notes to consolidated financial statements.

(1) Federal Deposit Insurance Corporation ("FDIC")

WESTAMERICA BANCORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1: Business and Accounting Policies

Westamerica Bancorporation, a registered bank holding company (the “Company”), provides a full range of banking services to corporate and individual customers in Northern and Central California through its wholly-owned subsidiary bank, Westamerica Bank (the “Bank”). The Bank is subject to competition from both financial and nonfinancial institutions and to the regulations of certain agencies and undergoes periodic examinations by those regulatory authorities. All of the financial service operations are considered by management to be aggregated in one reportable operating segment.

The Company has evaluated events and transactions subsequent to the balance sheet date. Based on this evaluation, the Company is not aware of any events or transactions that occurred subsequent to the balance sheet date but prior to filing that would require recognition or disclosure in its consolidated financial statements. Certain amounts in prior periods have been reclassified to conform to the current presentation.

Summary of Significant Accounting Policies

The consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States of America. The following is a summary of significant policies used in the preparation of the accompanying financial statements.

Accounting Estimates. Certain accounting policies underlying the preparation of these financial statements require Management to make 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 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 fair 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. The allowance for loan losses accounting is an area requiring the most subjective or complex judgments, and as such could be most subject to revision as new information becomes available. A discussion of the factors affecting the accounting for the allowance for loan losses is included in the following “Loans” and “Allowance for Credit Losses” sections. Carrying assets and liabilities at fair value inherently results in financial statement volatility. The fair values and the information used to record valuation adjustments for certain assets and liabilities are based either on quoted market prices or are provided by other third party sources, when available. The “Securities” section discusses the factors that may affect the valuation of the Company’s securities. Although the estimates contemplate current conditions and how Management expects them to change in the future, it is reasonably possible that in 2019 actual conditions could be worse than anticipated in those estimates, which could materially affect our results of operations and financial condition.

Principles of Consolidation. The consolidated financial statements include the accounts of the Company and all the Company’s subsidiaries. Significant intercompany transactions have been eliminated in consolidation. The Company does not maintain or conduct transactions with any unconsolidated special purpose entities.

Cash. Cash includes Due From Banks balances which are readily convertible to known amounts of cash and are generally 90 days or less from maturity at the time of initiation, presenting insignificant risk of changes in value due to interest rate changes.

Equity Securities. Equity securities consist of marketable equity securities and mutual funds which are recorded at fair value. Unrealized gains and losses are included in net income effective January 1, 2018 prior to such date unrealized gains and losses were included in other comprehensive income.

Debt Securities. Debt securities consist of securities of the U.S. Treasury, government sponsored entities, states, counties, municipalities, corporations, agency and non-agency mortgage-backed securities and asset-backed securities. Securities transactions are recorded on a trade date basis. The Company classifies its debt securities in one of three categories: trading, available for sale or held to maturity. Trading securities are bought and held principally for the purpose of selling them in the near term. Trading securities are recorded at fair value with unrealized gains and losses included in net income. Held to maturity debt securities are those securities which the Company has the ability and intent to hold until maturity. Held to maturity debt securities are recorded at cost, adjusted for the amortization of premiums or accretion of discounts. Securities not included in trading or held to maturity are classified as available for sale debt securities. Available for sale debt securities are recorded at fair value. Unrealized gains and losses, net of the related tax effect, on available for sale debt securities are included in accumulated other comprehensive income.

The Company utilizes third-party sources to value its investment securities; securities individually valued using quoted prices in active markets are classified as Level 1 assets in the fair value hierarchy, and securities valued using quoted prices in active markets for similar securities (commonly referred to as "matrix" pricing) are classified as Level 2 assets in the fair value hierarchy. The Company validates the reliability of third-party provided values by comparing individual security pricing for securities between more than one third-party source. When third-party information is not available, valuation adjustments are estimated in good faith by Management and classified as Level 3 in the fair value hierarchy.

A decline in the market value of any available for sale or held to maturity security below amortized cost that is deemed other than temporary results in a charge to earnings and the establishment of a new cost basis for the security. Unrealized investment securities losses are evaluated at least quarterly to determine whether such declines in value should be considered "other than temporary" and therefore be subject to immediate loss recognition in income. Although these evaluations involve significant judgment, an unrealized loss in the fair value of a debt security is generally deemed to be temporary when the fair value of the security is below the carrying value primarily due to changes in risk-free interest rates, there has not been significant deterioration in the financial condition of the issuer, and the Company does not intend to sell or be required to sell the securities before recovery of its amortized cost. An unrealized loss in the value of an equity security is generally considered temporary when the fair value of the security declined primarily due to current market conditions and not deterioration in the financial condition of the issuer, the Company expects the fair value of the security to recover in the near term and the Company does not intend to sell or be required to sell the securities before recovery of its cost basis. Other factors that may be considered in determining whether a decline in the value of either a debt or an equity security is "other than temporary" include ratings by recognized rating agencies, actions of commercial banks or other lenders relative to the continued extension of credit facilities to the issuer of the security, the financial condition, capital strength and near-term prospects of the issuer, and recommendations of investment advisors or market analysts.

The Company follows the guidance issued by the Board of Governors of the Federal Reserve System, "Investing in Securities without Reliance on Nationally Recognized Statistical Rating Agencies" (SR 12-15) and other regulatory guidance when performing investment security pre-purchase analysis or evaluating investment securities for impairment. Credit ratings issued by recognized rating agencies are considered in the Company's analysis only as a guide to the historical default rate associated with similarly-rated bonds.

Purchase premiums are amortized and purchase discounts are accreted over the estimated life of the related investment security as an adjustment to yield using the effective interest method. Unamortized premiums, unaccreted discounts, and early payment premiums are recognized as a component of gain or loss on sale upon disposition of the related security. Interest and dividend income are recognized when earned. Realized gains and losses from the sale of available for sale securities are included in earnings using the specific identification method.

Nonmarketable Equity Securities. Nonmarketable equity securities include securities that are not publicly traded, such as Visa Class B common stock, and securities acquired to meet regulatory requirements, such as Federal Reserve Bank stock, which are restricted. These restricted securities are accounted for under the cost method and are included in other assets. The Company reviews those assets accounted for under the cost method at least quarterly for possible declines in value that are considered “other than temporary”. The Company’s review typically includes an analysis of the facts and circumstances of each investment, the expectations for the investment’s cash flows and capital needs, the viability of its business model and any exit strategy. The asset value is reduced when a decline in value is considered to be other than temporary. The Company recognizes the estimated loss in noninterest income.

Loans. Loans are stated at the principal amount outstanding, net of unearned discount and unamortized deferred fees and costs. Interest is accrued daily on the outstanding principal balances. Loans which are more than 90 days delinquent with respect to interest or principal, unless they are well secured and in the process of collection, and other loans on which full recovery of principal or interest is in doubt, are placed on nonaccrual status. 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 (“performing nonaccrual loans”) even though the borrowers continue to repay the loans as scheduled. When the ability to fully collect nonaccrual loan principal is in doubt, payments received are applied against the principal balance of the loans on a cost-recovery method 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. Performing nonaccrual loans are reinstated to accrual status when improvements in credit quality eliminate the doubt as to the full collectability of both interest and principal. Certain consumer loans or auto receivables are charged off against the allowance for credit losses when they become 120 days past due.

The Company evaluates all classified loans and nonaccrual loans with outstanding principal balances in excess of $500 thousand, and all “troubled debt restructured” loans for impairment. The Company recognizes a loan as impaired when, based on current information and events, it is probable that it will be unable to collect both the contractual interest and principal payments as scheduled in the loan agreement. Income recognition on impaired loans conforms to that used on nonaccrual loans. In certain circumstances, the Company might agree to restructured loan terms with borrowers experiencing financial difficulties; such restructured loans are evaluated under ASC 310-40, “Troubled Debt Restructurings by Creditors.” In general, a restructuring constitutes a troubled debt restructuring when the Company, for reasons related to a borrower’s financial difficulties, grants a concession to the borrower it would not otherwise consider. Loans are evaluated on an individual basis. The Company follows its general nonaccrual policy for troubled debt restructurings. Performing troubled debt restructurings are reinstated to accrual status when improvements in credit quality eliminate the doubt as to full collectability of both principal and interest.

Nonrefundable fees and certain costs associated with originating or acquiring loans are deferred and amortized as an adjustment to interest income over the contractual loan lives. Upon prepayment, unamortized loan fees, net of costs, are immediately recognized in interest income. Other fees, including those collected upon principal prepayments, are included in interest income when received. Loans held for sale are identified upon origination and are reported at the lower of cost or market value on an aggregate loan basis.

Purchased Loans. Purchased loans are recorded at estimated fair value on the date of purchase. Impaired purchased loans are accounted for under FASB ASC 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality, when the loans have evidence of credit deterioration since origination and it is probable at the date of acquisition that the Company will not collect all contractually required principal and interest payments. Evidence of credit quality deterioration as of the purchase date may include attributes such as past due and nonaccural status. Generally, purchased loans that meet the Company’s definition for nonaccrual status fall within the scope of FASB ASC 310-30. The difference between contractually required payments at acquisition and the cash flows expected to be collected at acquisition is referred to as the nonaccretable difference. Subsequent decreases to the expected cash flows will generally result in a provision for loan losses. Subsequent increases in cash flows result in a reversal of the provision for loan losses to the extent of prior charges, or a reclassification of the difference from nonaccretable to accretable with a positive impact on interest income on a prospective basis. Any excess of expected cash flows over the estimated fair value is referred to as the accretable yield and is recognized into interest income over the remaining life of the loan when there is a reasonable expectation about the amount and timing of such cash flows. For covered purchased loans with an accretable difference, the corresponding FDIC receivable is amortized over the shorter of the contractual term of the indemnification asset or the remaining life of the loan. Further, the Company elected to analogize to ASC 310-30 and account for all other loans that had a discount due in part to credit not within the scope of ASC 310-30 using the same methodology.

Covered Loans. Loans covered under loss-sharing or similar credit protection agreements with the FDIC are reported in loans exclusive of the expected reimbursement cash flows from the FDIC. Covered loans are initially recorded at fair value at the acquisition date. Subsequent decreases in the amount expected to be collected results in a provision for loan losses and a corresponding increase in the estimated FDIC reimbursement, with the estimated net loss impacting earnings. Interest previously accrued on covered loans placed on nonaccrual status is charged against interest income, net of estimated FDIC reimbursements of such accrued interest. The FDIC reimburses the Company up to 80% of 90 days interest on covered loans. The indemnification expired February 6, 2019.

Allowance for Credit Losses. The Company extends loans to commercial and consumer customers primarily in Northern and Central California. These lending activities expose the Company to the risk borrowers will default, causing loan losses. The Company’s lending activities are exposed to various qualitative risks. All loan segments are exposed to risks inherent in the economy and market conditions. Significant risk characteristics related to the commercial loan segment include the borrowers’ business performance and financial condition, and the value of collateral for secured loans. Significant risk characteristics related to the commercial real estate segment include the borrowers’ business performance and the value of properties collateralizing the loans. Significant risk characteristics related to the construction loan segment include the borrowers’ performance in successfully developing the real estate into the intended purpose and the value of the property collateralizing the loans. Significant risk characteristics related to the residential real estate segment include the borrowers’ financial wherewithal to service the mortgages and the value of the property collateralizing the loans. Significant risk characteristics related to the consumer loan segment include the financial condition of the borrowers and the value of collateral securing the loans.

The preparation of these financial statements requires Management to estimate the amount of probable incurred losses inherent in the loan portfolio and establish an allowance for credit losses. In estimating credit losses, Management must exercise significant judgment in evaluating information deemed relevant. The amount of ultimate losses on the loan portfolio can vary from the estimated amounts. Management follows a systematic methodology to estimate loss potential in an effort to reduce the differences between estimated and actual losses.

The allowance for credit losses is established through provisions for credit losses charged to income. Losses on loans, including impaired loans, are charged to the allowance for loan losses when all or a portion of the recorded amount of a loan is deemed to be uncollectible. Recoveries of loans previously charged off are credited to the allowance when realized. 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 and classified loans, recommendations of regulatory authorities, prevailing economic conditions, FDIC loss-sharing or similar credit protection agreements and other factors. A portion of the allowance is specifically allocated to impaired loans whose full collectability is uncertain. Such allocations are determined by Management based on loan-by-loan analyses. The Company evaluates all classified loans and nonaccrual loans with outstanding principal balances in excess of $500 thousand, and all "troubled debt restructured" loans for impairment. A second allocation is based in part on quantitative analyses of historical credit loss experience. The results of this analysis are applied to current loan balances to allocate the reserve to the respective segments of the loan portfolio exclusive of loans individually evaluated for impairment. In addition, consumer installment loans which have similar characteristics and are 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. The remainder of the reserve 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 that are 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 segment of the loan portfolio in a statistically meaningful manner.

Liability for Off-Balance Sheet Credit Exposures. A liability for off-balance sheet credit exposures is established through expense recognition. Off-balance sheet credit exposures relate to letters of credit and unfunded loan commitments for commercial, construction and consumer loans. Historical credit loss factors for commercial, construction and consumer loans are applied to the amount of these off-balance sheet credit exposures to estimate inherent losses.

Other Real Estate Owned. Other real estate owned is comprised of property acquired through foreclosure proceedings, acceptances of deeds-in-lieu of foreclosure and, if applicable, vacated bank properties. Losses recognized at the time of acquiring property in full or partial satisfaction of debt are charged against the allowance for credit losses. Other real estate owned is recorded at the fair value of the collateral, generally based upon an independent property appraisal, less estimated disposition costs. Losses incurred subsequent to acquisition due to any decline in annual independent property appraisals are recognized as noninterest expense. Routine holding costs, such as property taxes, insurance and maintenance, and losses from sales and dispositions, are recognized as noninterest expense.

Premises and Equipment. Premises and equipment are stated at cost, less accumulated depreciation and amortization. Depreciation is computed substantially on the straight-line method over the estimated useful life of each type of asset. Estimated useful lives of premises and equipment range from 20 to 50 years and from 3 to 20 years, respectively. Leasehold improvements are amortized over the terms of the lease or their estimated useful life, whichever is shorter.

Revenue Recognition. The Company recognizes revenue as it is earned based on contractual terms, as transactions occur, or as services are provided and collectability is reasonably assured. In certain circumstances, noninterest income is reported net of associated expenses that are directly related to variable volume-based sales or revenue sharing arrangements or when the Company acts on an agency basis for others.

Life Insurance Cash Surrender Value. The Company has purchased life insurance policies on certain directors and officers as well as acquired such assets as part of the acquisition of other banks. Company owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement. These assets are included in other assets on the consolidated balance sheets.

Intangible Assets. Intangible assets are comprised of goodwill, core deposit intangibles and other identifiable intangibles acquired in business combinations. Intangible assets with definite useful lives are amortized on an accelerated basis over their respective estimated useful lives not exceeding 15 years. If an event occurs that indicates the carrying amount of an intangible asset may not be recoverable, Management reviews the asset for impairment. Any goodwill and any intangible asset acquired in a purchase business combination determined to have an indefinite useful life is not amortized, but is evaluated for impairment annually. The Company has the option to first assess qualitative factors to determine the likelihood of impairment pursuant to FASB ASU 2011-08, *Testing for Goodwill Impairment.* Although the Company has the option to first assess qualitative factors when determining if impairment exists, the Company has opted to perform a quantitative analysis to determine if impairment exists.

Impairment of Long-Lived Assets. The Company reviews its long-lived and certain intangible assets for impairment whenever events or changes indicate that the carrying amount of an asset may not be recoverable. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

Income Taxes. The Company and its subsidiaries file consolidated tax returns. The Company accounts for income taxes in accordance with FASB ASC 740, Income Taxes, resulting in two components of income tax expense: current and deferred. Current income tax expense approximates taxes to be paid or refunded for the current period. The Company determines deferred income taxes using the balance sheet method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities, and recognizes enacted changes in tax rates and laws in the period in which they occur. Deferred income tax expense results from changes in deferred tax assets and liabilities between periods. Deferred tax assets are recognized subject to Management's judgment that realization is more likely than not. A tax position that meets the more likely than not recognition threshold is measured to determine the amount of benefit to recognize. The tax position is measured at the largest amount of benefit that is greater than fifty percent likely of being realized upon settlement. Interest and penalties are recognized as a component of income tax expense.

Stock Options. The Company applies FASB ASC 718 – Compensation – Stock Compensation, to account for stock based awards granted to employees using the fair value method. The Company recognizes compensation expense for restricted performance share grants over the relevant attribution period. Restricted performance share grants have no exercise price, therefore, the intrinsic value is measured using an estimated per share price at the vesting date for each restricted performance share. The estimated per share price is adjusted during the attribution period to reflect actual stock price performance. The Company's obligation for unvested outstanding restricted performance share grants is classified as a liability until the vesting date due to a cash settlement feature, at which time the issued shares become classified as shareholders' equity.

Extinguishment of Debt. Gains and losses, including fees, incurred in connection with the early extinguishment of debt are charged to current earnings as reductions in noninterest income.

Postretirement Benefits. The Company uses an actuarial-based accrual method of accounting for post-retirement benefits.

Other. Securities and other property held by the Bank in a fiduciary or agency capacity are not included in the financial statements since such items are not assets of the Company or its subsidiaries.

Recently Adopted Accounting Standards

In 2018, the Company adopted the following new accounting guidance:

FASB Accounting Standard Update (ASU) 2014-09, *Revenue (Topic 606): Revenue from Contracts with Customers,* was issued May 2014. The ASU specifies a standardized approach for revenue recognition across industries and transactions. The ASU also requires additional disclosures. The scope of the ASU does not include revenue streams covered by other ASU topics; thus, Topic 606 does not apply to revenue related to financial instruments, guarantees and leases, which are the primary sources of the Company's net interest income.

All of the Company's net interest income and a portion of its noninterest income are out of scope of the guidance. The contracts that are in scope of the guidance are primarily related to service charges and fees on deposit accounts, merchant processing fees, debit card fees, ATM processing fees, trust fees and other service charges, commissions and fees. The Company's revenue recognition practices within the scope of the ASU as described below did not change in any material regard upon adoption of the ASU.

Service Charges on Deposit Accounts, ATM Processing Fees and Other Service Fees: The Company earns fees from its deposit customers for transaction-based, account maintenance, and overdraft services. Transaction-based fees are recognized at the time the transaction is executed as that is the point in time the Company fulfills the customer's request. Account maintenance fees, which relate primarily to monthly maintenance, are earned over the course of a month, representing the period over which the Company satisfies the performance obligation. Overdraft fees are recognized at the point in time that the overdraft occurs. Service charges on deposits are withdrawn from the customer's account balance. ATM processing fees and other service fees are recognized at the point in time that the transaction occurs or the services provided.

Merchant Processing Services and Debit Card Fees: The Company earns interchange fees from cardholder transactions conducted through the payment networks. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized daily, concurrently with the transaction processing services provided to the cardholder.

Trust Fees: The Company earns trust fees from its contracts with customers to manage assets for investment or custody services. These fees are primarily earned over time as the Company provides the contracted monthly services and are generally assessed based on a tiered scale of the market value of assets under management (AUM) at month-end. Other related services provided, which are based on a fixed fee schedule, are recognized when the services are rendered.

Gains/Losses on Sales of OREO: The Company records a gain or loss from the sale of OREO when control of the property transfers to the buyer, which generally occurs at the time of an executed deed. The Company does not finance the sale of OREO. Gains on sale of OREO were $110 thousand, and $72 thousand and $1,185 thousand in the twelve months ended December 31, 2018 and 2017 and 2016, respectively.

The Company adopted the ASU on January 1, 2018 and no cumulative adjustment was required.

FASB ASU 2016-01, *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities,* was issued January 2016. The ASU addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. Most notably, the ASU changes the income statement impact of equity investments held by the Company and the requirement for the Company to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes (Note 11).

The Company was required to adopt the ASU provisions on January 1, 2018, and for those equity securities with readily determinable fair values, the Company elected the retrospective transition approach with a cumulative effect adjustment to the balance sheet and for those equity securities that do not have readily determinable fair values, the Company elected the prospective transition approach. The impact of the adoption of this accounting standard on the Company's consolidated financial statements will be subject to the price volatility of the equity investments. As a result of implementing the ASU provisions, effective January 1, 2018, the Company recorded a cumulative effect adjustment to decrease retained earnings by $142 thousand.

FASB ASU 2018-02, *Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income,* was issued February 2018. The ASU eliminates the stranded tax effects resulting from the Tax Cuts and Jobs Act of 2017 by allowing a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act of 2017. The Company early adopted the provisions of the ASU effective January 1, 2018, by reclassifying the

Company’s $3,625 thousand stranded tax effect.

Recently Issued Accounting Standards

FASB ASU 2016-02, *Leases (Topic 842),* was issued February 25, 2016. The provisions of the new standard require lessees to recognize most leases on-balance sheet, increasing reported assets and liabilities. Lessor accounting remains substantially similar to current U.S. GAAP.

The Company will be required to adopt the ASU provisions effective January 1, 2019, and plans to elect the modified retrospective transition approach. The implementing entry will recognize a lease liability of $15.3 million and right-to-use asset of $15.3 million for facilities leases. The change in occupancy and equipment expense will not be material.

FASB ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments,* was issued on June 16, 2016. The ASU significantly changes estimates for credit losses related to financial assets measured at amortized cost and certain other contracts. For estimating credit losses, the FASB is replacing the incurred loss model with the current expected credit loss (CECL) model, which will accelerate recognition of credit losses. Additionally, credit losses relating to debt securities available-for-sale will be recorded through an allowance for credit losses under the new standard. The Company will also be required to provide additional disclosures related to the financial assets within the scope of the new standard.

The Company will be required to adopt the ASU provisions on January 1, 2020. Management has evaluated available data, defined portfolio segments of loans with similar attributes, and selected loss estimate models for each identified loan portfolio segment. Management has preliminarily measured historical loss rates for each portfolio segment. The ultimate adjustment to the allowance for loan losses will be accomplished through an offsetting after-tax adjustment to shareholders’ equity. Management has also segmented debt securities held to maturity, selected methods to estimate losses for each segment, and preliminarily measured a loss estimate. Economic conditions and the composition of the Company’s loan portfolio and debt securities held to maturity at the time of adoption will influence the extent of the adopting accounting adjustment. Management expects to develop an aggregate loss estimate by September 30, 2019.

FASB ASU 2017-08, *Receivables – Non-Refundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities*, was issued March 2017. The ASU will shorten the amortization period for certain callable debt securities held at a premium. Specifically, the ASU requires the premium to be amortized to the earliest call date. The ASU does not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity. The Company will be required to adopt the ASU provisions on January 1, 2019. The implementing entry will reduce the carrying value of investment securities, specifically obligations of states and political subdivisions, by $3.1 million and reduce retained earnings by $2.8 million, net of tax. The change in premium amortization method will not be material to revenue recognition.

FASB ASU 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*, was issued August 2017. The ASU will expand and refine hedge accounting for both nonfinancial and financial risk components and align the recognition and presentation of the effects of the hedging instrument and the hedged item in the financial statements. The ASU also provides for a one-time reclassification of prepayable assets from held-to-maturity (HTM) to available for sale (AFS) regardless of derivative use.

The Company will be required to adopt the ASU provisions on January 1, 2019. 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. The Company has evaluated the prepayable assets in the HTM portfolio and will not effect a one-time reclassification of prepayable assets from HTM to the AFS upon implementation.

FASB ASU 2018-13, *Fair Value Measurements (Topic 820): Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement*, was issued August 2018. The ASU is part of the disclosure framework project, where the primary focus is to improve the effectiveness of disclosures in the financial statements. The ASU removes, modifies and adds disclosure requirements related to Fair Value Measurements.

The provisions of the ASU are effective January 1, 2020 with the option to early adopt any removed or modified disclosures upon issuance of the ASU. The Company early adopted the provisions to remove and/or modify relevant disclosures in Note 11 to the consolidated financial statements. The requirement to include additional disclosures will be adopted by the Company January 1, 2020. The additional disclosures will not affect the financial results upon adoption.

[The remainder of this page intentionally left blank]

Note 2: Investment Securities

Effective January 1, 2018, upon adoption of ASU 2016-01, equity securities included in the Company's available for sale portfolio of $1,800 thousand were reclassified to equity securities. The reclassification of equity securities resulted in recording a cumulative effect adjustment to decrease retained earnings by $142 thousand, net of tax.

At December 31, 2018, the market value of equity securities was $1,747 thousand. During the twelve months ended December 31, 2018, the Company recognized gross unrealized holding losses of $52 thousand in earnings.

An analysis of the amortized cost and fair value by major categories of debt securities available for sale, which are carried at fair value with net unrealized gains (losses) reported on an after-tax basis as a component of cumulative other comprehensive income, and debt securities held to maturity, which are carried at amortized cost, follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
At December 31, 2018	(In thousands)			
Debt securities available for sale				
U.S. Treasury securities	$139,572	$ 5	$ (3)	$139,574
Securities of U.S. Government sponsored entities	167,228	65	(3,275)	164,018
Agency residential mortgage-backed securities (MBS)	883,715	595	(30,439)	853,871
Non-agency residential MBS	113	1	-	114
Agency commercial MBS	1,869	-	(27)	1,842
Securities of U.S. Government entities	1,128	-	(9)	1,119
Obligations of states and political subdivisions	180,220	1,856	(2,985)	179,091
Corporate securities	1,337,608	1,075	(23,642)	1,315,041
Total debt securities available for sale	2,711,453	3,597	(60,380)	2,654,670
Debt securities held to maturity				
Agency residential MBS	447,332	249	(14,129)	433,452
Non-agency residential MBS	3,387	40	-	3,427
Obligations of states and political subdivisions	533,890	3,403	(2,727)	534,566
Total debt securities held to maturity	984,609	3,692	(16,856)	971,445
Total	$3,696,062	$ 7,289	$ (77,236)	$3,626,115

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
At December 31, 2017	(In thousands)			

Debt securities available for sale				
Securities of U.S. Government sponsored entities	$122,285	$ 1	$ (2,967)	$119,319
Agency residential MBS	787,679	522	(20,495)	767,706
Non-agency residential MBS	153	1	-	154
Agency commercial MBS	2,244	-	(25)	2,219
Securities of U.S. Government entities	1,612	-	(22)	1,590
Obligations of states and political subdivisions	182,907	3,796	(1,482)	185,221
Corporate securities	1,123,671	1,104	(9,277)	1,115,498
Total debt securities available for sale	2,220,551	5,424	(34,268)	2,191,707
Debt securities held to maturity				
Agency residential MBS	545,883	606	(9,850)	536,639
Non-agency residential MBS	4,462	70	-	4,532
Agency commercial MBS	9,041	-	(66)	8,975
Obligations of states and political subdivisions	599,478	7,736	(2,018)	605,196
Total debt securities held to maturity	1,158,864	8,412	(11,934)	1,155,342
Total	$3,379,415	$ 13,836	$ (46,202)	$3,347,049

The amortized cost and fair value of debt securities by contractual maturity are shown in the following table s at the dates indicated:

	At December 31, 2018			
	Debt Securities Available for Sale		Debt Securities Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(In thousands)			
Maturity in years:				
1 year or less	$262,418	$261,976	$86,172	$86,148
Over 1 to 5 years	1,438,849	1,414,020	214,137	213,829
Over 5 to 10 years	85,817	85,877	232,544	233,515
Over 10 years	38,672	36,970	1,037	1,074
Subtotal	1,825,756	1,798,843	533,890	534,566
MBS	885,697	855,827	450,719	436,879
Total	$2,711,453	$2,654,670	$984,609	$971,445

	At December 31, 2017			
	Debt Securities Available for Sale		Debt Securities Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(In thousands)			
Maturity in years:				
1 year or less	$193,337	$193,385	$50,295	$51,105
Over 1 to 5 years	1,031,807	1,023,047	269,050	269,471
Over 5 to 10 years	159,266	160,042	277,170	281,546
Over 10 years	46,065	45,154	2,963	3,074
Subtotal	1,430,475	1,421,628	599,478	605,196
MBS	790,076	770,079	559,386	550,146
Total	$2,220,551	$2,191,707	$1,158,864	$1,155,342

Expected maturities of mortgage-related securities can differ from contractual maturities because borrowers have the right to call or prepay obligations with or without call or prepayment penalties. In addition, such factors as prepayments and interest rates may affect the yield on the carrying value of mortgage-related securities. At December 31, 2018 and December 31, 2017, the Company had no high-risk collateralized mortgage obligations as defined by regulatory guidelines.

[The remainder of this page intentionally left blank]

-61-

An analysis of the gross unrealized losses of the debt securities available for sale portfolio follows:

	Debt Securities Available for Sale At December 31, 2018								
	Less than 12 months			12 months or longer			Total		
	No. of Investment Positions	Fair Value	Unrealized Losses	No. of Investment Positions	Fair Value	Unrealized Losses	No. of Investment Positions	Fair Value	Unrealized Losses
	($ in thousands)								
U.S. Treasury securities	2	$54,805	$(3)	-	$-	$-	2	$54,805	$(3)
Securities of U.S. Government sponsored entities	1	990	(5)	9	117,963	(3,270)	10	118,953	(3,275)
Agency residential MBS	8	107,497	(507)	58	640,210	(29,932)	66	747,707	(30,439)
Agency commercial MBS	1	1,842	(27)	-	-	-	1	1,842	(27)
Securities of U.S. Government entities	-	-	-	2	1,119	(9)	2	1,119	(9)
Obligations of states and political subdivisions	32	26,452	(166)	71	67,121	(2,819)	103	93,573	(2,985)
Corporate securities	38	308,157	(3,403)	79	722,740	(20,239)	117	1,030,897	(23,642)
Total	82	$499,743	$(4,111)	219	$1,549,153	$(56,269)	301	$2,048,896	$(60,380)

An analysis of gross unrecognized losses of the debt securities held to maturity portfolio follows:

	Debt Securities Held to Maturity At December 31, 2018								
	Less than 12 months			12 months or longer			Total		
	No. of Investment Positions	Fair Value	Unrecognized Losses	No. of Investment Positions	Fair Value	Unrecognized Losses	No. of Investment Positions	Fair Value	Unrecognized Losses
	($ in thousands)								
Agency residential MBS	16	$8,495	$(34)	78	$412,574	$(14,095)	94	$421,069	$(14,129)
Non-agency residential MBS	1	26	-	-	-	-	1	26	-
Obligations of states and political subdivisions	97	83,633	(271)	142	151,546	(2,456)	239	235,179	(2,727)
Total	114	$92,154	$(305)	220	$564,120	$(16,551)	334	$656,274	$(16,856)

The unrealized losses on the Company's debt securities were caused by market conditions for these types of investments, particularly changes in risk-free interest rates. The Company evaluates debt securities on a quarterly basis including changes in security ratings issued by rating agencies, changes in the financial condition of the issuer, and, for mortgage-backed and asset-backed securities, delinquency and loss information with respect to the underlying collateral, changes in the levels of subordination for the Company's particular position within the repayment structure and remaining credit enhancement as compared to expected credit losses of the security. Substantially all of these securities continue to be investment grade rated by a major rating agency. One corporate bond with a carrying value of $15.0 million and a market value of $13.8 million at December 31, 2018, is rated below investment grade. In addition to monitoring credit rating agency evaluations, Management performs its own evaluations regarding the credit worthiness of the issuer or the securitized assets underlying asset backed securities.

The Company does not intend to sell any debt securities and has concluded that it is more likely than not that it will not be required to sell the debt securities prior to recovery of the amortized cost basis. Therefore, the Company does not consider these debt securities to be other-than-temporarily impaired as of December 31, 2018.

The fair values of the debt securities could decline in the future if the general economy deteriorates, inflation increases, credit ratings decline, the issuer's financial condition deteriorates, or the liquidity for debt securities declines. As a result, other than temporary impairments may occur in the future.

As of December 31, 2018 and December 31, 2017, the Company had debt securities pledged to secure public deposits and short-term borrowed funds of $728,161 thousand and $715,774 thousand, respectively.

An analysis of gross unrealized losses of debt securities available for sale follows:

	Debt Securities Available for Sale At December 31, 2017								
	No. of	Less than 12 months		No. of	12 months or longer		No. of	Total	
	Investment Positions	Fair Value	Unrealized Losses	Investment Positions	Fair Value	Unrealized Losses	Investment Positions	Fair Value	Unrealized Losses
	($ in thousands)								
Securities of U.S. Government sponsored entities	1	$996	$(2)	8	$117,252	$(2,965)	9	$118,248	$(2,967)
Agency residential MBS	7	238,554	(1,501)	51	516,711	(18,994)	58	755,265	(20,495)
Non-agency residential MBS	1	1	-	-	-	-	1	1	-
Agency commercial MBS	2	2,219	(25)	-	-	-	2	2,219	(25)
Securities of U.S. Government entities	-	-	-	3	1,590	(22)	3	1,590	(22)
Obligations of states and political subdivisions	50	21,453	(228)	35	52,071	(1,254)	85	73,524	(1,482)
Corporate securities	64	571,112	(4,047)	38	282,924	(5,230)	102	854,036	(9,277)
Total	125	$834,335	$(5,803)	135	$970,548	$(28,465)	260	$1,804,883	$(34,268)

An analysis of gross unrecognized losses of the debt securities held to maturity portfolio follows:

	Debt Securities Held to Maturity At December 31, 2017								
	No. of	Less than 12 months		No. of	12 months or longer		No. of	Total	
	Investment Positions	Fair Value	Unrecognized Losses	Investment Positions	Fair Value	Unrecognized Losses	Investment Positions	Fair Value	Unrecognized Losses
	($ in thousands)								
Agency residential MBS	15	$30,218	$ (201)	65	$479,775	$(9,649)	80	$509,993	$(9,850)
Agency commercial MBS	1	1,913	(4)	1	7,062	(62)	2	8,975	(66)
Obligations of states and political subdivisions	146	131,032	(553)	59	58,979	(1,465)	205	190,011	(2,018)
Total	162	$163,163	$ (758)	125	$545,816	$(11,176)	287	$708,979	$(11,934)

The following table provides information about the amount of interest income earned on investment securities which is fully taxable and which is exempt from regular federal income tax:

	For the Years Ended December 31,		
	2018	2017	2016
	(In thousands)		
Taxable	$65,330	$51,445	$42,718
Tax-exempt from regular federal income tax	19,438	20,651	22,194
Total interest income from investment securities	$84,768	$72,096	$64,912

[The remainder of this page intentionally left blank]

Note 3: Loans and Allowance for Credit Losses

At December 31, 2018, the Company had $5.7 million in residential real estate secured loans which are indemnified from loss by the FDIC up to eighty percent of principal; the indemnification expired February 6, 2019.

A summary of the major categories of loans outstanding is shown in the following tables at the dates indicated.

	At Decmber 31,	
	2018	2017
	(In thousands)	
Commercial	$275,080	$335,996
Commercial Real Estate	580,480	568,584
Construction	3,982	5,649
Residential Real Estate	44,866	65,183
Consumer Installment & Other	302,794	312,570
Total	$1,207,202	$1,287,982

Total loans outstanding reported above include loans purchased from the FDIC of $58,247 thousand and $83,478 thousand at December 31, 2018 and December 31, 2017, respectively.

Changes in the accretable yield for purchased loans were as follows:

	For the Years Ended December 31,	
	2018	2017
Accretable yield:	(In thousands)	
Balance at the beginning of the period	$738	$1,237
Reclassification from nonaccretable difference	1,119	1,852
Accretion	(1,675)	(2,351)
Balance at the end of the period	$182	$738
Accretion	$(1,675)	$(2,351)
Change in FDIC indemnification	2	192
(Increase) in interest income	$(1,673)	$(2,159)

The following summarizes activity in the allowance for loan losses:

	Allowance for Loan Losses For the Year Ended December 31, 2018						
	Commercial	Commercial Real Estate	Construction	Residential Real Estate	Consumer Installment and Other	Unallocated	Total
	(In thousands)						
Allowance for loan losses:							
Balance at beginning of period	$7,746	$ 3,849	$ 335	$ 995	$ 6,418	$ 3,666	$23,009
(Reversal) provision	(2,369)	275	1,130	(126)	1,579	(489)	-
Chargeoffs	(513)	(240)	-	-	(4,124)	-	(4,877)
Recoveries	1,447	-	-	-	1,772	-	3,219
Total allowance for loan losses	$6,311	$ 3,884	$ 1,465	$ 869	$ 5,645	$ 3,177	$21,351

	Allowance for Loan Losses For the Year Ended December 31, 2017						
	Commercial	Commercial Real Estate	Construction	Residential Real Estate	Consumer Installment and Other	Unallocated	Total
	(In thousands)						
Allowance for loan losses:							
Balance at beginning of period	$8,327	$ 3,330	$ 152	$ 1,330	$ 7,980	$ 4,835	$25,954
(Reversal) provision	(382)	431	(1,716)	(335)	1,271	(1,169)	(1,900)
Chargeoffs	(961)	-	-	-	(4,957)	-	(5,918)
Recoveries	762	88	1,899	-	2,124	-	4,873
Total allowance for loan losses	$7,746	$ 3,849	$ 335	$ 995	$ 6,418	$ 3,666	$23,009

Allowance for Credit Losses
For the Year Ended December 31, 2016

	Commercial	Commercial Real Estate	Construction	Residential Real Estate	Consumer Installment and Other	Unallocated	Total
	(In thousands)						
Allowance for loan losses:							
Balance at beginning of period	$9,559	$ 4,212	$ 235	$ 1,801	$ 8,001	$ 5,963	$29,771
(Reversal) provision	(3,237)	(1,436)	(83)	(471)	3,155	(1,128)	(3,200)
Chargeoffs	(2,023)	-	-	-	(4,749)	-	(6,772)
Recoveries	4,028	554	-	-	1,573	-	6,155
Total allowance for loan losses	$8,327	$ 3,330	$ 152	$ 1,330	$ 7,980	$ 4,835	$25,954

The allowance for loan losses and recorded investment in loans evaluated for impairment were as follows:

Allowance for Loan Losses and Recorded Investment in Loans Evaluated for Impairment
At December 31, 2018

	Commercial	Commercial Real Estate	Construction	Residential Real Estate	Consumer Installment and Other	Unallocated	Total
	(In thousands)						
Allowance for loan losses:							
Individually evaluated for impairment	$2,752	$ -	$ -	$ -	$ -	$ -	$2,752
Collectively evaluated for impairment	3,559	3,884	1,465	869	5,645	3,177	18,599
Purchased loans with evidence of credit deterioration	-	-	-	-	-	-	-
Total	$6,311	$3,884	$ 1,465	$869	$5,645	$ 3,177	$21,351
Carrying value of loans:							
Individually evaluated for impairment	$9,921	$8,217	$ -	$717	$ -	$ -	$18,855
Collectively evaluated for impairment	265,136	572,042	3,982	44,149	302,651	-	1,187,960
Purchased loans with evidence of credit deterioration	23	221					