

First California Financial Group, Inc.
Form 10-K
March 15, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

Form 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2011

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 000-52498

FIRST CALIFORNIA FINANCIAL GROUP, INC.
(Exact Name of Registrant as Specified in Its Charter)

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

38-3737811
(I.R.S. Employer
Identification Number)

3027 Townsgate Road, Suite 300
Westlake Village, California
(Address of Principal Executive Offices)

91361
(Zip Code)

Registrant's telephone number, including area code: (805) 322-9655

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

Title of Each Class
Common Stock, \$0.01 par value

Name of Each Exchange on Which Registered
The Nasdaq Global Select Market

Securities registered pursuant to Section 12(g) of the Exchange 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

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Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange 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 whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K 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, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

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

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

Aggregate market value of common stock held by non-affiliates as of June 30, 2011: \$80,865,130

As of March 12, 2012, there were 29,249,104 shares of Common Stock, \$0.01 par value, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

INDEX

Part I

<u>Item 1. Business</u>	1
<u>Item 1A. Risk Factors</u>	15
<u>Item 1B. Unresolved Staff Comments</u>	23
<u>Item 2. Properties</u>	24
<u>Item 3. Legal Proceedings</u>	25
<u>Item 4. Mine Safety Disclosures</u>	25

Part II

<u>Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	26
<u>Item 6. Selected Financial Data</u>	27
<u>Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	28
<u>Item 7A. Quantitative and Qualitative Disclosures About Market Risk</u>	60
<u>Item 8. Financial Statements and Supplementary Data</u>	61
<u>Item 9. Changes In and Disagreements with Accountants on Accounting and Financial Disclosure</u>	113
<u>Item 9A. Controls and Procedures</u>	113
<u>Item 9B. Other Information</u>	114

Part III

<u>Item 10. Directors, Executive Officers and Corporate Governance</u>	115
<u>Item 11. Executive Compensation</u>	115
<u>Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	115
<u>Item 13. Certain Relationships and Related Transactions, and Director Independence</u>	115

<u>Item 14. Principal Accountant Fees and Services</u>	115
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Part IV

<u>Item 15. Exhibits and Financial Statement Schedules</u>	115
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<u>Signatures</u>	122
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Certifications

PART I

Item 1. Business

Our Business

As used herein, the term “First California Financial Group,” “First California,” “FCAL,” “the Company,” “our,” “us,” “we” or expression includes First California Financial Group, Inc. and First California Bank unless the context indicates otherwise.

Business of First California Financial Group

First California is a bank holding company registered under the Bank Holding Company Act of 1956, as amended, or the BHCA. First California’s primary function is to coordinate the general policies and activities of its bank subsidiary, First California Bank, or the Bank, as well as to consider from time to time other legally available investment opportunities. SC Financial is an inactive subsidiary of First California.

First California incorporated under the laws of the State of Delaware on June 7, 2006. The Company formed as a wholly-owned subsidiary of National Mercantile Bancorp, a California corporation, or National Mercantile, for the purposes of facilitating the mergers of National Mercantile and FCB Bancorp, a California corporation, or FCB. On March 12, 2007, National Mercantile merged with and into First California. Immediately thereafter, the parties completed the previously announced merger of FCB with and into First California. In this document, we refer to the two-step merger of National Mercantile into First California and FCB into First California as the Mergers. As a result of the Mergers, the separate corporate existence of National Mercantile and FCB ceased, and First California succeeded, and assumed all the rights and obligations of, National Mercantile, whose principal assets were the capital stock of two bank subsidiaries, Mercantile National Bank, or Mercantile, and South Bay Bank, N.A., or South Bay, and the rights and obligations of FCB, whose principal assets was the capital stock of First California Bank. On June 18, 2007, First California integrated its bank subsidiaries into First California Bank. All references to the Bank on or before June 18, 2007 refer to the Bank, Mercantile and South Bay.

Business of First California Bank

The Bank is a full-service commercial bank headquartered in Westlake Village, California. The Bank is chartered under the laws of the State of California and is subject to supervision by the California Department of Financial Institutions, or the DFI. The Federal Deposit Insurance Corporation, or the FDIC, insures its deposits up to the maximum legal limit.

On November 5, 2010, the Bank assumed certain liabilities and acquired certain assets and substantially all of the operations of Western Commercial Bank, or WCB, located in Woodland Hills, California, from the FDIC. The Bank acquired, received and recognized certain assets with an estimated fair value of approximately \$109 million, including \$55 million of loans, \$32 million of cash, \$16.7 million of a FDIC shared-loss asset, \$2 million of securities and \$3 million of other assets. Liabilities with an estimated fair value of approximately \$107 million were also assumed and recognized, including \$105 million of deposits and \$2 million of other liabilities. The Bank recorded a pre-tax bargain purchase gain of \$2.3 million in connection with this transaction. The transaction increased the number of the Bank’s full-service branch locations to 18 and the Bank fully integrated the former WCB branch into its full-service branch network prior to December 31, 2010.

On February 18, 2011, the Bank assumed certain liabilities and acquired certain assets and substantially all of the operations of San Luis Trust Bank, or SLTB, located in San Luis Obispo, California, from the FDIC. The Bank

acquired, received and recognized certain assets with an estimated fair value of approximately \$367 million, including \$139 million of loans, \$99 million of cash and federal funds sold, \$70 million of a FDIC shared-loss asset, \$41 million of securities, \$13 million of foreclosed property and \$5 million of other assets. Liabilities with an estimated fair value of approximately \$346 million were also assumed and recognized, including \$266 million of deposits, \$62 million of Federal Home Loan Bank advances, \$15 million in a deferred tax liability, \$2.6 million of a FDIC shared-loss liability and \$0.4 million of other liabilities. The Bank recorded a pre-tax bargain purchase gain of \$36.5 million in connection with this transaction. This transaction increased the number of the Bank's full-service branch locations to 19 and the Bank fully integrated the former SLTB branch into its full-service branch network in June 2011.

On April 8, 2011, the Bank completed the acquisition of the Electronic Banking Solutions division of Palm Desert National Bank. The transaction included the division's customer base, core deposits, and employees. The Electronic Payment Services Division, or the EPS division, its new name under the Bank, issues prepaid cards and sponsors merchant acquiring services for all national and regional networks, including Visa, MasterCard, and Discover throughout all 50 states and U.S. territories. The Bank acquired cash of \$85.4 million, recognized intangible assets of \$6.0 million, assumed \$91 million of deposits and recognized a pre-tax bargain purchase gain of \$0.5 million in connection with this transaction.

The Bank's business strategy has been to attract individuals, professionals, and small- to mid-sized business borrowers in our primary service areas by offering a variety of loan products and a full range of banking services coupled with highly personalized service. The Bank's operations are primarily located within the areas commonly known as the "101 corridor" stretching from the City of Ventura to Calabasas, California, the Moorpark-Simi Valley corridor, the western San Fernando Valley, the Tri-Cities area of Glendale-Burbank-Pasadena, the South Bay, the Inland Empire, north San Diego County, Century City and other parts of Los Angeles, Orange, San Luis Obispo and Ventura Counties in Southern California. Our lending products include revolving lines of credit, term loans, commercial real estate loans, construction loans and consumer and home equity loans, which often contain terms and conditions tailored to meet the specific demands of the market niche in which the borrower operates. Additionally, the Bank provides a wide array of deposit products serving the comprehensive banking needs of businesses and consumers in Los Angeles, Orange, Ventura, San Diego, Riverside, San Bernardino and San Luis Obispo counties through traditional business and consumer banking, construction finance, SBA lending, entertainment finance and commercial real estate lending via 19 full-service branch locations.

Business loans, represented by commercial mortgage loans, commercial loans and construction loans, comprise the largest portion of the Bank's loan portfolio. Commercial real estate loans rely upon the cash flow originating from the underlying real property. Commercial real estate is a cyclical industry that is affected not only by general economic conditions but also by local supply and demand. Commercial loans rely upon the cash flow originating from the underlying business activity of the enterprise. The manufacture, distribution or sale of goods or sale of services are not only affected by general economic conditions but also by the ability of the enterprise's management to adjust to local supply and demand conditions, maintain good labor, vendor and customer relationships, as well as market and sell their goods or services for a profit. Construction loans provide developers or owners with funds to build or improve properties that will ultimately be sold or leased. Construction loans are generally considered to involve a higher degree of risk than other loan categories because they rely upon the developer's or owner's ability to complete the project within specified cost and time limits.

Consumer loans, a smaller component of the Bank's loan portfolio, are represented by home mortgages and home equity loans and lines of credit that are secured by first or second trust deeds on a borrower's real estate property, typically their principal residence. These loans are dependent on a person's ability to regularly pay the principal and interest due on the loan and, secondarily, on the value of real estate property that serves as collateral for the loan.

The Bank's business strategy also stresses the importance of customer deposit relationships to support its lending activities. Checking deposits, savings deposits and certificates of deposit represent a significant low-cost and stable source of funds. Business customers are offered cash management products, including on-line banking and remote deposit capture, to meet their specific banking needs.

The Bank's goal is to offer its customers a consistently high level of individualized personal service. Accordingly, in order to meet the changing needs of our customers, the Bank is constantly evaluating a variety of options to broaden the services and products it provides. The Bank's strategy in attaining its goals has been to implement and maintain risk management and controls to achieve a safe and sound business policy, employing an aggressive marketing plan which emphasizes relationship banking and the "personal touch," offering competitive products and managing growth. The Bank provides convenience through 19 banking offices with ATM access, 24 hour telephone access to account information, on-line banking, courier service and remote deposit capture. The diversity of our delivery systems enables customers to choose the method of banking that is most convenient for them. The Bank trains its staff to recognize each customer, greet them, and be able to address them by name so that they feel as if they have a "private banker."

Financial and Statistical Disclosure

Certain of our financial and statistical information is presented within "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations." This information should be read in conjunction with the consolidated financial statements contained in "Item 8. Financial Statements and Supplementary Data."

Competition

The banking business in California, generally, and in the Bank's service areas, specifically, is highly competitive with respect to both loans and deposits and is dominated by a number of major banks that have many offices operating over wide geographic areas. The Bank competes for deposits and loans principally with these major banks and other financial institutions located in our market areas. Among the advantages that the major banks have over the Bank are their ability to finance extensive advertising campaigns and to allocate their investment assets to regions of highest yield and demand. Many of the major commercial banks operating in the Bank's service areas offer certain services (such as trust and international banking services) that are not offered directly by the Bank and, by virtue of their greater total capitalization, such banks have substantially higher lending limits. Moreover, all banks face increasing

competition for loans and deposits from non-bank financial intermediaries such as mortgage companies, insurance companies, credit unions and securities firms.

In November 1999, the Gramm-Leach-Bliley Act, or the GLBA, was signed into law. The GLBA significantly changed the regulatory structure and oversight of the financial services industry. The GLBA revised the BHCA and repealed the affiliation prohibitions of the Glass-Steagall Act of 1933. Consequently, a qualifying holding company, called a financial holding company, can engage in a full range of financial activities, including banking, insurance, and securities activities, as well as merchant banking and additional activities that are “financial in nature” or “incidental” to those financial activities. Expanded financial affiliation opportunities for existing bank holding companies are now permitted. Moreover, various non-bank financial services providers can acquire banks while also offering services like securities underwriting and underwriting and brokering insurance products. The GLBA also expanded passive investment activities by financial holding companies, permitting investments in any type of company, financial or non-financial, through acquisitions of merchant banking firms and insurance companies.

Given that the traditional distinctions between banks and other providers of financial services have been effectively eliminated, the Bank has faced and will continue to face additional competition from thrift institutions, credit unions, insurance companies and securities firms. Additionally, the Bank's ability to cross-market banking products to existing customers or the customers of affiliated companies may make it more difficult to compete.

In order to compete, the Bank uses to the fullest extent possible the familiarity of its directors and officers with the market area and its residents and businesses and the flexibility that the Bank's independent status will permit. This includes an emphasis on specialized services, local promotional activity, and personal contacts by directors, officers and other employees. The Bank uses advertising, including newspaper ads and direct mail pieces, to inform the community of the services it offers. The Bank also utilizes emerging marketing techniques, such as the Internet, to reach target markets. The Bank also has an active calling program where officers, including commissioned business development officers, contact targeted prospects to solicit both deposit and loan business.

The Bank has developed programs that specifically address the needs of consumers, professionals and small-to medium-sized businesses. In the event there are customers whose loan demands exceed the Bank's lending limits, it arranges for such loans on a participation basis with other financial institutions and intermediaries. The Bank also assists those customers requiring other services not offered by the Bank to obtain those services from correspondent banks. In addition, the Bank offers ATM services, a night depository, remote deposit capture, courier services, bank-by-mail services, merchant windows, lockbox and direct deposit services.

The Bank's management believes that the Bank's reputation in the communities served and personal service philosophy enhance the ability to compete favorably in attracting and retaining individual, professional and business clients. The Bank also believes that it has an advantage over the larger national and "super regional" institutions because it is managed by locally-known, well-respected and experienced bankers. Moreover, our larger competitors may not offer adequate personalized banking services, since their emphasis is on large volume and standardized retail products.

The Bank also faces growing competition from other community banks. These institutions have similar marketing strategies, have also been successful and offer strong evidence regarding the potential success of the community banking sector.

No assurance can be given that ongoing efforts to compete will continue to be successful.

Dependence on One or a Few Major Customers; Business Concentrations

No individual or single group of related accounts is considered material in relation to our total assets or to the assets or deposits of the Bank, or in relation to our overall business. However, approximately 82% of our loan portfolio at December 31, 2011 consisted of real estate-secured loans, including commercial real estate loans, construction loans, home mortgage loans, home equity loans and lines of credit. See "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations — Financial Position — December 31, 2011 compared with December 31, 2010" in Part II of this Annual Report on Form 10-K. Moreover, our business activities are currently focused primarily in Southern California, with the majority of our business concentrated in Ventura, Orange and Los Angeles Counties. Consequently, our results of operations and financial condition are dependent upon the general trends in the Southern California economies and, in particular, the residential and commercial real estate markets. In addition, the concentration of our operations in Southern California exposes us to greater risk than other banking companies with a wider geographic base in the event of catastrophes, such as earthquakes, fires and floods in this region.

Internet Banking Services

The Bank maintains an internet website, which serves as an additional means of providing customer access to a variety of banking services, including 24/7 online banking. The Bank's website address is www.fcbank.com. No information contained on the website is incorporated herein by reference.

Employees

At December 31, 2011, the Bank had 304 full-time equivalent employees. The Bank's employees are not represented by any union or other collective bargaining agreement and the Bank considers its relations with employees to be excellent.

Supervision and Regulation

Recent Developments

On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act, or Dodd-Frank, was signed into law. Dodd-Frank will have a broad impact on the financial services industry and will impose significant new regulatory and compliance requirements, including the designation of certain financial companies as systemically significant, the imposition of increased capital, leverage and liquidity requirements, and numerous other provisions designed to improve supervision and oversight of, and strengthen safety and soundness within, the financial services sector. Additionally, Dodd-Frank establishes a new framework of authority to conduct systemic risk oversight within the financial system to be distributed among new and existing regulatory agencies, including the Financial Stability Oversight Council, or Council, the Board of Governors of the Federal Reserve System, or FRB, the Office of the Comptroller of the Currency, or OCC, and the FDIC. The rules and regulations promulgated under Dodd-Frank are likely to impact our operations and cost. Dodd-Frank includes, among other things, the following:

- (i) the creation of a Financial Stability Oversight Counsel to identify emerging systemic risks and improve interagency cooperation;
- (ii) requirement by statute that bank holding companies serve as a source of financial strength for their depository institution subsidiaries;
- (iii) the elimination and phase-out of trust preferred securities from Tier 1 capital with certain exceptions;
- (iv) the elimination of remaining barriers to de novo interstate branching by banks;
- (v) expanded FDIC resolution authority to conduct the orderly liquidation of certain systemically significant non-bank financial companies in addition to depository institutions;
- (vi) enhanced regulation of financial markets, including the derivative and securitizations markets, and the elimination of certain proprietary trading activities by banks;
- (vii) the establishment of strengthened capital and liquidity requirements for banks and bank holding companies, including minimum leverage and risk-based capital requirements no less than the strictest requirements in effect for depository institutions as of the date of enactment;
- (viii) a permanent increase of the previously implemented temporary increase of FDIC deposit insurance to \$250,000 and an extension of federal deposit coverage until January 1, 2013 for the full net amount held by depositors in non-interest bearing transaction accounts;
- (ix) authorization for financial institutions to pay interest on business checking accounts;
- (x) changes in the calculation of FDIC deposit insurance assessments, such that the assessment base will no longer be the institution's deposit base, but instead, will be its average consolidated total assets less its average tangible equity and increase the minimum reserve ratio for the Deposit Insurance Fund, or DIF, from 1.15 percent to 1.35 percent;
- (xi) the transfer of oversight of savings and loan holding companies to the FRB, federally chartered thrift institutions to the Office of the Comptroller of the Currency and state-chartered savings banks to the FDIC, and the elimination of the Office of Thrift Supervision;

- (xii) the creation of a Consumer Financial Protection Bureau, or CFPB, which is authorized to promulgate and enforce consumer protection regulations relating to bank and non-bank financial products and examine and enforce these regulations on banks with more than \$10 billion in assets;
- (xiii) expanded restrictions on transactions with affiliates and insiders under Sections 23A and 23B of the Federal Reserve Act and lending limits for derivative transactions, repurchase agreements and securities lending and borrowing transactions; and
- (xiv) provisions that affect corporate governance and executive compensation at most United States publicly traded companies, including (1) stockholder advisory votes on executive compensation, (2) executive compensation “clawback” requirements for companies listed on national securities exchanges in the event of materially inaccurate statements of earnings, revenues, gains or other criteria similar to the requirements of the American Recovery and Reinvestment Act of 2009 for the Troubled Assets Relief Program Capital Purchase Program for the SEC recipients, (3) enhances independence requirements for compensation committee members, and (4) authority for the SEC to adopt proxy access rules which would permit stockholders of publicly traded companies to nominate candidates for election as a director and have those nominees included in a company’s proxy statement.

We cannot predict the extent to which the interpretations and implementation of this wide-ranging federal legislation may affect us. Many of the requirements of Dodd-Frank will be implemented over time and most will be subject to regulations implemented over the course of several years. There can be no assurance that these or future reforms (such as possible new standards for commercial real estate lending or new stress testing guidance for all banks) arising out of studies and reports required by Dodd-Frank will not significantly increase our compliance or other operating costs and earnings or otherwise have a significant impact on our business, financial condition and results of operations. Dodd-Frank is likely to impose upon us more stringent capital, liquidity and leverage requirements or otherwise adversely affect our business. As a result of the changes required by Dodd-Frank, the profitability of our business activities may be impacted and we may be required to make changes to certain of our business practices. These changes may also require us to invest significant management attention and resources to evaluate and make any changes necessary to comply with new statutory and regulatory requirements.

In response to the financial crisis affecting the banking system and financial markets and going concern threats to investment banks and other financial institutions, on October 3, 2008, the Emergency Economic Stabilization Act of 2008, or the EESA, became law. Through its authority under the EESA, the Treasury announced in October 2008 the Troubled Asset Relief Program—Capital Purchase Program, or the CPP, a program designed to bolster healthy institutions, like First California, by making \$250 billion of capital available to U.S. financial institutions in the form of preferred stock.

We participated in the CPP in December 2008 so that we could continue to lend and support our current and prospective clients, especially during this unstable economic environment. Under the terms of our participation, we received \$25 million in exchange for the issuance of preferred stock and a warrant to purchase common stock, and became subject to various requirements, including certain restrictions on paying dividends on our common stock and repurchasing our equity securities, unless the Treasury has consented. The common stock warrant entitled the Treasury to purchase 599,042 shares of our common stock at an exercise price of \$6.26 for a term of ten years. On July 14, 2011, we redeemed all 25,000 preferred stock series B shares and exited the CPP program. On August 24, 2011, we purchased the 10-year warrant from the Treasury for \$599,042. In connection with the redemption of the preferred stock series B shares, the Company accelerated the amortization of the remaining difference between the par amount and the initially recorded fair value of the preferred stock series B shares. This \$1.1 million deemed dividend reduced the amount of net income available to common shareholders in 2011.

We redeemed the \$25 million of preferred stock series B shares with the \$25 million of proceeds received in exchange for issuing 25,000 preferred stock series C shares to the Treasury as a participant in the Small Business Lending Fund program, or the SBLF. The preferred stock series C shares will receive non-cumulative quarterly dividends and the initial dividend rate was 5 percent. The dividend rate can fluctuate between 1 percent and 5 percent during the next eight quarters and is a function of the growth in qualified small business loans each quarter.

The EESA also temporarily increased FDIC deposit insurance on most accounts from \$100,000 to \$250,000. Dodd-Frank made the \$250,000 deposit insurance limit permanent. In addition, the FDIC has implemented two temporary programs under the Temporary Liquidity Guaranty Program, or the TLGP, to provide deposit insurance for the full amount of most non-interest bearing transaction accounts through June 30, 2010 (for depository institutions that did not opt out prior to November 2, 2009) and to guarantee certain unsecured debt of financial institutions and their holding companies through June 2012. The Bank did not participate in these TLGP programs. Dodd-Frank extended until January 1, 2013 deposit insurance for the full net amount of non-interest bearing transaction accounts. The FDIC charges “systemic risk special assessments” to depository institutions that participate in the TLGP. The FDIC has recently proposed that Congress give the FDIC expanded authority to charge fees to the holding companies which benefit directly and indirectly from the FDIC guarantees. See “FDIC Deposit Insurance” below.

Dodd-Frank adopts the so-called “Volcker Rule” which, subject to a transition period and certain exceptions, will become effective on July 21, 2012 and prohibits a banking entity from engaging in “proprietary trading,” which is defined as engaging as principal for the “trading account” of the banking entity in securities or other instruments, as determined by federal regulators. After the conformance period commencing July 21, 2012, the Volcker Rule prohibitions and restrictions will apply to banking entities, including the Company, the Bank and their affiliates, unless an exception applies. Certain forms of proprietary trading may qualify as “permitted activities,” and thus not be subject to the ban on proprietary trading, such as “market-making-related activities”, “risk-mitigating hedging activities”, and trading in U.S. government or agency obligations, certain other U.S., state or municipal obligations, and the obligations of Fannie Mae, Freddie Mac or Ginnie Mae. Additionally, subject to a transition period and certain exceptions, the rule restricts a banking entity from sponsoring or investing in certain private funds. A banking entity that sponsors or invests in certain private funds is also restricted from providing credit or other support to the fund or permitting the fund to use the name of the bank. In October 2011, the OCC, FRB, FDIC, and SEC, in consultation with the Commodity Futures Trading Commission, jointly released a notice of proposed rulemaking implementing the

Volcker Rule limitations of Dodd-Frank. In light of the complexity of the proposed regulation and the likelihood that a substantial number of comments will be submitted, the Company cannot fully assess the impact of the Volcker Rule on its business until final rules and regulations are adopted.

General

Banking is a complex, highly regulated industry. The primary goals of the regulatory scheme are to maintain a safe and sound banking system, protect depositors and the FDIC insurance fund, and facilitate the conduct of sound monetary policy. This regulatory scheme is not designed for the benefit of stockholders of the Company or its successors. In furtherance of these goals, Congress and the states have created several largely autonomous regulatory agencies and enacted numerous laws that govern banks, bank holding companies and the financial services industry. Consequently, the growth and earnings performance of the Company or its successors and the Bank can be affected not only by management decisions and general economic conditions, but also by the requirements of applicable state and federal statutes, regulations and the policies of various governmental regulatory authorities, including the FRB, the FDIC, the DFI, and the United States Department of the Treasury, or the Treasury.

The commercial banking business is also influenced by the monetary and fiscal policies of the federal government and the policies of the FRB. The FRB implements national monetary policies (with objectives such as curbing inflation and combating recession) by its open-market operations in United States Government securities, by adjusting the required level of reserves for financial intermediaries subject to its reserve requirements and by varying the discount rates applicable to borrowings by depository institutions. The actions of the FRB in these areas influence the growth of bank loans, investments and deposits and also affect interest rates charged on loans and paid on deposits. Indirectly, such actions may also impact the ability of non-bank financial institutions to compete with the Bank. The nature and impact of any future changes in monetary policies cannot be predicted.

The system of supervision and regulation applicable to financial services businesses governs most aspects of the business of the Company and the Bank, including: (i) the scope of permissible business; (ii) investments; (iii) reserves that must be maintained against deposits; (iv) capital levels that must be maintained; (v) the nature and amount of collateral that may be taken to secure loans; (vi) the establishment of new branches; (vii) mergers and consolidations with other financial institutions; and (viii) the payment of dividends.

From time to time laws or regulations are enacted which have the effect of increasing the cost of doing business, limiting or expanding the scope of permissible activities, or changing the competitive balance between banks and other financial and non-financial institutions. Proposals to change the laws and regulations governing the operations of banks and bank holding companies are frequently made in Congress, in the California legislature and by various bank and other regulatory agencies. For example, as noted above, Dodd-Frank, among other things, creates CFPB which has broad powers to regulate consumer financial services and products, creates the Financial Stability Oversight Council with regulatory authority over certain financial companies and activities, and would give shareholders a “say on pay” regarding executive compensation. The FRB has also issued proposed guidance on incentive compensation to ensure that banking organizations’ incentive compensation policies do not undermine the safety and soundness of their organizations. Future changes in the laws, regulations or policies that impact the Company or its successors and the Bank cannot necessarily be predicted, but they may have a material effect on the business and earnings of the Company and the Bank.

Set forth below is a summary description of certain of the material laws and regulations that relate to our operations and those of the Bank. The description does not purport to be a complete description of these laws and regulations and is qualified in its entirety by reference to the applicable laws and regulations.

Regulation of First California

As a registered bank holding company, First California and its subsidiaries are subject to the FRB’s supervision, regulation and examination under the BHCA. Under the BHCA, we are subject to periodic examination by the FRB. We are also required to file with the FRB periodic reports of our operations and such additional information regarding the Company and its subsidiaries as the FRB may require.

Under FRB regulations, a bank holding company is required to serve as a source of financial and managerial strength to its subsidiary banks and may not conduct its operations in an unsafe or unsound manner. In addition, it is the FRB’s policy that in serving as a source of strength to its subsidiary banks, a bank holding company should stand ready to use available resources to provide adequate capital funds to its subsidiary banks during periods of financial stress or adversity and should maintain the financial flexibility and capital-raising capacity to obtain additional resources for assisting its subsidiary banks. A bank holding company’s failure to meet its obligations to serve as a source of strength to its subsidiary banks will generally be considered by the FRB to be an unsafe and unsound banking practice or a violation of the FRB’s regulations or both.

Dodd-Frank amends the Federal Deposit Insurance Act, or FDIA, to obligate the FRB to require bank holding companies to serve as a source of financial strength for any subsidiary depository institution. The appropriate federal banking agency for such a depository institution may require reports from companies that own the insured depository institution to assess their ability to serve as a source of strength and to enforce compliance with the source-of-strength requirements. The term “source of financial strength” is defined as the ability of a company to provide financial assistance to its insured depository institution subsidiaries in the event of financial distress at such subsidiaries. Under this requirement, First California in the future could be required to provide financial assistance to the Bank should it experience financial distress.

First California is required to obtain the FRB’s prior approval before acquiring ownership or control of more than 5% of the outstanding shares of any class of voting securities, or substantially all the assets, of any company, including a bank or bank holding company. Further, we are allowed to engage, directly or indirectly, only in banking and other activities that the FRB deems to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. Pursuant to the GLBA, in order to elect and retain financial holding company status, a bank holding company and all depository institution subsidiaries must be well capitalized, well managed, and, except in limited circumstances, be in satisfactory compliance with the Community Reinvestment Act, or the CRA.

First California’s securities are registered with the Securities and Exchange Commission, or the SEC, under the Securities Exchange Act of 1934, as amended, or the Exchange Act, and listed on the NASDAQ Global Select Market. As such, First California is subject to the information, proxy solicitation, insider trading, corporate governance, and other requirements and restrictions of the Exchange Act, as well as the Marketplace Rules and other requirements promulgated by the NASDAQ Stock Market, Inc.

First California is subject to the accounting oversight and corporate governance requirements of the Sarbanes-Oxley Act of 2002, including, among other things, required executive certification of financial reports, increased requirements for board audit committees and their members, and enhanced disclosure of controls and procedures and internal controls over financial reporting.

First California's earnings and activities are affected by legislation, by regulations and by local legislative and administrative bodies and decisions of courts in the jurisdictions in which First California and the Bank conduct business. For example, these include limitations on the ability of the Bank to pay dividends to us and our ability to pay dividends to our stockholders. It is the policy of the FRB that bank holding companies should pay cash dividends on common stock only out of income available over the past year and only if prospective earnings retention is consistent with the organization's expected future needs and financial condition. The policy provides that bank holding companies should not maintain a level of cash dividends that undermines the bank holding company's ability to serve as a source of strength to its banking subsidiaries. Various federal and state statutory provisions limit the amount of dividends that subsidiary banks can pay to their holding companies without regulatory approval. In addition to these explicit limitations, the federal regulatory agencies have general authority to prohibit a banking subsidiary or bank holding company from engaging in an unsafe or unsound banking practice. Depending upon the circumstances, the agencies could take the position that paying a dividend would constitute an unsafe or unsound banking practice. In addition, as discussed below under "Regulation of the Bank", a bank holding company such as the Company is required to maintain minimum ratios of Tier 1 capital and total capital to total risk-weighted assets, as well as a minimum ratio of Tier 1 capital to total adjusted quarterly average assets as defined in such regulations.

Under the terms of the SBLF, for so long as any preferred stock issued under the SBLF remains outstanding,