

**SAN LUIS TRUST BANK**

**FINANCIAL STATEMENTS**

**AS OF DECEMBER 31, 2009 AND 2008**

**AND FOR THE YEARS THEN ENDED**

**AND**

**INDEPENDENT AUDITOR'S REPORT**

## INDEPENDENT AUDITOR'S REPORT

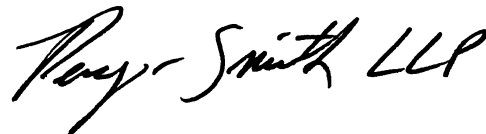
The Shareholders and  
Board of Directors  
San Luis Trust Bank

We have audited the accompanying balance sheet of San Luis Trust Bank as of December 31, 2009 and 2008 and the related statements of operations, changes in shareholders' equity and cash flows for years then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of San Luis Trust Bank as of December 31, 2009 and 2008 and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 10 to the financial statements, the Bank entered into a Cease and Desist Order with the Office of Thrift Supervision on November 2, 2009.



April 13, 2010

**SAN LUIS TRUST BANK**

**BALANCE SHEET**

**December 31, 2009 and 2008**

	<b>2009</b>	<b>2008</b>
<b>ASSETS</b>		
Cash and due from banks	\$ 19,635,757	\$ 1,633,366
Federal funds sold	110,000	
	19,745,757	1,633,366
Cash and cash equivalents	19,745,757	1,633,366
Held-to-maturity investment securities (Note 3)	40,000,000	57,373,125
Loans, less allowance for loan losses of \$7,001,206 in 2009 and \$5,012,419 in 2008 (Notes 2, 4, 8, 9 and 13)	254,060,548	247,345,202
Federal Home Loan Bank stock	4,606,000	4,221,300
Bank premises and equipment, net (Notes 5 and 9)	1,740,387	1,722,279
Other real estate	4,010,648	4,908,773
Accrued interest receivable and other assets (Note 7)	6,949,564	4,844,031
	\$ 331,112,904	\$ 322,048,076
Total assets	\$ 331,112,904	\$ 322,048,076
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Deposits:		
Non-interest-bearing	\$ 9,780,431	\$ 8,073,637
Interest-bearing (Note 6)	232,348,517	210,350,001
	242,128,948	218,423,638
Total deposits	242,128,948	218,423,638
Federal funds purchased (Note 8)		120,000
Federal Home Loan Bank advances (Note 8)	62,500,000	71,000,000
Accrued interest payable and other liabilities	791,920	1,366,487
	305,420,868	290,910,125
Total liabilities	305,420,868	290,910,125
Commitments and contingencies (Note 9)		
Shareholders' equity (Notes 10 and 11):		
Common stock, \$1.60 par value, 10,000,000 shares authorized; 4,366,927 shares issued and outstanding at December 31, 2009 and 2008	6,987,083	6,987,083
Additional paid-in capital	7,437,711	7,437,711
Retained earnings	11,267,242	16,713,157
	25,692,036	31,137,951
Total shareholders' equity	25,692,036	31,137,951
Total liabilities and shareholders' equity	\$ 331,112,904	\$ 322,048,076

The accompanying notes are an integral  
part of these financial statements.

**SAN LUIS TRUST BANK**  
**STATEMENT OF OPERATIONS**

**For the Years Ended December 31, 2009 and 2008**

	<u>2009</u>	<u>2008</u>
Interest income:		
Interest and fees on loans	\$ 15,782,190	\$ 17,604,280
Interest on investment securities	1,789,377	4,384,545
Interest on Federal Funds sold	<u>121,418</u>	<u>77,677</u>
Total interest income	<u>17,692,985</u>	<u>22,066,502</u>
Interest expense:		
Interest on deposits (Note 6)	6,120,416	7,126,531
Interest on borrowings (Note 8)	<u>2,208,682</u>	<u>2,618,219</u>
Total interest expense	<u>8,329,098</u>	<u>9,744,750</u>
Net interest income before provision for loan losses	9,363,887	12,321,752
Provision for loan losses (Note 4)	<u>10,608,420</u>	<u>4,328,383</u>
Net interest (expense) income after provision for loan losses	<u>(1,244,533)</u>	<u>7,993,369</u>
Non-interest income	<u>78,504</u>	<u>80,478</u>
Non-interest expenses:		
Salaries and employee benefits (Notes 4 and 14)	2,945,999	2,624,772
Occupancy and equipment (Notes 5 and 9)	255,057	278,085
Impairment charges and expenses on other real estate	1,693,238	
Other expenses (Note 12)	<u>3,367,701</u>	<u>2,317,124</u>
Total non-interest expenses	<u>8,261,995</u>	<u>5,219,981</u>
(Loss) income before (benefit from) provision for income taxes	(9,428,024)	2,853,866
(Benefit from) provision for income taxes (Note 7)	<u>(3,982,109)</u>	<u>1,087,016</u>
Net (loss) income	<u>\$ (5,445,915)</u>	<u>\$ 1,766,850</u>
(Loss) earnings per share (Note 10)	<u>\$ (1.25)</u>	<u>\$ 0.40</u>

The accompanying notes are an integral part of these financial statements.

**SAN LUIS TRUST BANK**

**STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY**

**For the Years Ended December 31, 2009 and 2008**

	<u>Common Stock</u>		<u>Additional Paid-In Capital</u>	<u>Retained Earnings</u>	<u>Total Share- holders' Equity</u>
	<u>Shares</u>	<u>Amount</u>			
Balance, January 1, 2008	4,360,927	\$ 6,977,483	\$ 7,428,072	\$ 14,946,307	\$ 29,351,862
Net income				1,766,850	1,766,850
Issuance of common stock under stock option plan (Note 11)	<u>6,000</u>	<u>9,600</u>	<u>9,639</u>		<u>19,239</u>
Balance, December 31, 2008	4,366,927	6,987,083	7,437,711	16,713,157	31,137,951
Net loss				<u>(5,445,915)</u>	<u>(5,445,915)</u>
Balance, December 31, 2009	<u>4,366,927</u>	<u>\$ 6,987,083</u>	<u>\$ 7,437,711</u>	<u>\$ 11,267,242</u>	<u>\$ 25,692,036</u>

The accompanying notes are an integral  
part of these financial statements.

**SAN LUIS TRUST BANK**

**STATEMENT OF CASH FLOWS**

**For the Years Ended December 31, 2009 and 2008**

	<b>2009</b>	<b>2008</b>
Cash flows from operating activities:		
Net (loss) income	\$ (5,445,915)	\$ 1,766,850
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	10,608,420	4,328,383
Depreciation and amortization	107,418	101,481
Decrease in deferred loan origination fees, net	(110,992)	(187,588)
Net increase in accrued interest receivable and other assets	(894,533)	(1,793,018)
Net (decrease) increase in accrued interest payable and other liabilities	(574,567)	856,946
Loss on sale of other real estate	493,188	
Impairment of other real estate	1,200,050	
Change in deferred taxes	(1,101,000)	
	<u>4,282,069</u>	<u>5,073,054</u>
Net cash provided by operating activities		
Cash flows from investing activities:		
Purchase of held-to-maturity investment securities	(40,000,000)	(15,000,000)
Proceeds from maturities, principal repayments or calls of held-to-maturity investment securities	57,373,125	34,200,000
Net increase in loans	(22,870,537)	(39,986,894)
Purchase of Federal Home Loan Bank stock	(384,700)	(446,700)
Purchases of premises and equipment	(125,526)	(106,712)
Proceeds from sales of other real estate	4,960,531	
Purchase of The Independent Bankers Bank (TIB) stock	(110,000)	
Capitalized additions to other real estate	(97,881)	
	<u>(1,254,988)</u>	<u>(21,340,306)</u>
Net cash used in investing activities		
Cash flows from financing activities:		
Net increase (decrease) demand, interest-bearing and savings deposits	8,682,258	(658,408)
Net increase in time deposits	15,023,052	27,786,071
Net decrease in federal funds purchased	(120,000)	(4,820,000)
Net decrease in borrowings from Federal Home Loan Bank	(8,500,000)	(5,910,000)
Proceeds from exercise of stock options		19,239
	<u>15,085,310</u>	<u>16,416,902</u>
Net cash provided by financing activities		
Increase in cash and cash equivalents	18,112,391	149,650
Cash and cash equivalents, beginning of year	<u>1,633,366</u>	<u>1,483,716</u>
Cash and cash equivalents, end of year	<u>\$ 19,745,757</u>	<u>\$ 1,633,366</u>
Additional cash flow information:		
Cash paid during the year for:		
Interest	\$ 8,399,982	\$ 9,944,770
Income taxes	\$ -	\$ 1,087,016
Supplemental disclosures of non-cash investing and financing activity:		
Loans transferred to other real estate	\$ 5,657,763	\$ 4,550,856

The accompanying notes are an integral part of these financial statements.

**SAN LUIS TRUST BANK**  
**NOTES TO FINANCIAL STATEMENTS**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Organization and Nature of Business

San Luis Trust Bank (the "Bank") provides a variety of financial services to individuals and corporate customers through its office in San Luis Obispo, California. The Bank operates under a federal stock savings bank charter and is subject to regulation by the Office of Thrift Supervision (OTS) and the Federal Deposit Insurance Corporation (FDIC).

The accounting and reporting policies of the Bank conform with accounting principles generally accepted in the United States of America and general practice within the financial services industry.

The Bank is participating in the FDIC's Transaction Account Guarantee Program. Under this program, through June 30, 2010, all noninterest-bearing transaction accounts are fully guaranteed by the FDIC for the entire amount in the account and the Bank is assessed an annual fee of 15 basis points for all deposit amounts exceeding the existing deposit insurance limit of \$250,000. Coverage under the Transaction Account Guarantee Program is in addition to and separate from the coverage available under the FDIC's general deposit insurance rules.

Subsequent Events

The Bank has reviewed all events occurring from December 31, 2009 through April 13, 2010, the date the financial statements were available to be issued and no subsequent events occurred requiring accrual or disclosure.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Reclassifications

Certain reclassifications have been made to the 2008 financial statements to conform to classifications used in 2009.

Cash and Cash Equivalents

For purposes of the statement of cash flows, cash and cash equivalents consist of cash and due from banks and Federal Funds sold. Generally, Federal Funds sold are for one-day periods.

# SAN LUIS TRUST BANK

## NOTES TO FINANCIAL STATEMENTS

(Continued)

### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

#### Investment Securities

Investment securities are classified into the following categories:

- Available-for-sale securities, reported at fair value, with unrealized gains and losses excluded from earnings and reported, net of taxes, as accumulated other comprehensive income (loss) within shareholders' equity.
- Held-to-maturity securities, which management has the positive intent and ability to hold, reported at amortized cost, adjusted for the accretion of discounts and amortization of premiums.

Management determines the appropriate classification of its investments at the time of purchase and may only change the classification in certain limited circumstances. All transfers between categories are accounted for as fair value. At December 31, 2009 and 2008, all securities are classified as held-to-maturity and there were no transfers between categories.

Gains or losses on the sale of securities are computed on the specific identification method. Interest earned on investment securities is reported in interest income, net of applicable adjustments for accretion of discounts and amortization of premiums.

Investment securities are evaluated for impairment on at least a quarterly basis and more frequently when economic or market conditions warrant such an evaluation to determine whether a decline in their value is other than temporary. Management utilizes criteria such as the magnitude and duration of the decline and the intent and ability of the Bank to retain its investment in the securities for a period of time sufficient to allow for an anticipated recovery in fair value, in addition to the reasons underlying the decline, to determine whether the loss in value is other than temporary. The term "other than temporary" is not intended to indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value is not necessarily favorable, or that there is a lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. Once a decline in value is determined to be other than temporary, and management does not intend to sell the security or it is more likely than not that the Bank will not be required to sell the security before recovery, only the portion of the impairment loss representing credit exposure is recognized as a charge to earnings, with the balance recognized as a charge to other comprehensive income. If management intends to sell the security or it is more likely than not that the Bank will be required to sell the security before recovering its forecasted cost, the entire impairment loss is recognized as a charge to earnings.

# SAN LUIS TRUST BANK

## NOTES TO FINANCIAL STATEMENTS

(Continued)

### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

#### Loans

Loans are reported at principal balances outstanding and net of deferred loan origination fees and costs, write-downs and the allowance for loan losses. Interest is accrued daily based upon outstanding loan balances. However, when, in the opinion of management, loans are considered to be impaired and the future collectibility of interest and principal is in serious doubt, loans are placed on nonaccrual status and the accrual of interest income is suspended. Any interest accrued but unpaid is charged against income. Payments received are applied to reduce principal to the extent necessary to ensure collection. Subsequent payments on these loans, or payments received on nonaccrual loans for which the ultimate collectibility of principal is not in doubt, are applied first to earned but unpaid interest and then to principal.

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due (including both principal and interest) in accordance with the contractual terms of the loan agreement. An impaired loan is measured based on the present value of expected future cash flows discounted at the loan's effective rate or, as a practical matter, at the loan's observable market price or the fair value of collateral if the loan is collateral dependent.

Substantially all loan origination fees, commitment fees and direct loan origination costs on loans are deferred and recognized as an adjustment of yield, to be amortized to interest income over the contractual term of the loan. The unamortized balance of deferred fees and costs is reported as a component of net loans.

The Bank services loans that have been participated with other financial institutions totaling approximately \$4.5 million and \$7.0 million as of December 31, 2009 and 2008, respectively. The participated balances of these loans were sold without recourse and are not included on the Bank's balance sheet.

#### Allowance for Loan Losses

The allowance for loan losses is maintained to provide for losses related to impaired loans and other losses that can be expected to occur in the normal course of business. The determination of the allowance is based on estimates made by management, to include consideration of the character of the loan portfolio, specifically identified problem loans, potential losses inherent in the portfolio taken as a whole and economic conditions in the Bank's service area.

Loans determined to be impaired are evaluated by management for specific risk of loss. In addition, reserve factors are assigned to currently performing loans based on management's assessment of the following for each identified loan type: (1) inherent credit risk, (2) historical losses, and where the Bank has not experienced losses, the loss experience of peer banks, (3) qualitative factors such as changes in local economies, nature and volume of the loan portfolio, volume and severity of past due loans, and levels of concentrations, and (4) where the Bank has not experienced losses, the loss experience of peer banks. These estimates are particularly susceptible to changes in the economic environment and market conditions.

# SAN LUIS TRUST BANK

## NOTES TO FINANCIAL STATEMENTS

(Continued)

### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

#### Allowance for Loan Losses (Continued)

The Bank's Board of Directors reviews the adequacy of the allowance for loan losses quarterly, to include consideration of the relative risks in the portfolio and current economic conditions. The allowance is adjusted based on that review if, in the judgment of the Board of Directors and management, changes are warranted.

The allowance is established through a provision for loan losses which is charged to expense. Additions to the allowance are expected to maintain the adequacy of the total allowance after loan losses and loan growth. The allowance for loan losses at December 31, 2009 and 2008 reflects management's estimate of probable losses in the portfolio. Although management believes the allowance for loan losses to be adequate, ultimate losses may vary from their estimates. In addition, the FDIC and OTS, as an integral part of their examination process, review the adequacy of the allowance for loan losses. These agencies may require additions to the allowance for loan losses based on their judgment about information available at the time of their examinations.

#### Investment in Federal Home Loan Bank Stock

As a member of the Federal Home Loan Bank of San Francisco, the Bank is required to maintain an investment in the capital stock of the Federal Home Loan Bank (FHLB) in order to participate in FHLB programs. The investment is carried at cost. At December 31, 2009 and 2008, FHLB stock totaled \$4,606,000 and \$4,221,300, respectively. Since January 2009, the FHLB has suspended its repurchase of excess capital stock and its dividends in 2009 were nominal.

#### Bank Premises and Equipment

Bank premises and equipment are carried at cost, less accumulated depreciation. Depreciation is calculated by the straight-line method over the estimated useful lives, which range from five to seven years for furniture and equipment and thirty-nine years for premises. The Bank evaluates the recoverability of long-lived assets on an ongoing basis. When assets are sold or otherwise disposed of, the cost and related accumulated depreciation or amortization are removed from the accounts, and any resulting gain or loss is recognized in income for the period. The cost of maintenance and repairs is charged to expense as incurred. The Bank evaluates premises and equipment for financial impairment as events or changes in circumstances indicate that the carrying amount of such assets may not be fully recoverable.

# SAN LUIS TRUST BANK

## NOTES TO FINANCIAL STATEMENTS

(Continued)

### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

#### Other Real Estate (ORE)

ORE is initially recorded at fair value at the date acquired less costs to sell. Losses incurred upon initial acquisition of real estate owned through foreclosure are charged to the allowance for loan losses. Subsequently, the Bank provides for losses on ORE when the fair value is estimated to be less than the Bank's recorded investment in the property by establishing a specific valuation allowance with a corresponding charge to expense or by adjusting an existing valuation allowance on the property. Costs related to the development of such properties are capitalized and costs related to holding are charged to non-interest expense as incurred. Gains and losses realized and expenses incurred in connection with the disposition of foreclosed real estate are recognized in income for the period. At December 31, 2009 and 2008, the Bank had ORE of \$4,010,648 and \$4,908,773, respectively.

#### Income Taxes

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates which are expected to be applied to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is recognized if, based on the weight of available evidence, management believes it is more likely than not that some portion or all of the deferred tax assets will not be realized.

The determination of the amount of deferred tax assets which are more likely than not to be realized is primarily dependent on projections of future earnings, which are subject to uncertainty and estimates that may change given economic conditions and other factors. The realization of deferred tax assets is assessed and a valuation allowance is recorded if it is "more likely than not" that all or a portion of the deferred tax asset will not be realized. "More likely than not" is defined as greater than a 50% chance. All available evidence, both positive and negative, is considered to determine whether, based on the weight of that evidence, a valuation allowance is needed. Based upon an analysis of available evidence, management has determined that it is "more likely than not" that all of the Bank's deferred tax assets as of December 31, 2009 and 2008, will be fully realized and, therefore, no valuation allowance was recorded.

#### Accounting for Uncertainty in Income Taxes

The Bank uses a comprehensive model for recognizing, measuring, presenting and disclosing in the financial statements tax positions taken or expected to be taken on a tax return. A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded.

# SAN LUIS TRUST BANK

## NOTES TO FINANCIAL STATEMENTS

(Continued)

### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

#### Accounting for Uncertainty in Income Taxes (Continued)

The Bank recognizes interest accrued and penalties related to unrecognized tax benefits in income tax expense. During the years ended December 31, 2009 and 2008, the Bank did not recognize any interest and penalties.

#### Stock-Based Compensation

At December 31, 2009, the Bank has one stock-based compensation plan (the "Plan"), which has been approved by its shareholders. The Plan provides for the grant of up to 30% of the Bank's issued and outstanding common shares. Under these plans, 45,500 shares of common stock are reserved for issuance to employees under incentive agreements and 12,500 shares of common stock are reserved for Directors under nonstatutory agreements as of December 31, 2009. The Plan requires that the option price may not be less than the fair market value of the stock at the date the option is granted, and that the stock must be paid for in full at the time the option is exercised. All options expire on a date determined by the Board of Directors, but not later than ten years from the date of grant. Upon grant, options vest ratably over a five year period. The Plan does not provide for the settlement of awards in cash and new shares are issued upon option exercise or restricted share grants.

There have been no grants of stock options during 2008 or 2009. No share-based compensation expense was recorded during 2008 or 2009.

#### Earnings (Loss) Per Share

Basic earnings (loss) per share (EPS), which excludes dilution, is computed by dividing net income (loss) by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock, such as stock options, result in the issuance of common stock which share in the earnings of the Bank. The treasury stock method is applied to determine the dilutive effect of stock options in computing diluted earnings per share. However, diluted earnings per share is not presented when a net loss occurs because the conversion of potential common stock is anti-dilutive or when diluted EPS does not differ materially from basic EPS.

#### Adoption of New Financial Accounting Standards

##### *FASB Accounting Standards Codification<sup>TM</sup> (ASC or Codification)*

In June 2009, the Financial Accounting Standards Board (FASB) issued new accounting standards ASC 105-10 (previously SFAS No. 168), *The FASB Accounting Standards Codification<sup>TM</sup> and the Hierarchy of Generally Accepted Accounting Principles*. With the issuance of ASC 105-10, the FASB Accounting Standards Codification ("the Codification" or "ASC") becomes the single source of authoritative U.S. accounting and reporting standards applicable for all nongovernmental entities. This change is effective for financial statements issued for interim or annual periods ended after September 15, 2009. Accordingly, all specific references to generally accepted accounting principles (GAAP) refer to the Codification.

# SAN LUIS TRUST BANK

## NOTES TO FINANCIAL STATEMENTS

(Continued)

### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

#### Adoption of New Financial Accounting Standards (Continued)

##### *FASB Clarifies Other-Than-Temporary Impairment*

In April 2009, the FASB issued ASC No. 320-10-35 (previously FSP 115-2 and 124-2 and EITF 99-20-2), *Recognition and Presentation of Other-Than-Temporary-Impairment*. This standard (i) changes previously existing guidance for determining whether an impairment to debt securities is other than temporary and (ii) replaces the previously existing requirement that the entity's management assert it has both the intent and ability to hold an impaired security until recovery with a requirement that management assert: (a) it does not have the intent to sell the security; and (b) it is more likely than not it will not have to sell the security before recovery of its cost basis. Under this standard, declines in fair value below cost that are deemed to be other than temporary are reflected in earnings as realized losses to the extent the impairment is related to credit losses for both held-to-maturity and available-for-sale securities. The amount of impairment related to other factors is recognized in other comprehensive income. These changes were effective for interim and annual periods ended after June 15, 2009. The Bank adopted the provisions of this standard on April 1, 2009 and they did not have a material impact on its financial condition, results of operations or cash flows.

##### *FASB Clarifies Application of Fair Value Accounting*

In April 2009, the FASB issued ASC 820-10 (previously FSP FAS 157-4), *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*. This standard affirms the objective of fair value when a market is not active, clarifies and includes additional factors for determining whether there has been a significant decrease in market activity, eliminates the presumption that all transactions are distressed unless proven otherwise, and requires an entity to disclose a change in valuation technique. This standard was effective for interim and annual periods ended after June 15, 2009. The Bank adopted the provisions of this standard on April 1, 2009 and they did not have a material impact on its financial condition, results of operations or cash flows.

##### *Measuring Liabilities at Fair Value*

In August 2009, the FASB issued ASU No. 2009-05, *Fair Value Measurements and Disclosures (ASC Topic 820) — Measuring Liabilities at Fair Value*. This update provides amendments for the fair value measurement of liabilities. It provides clarification that in circumstances in which a quoted price in an active market for the identical liability is not available, a reporting entity is required to measure fair value using one or more techniques. It also clarifies that when estimating the fair value of a liability, a reporting entity is not required to include a separate input or adjustment to other inputs relating to the existence of a restriction that prevents the transfer of the liability. This update was effective for the first reporting period (including interim periods) beginning after August 2009. The Bank adopted the provisions of this update on October 1, 2009 and they did not have a material impact on its financial condition or results of operations.

# SAN LUIS TRUST BANK

## NOTES TO FINANCIAL STATEMENTS

(Continued)

### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

#### Adoption of New Financial Accounting Standards (Continued)

##### *Business Combinations*

In December 2007, the FASB issued ASC Topic 805 (previously SFAS 141(R)), *Business Combinations*. This standard broadens the guidance for business combinations and extends its applicability to all transactions and other events in which one entity obtains control over one or more other businesses. It broadens the fair value measurement and recognition of assets acquired, liabilities assumed, and interests transferred as a result of business combinations. The acquirer is no longer permitted to recognize a separate valuation allowance as of the acquisition date for loans and other assets acquired in a business combination. It also requires acquisition-related costs and restructuring costs that the acquirer expected but was not obligated to incur to be expensed separately from the business combination. It also expands on required disclosures to improve the ability of the users of the financial statements to evaluate the nature and financial effects of business combinations. The Bank adopted this standard on January 1, 2009, and it will be applied to all future business combinations.

##### *Subsequent Events*

In May 2009, the FASB issued ASC 855-10 (previously SFAS No. 165), *Subsequent Events*, which establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. The adoption of this standard on July 1, 2009 required the Bank to disclose the date through which it evaluated subsequent events and had no effect on its financial position, results of operations or cash flows.

#### Impact of Recently Issued Financial Accounting Standards

##### *Accounting for Transfers of Financial Assets*

In June 2009, the FASB issued ASC Topic 860 (previously SFAS No. 166), *Accounting for Transfers of Financial Assets, an amendment of SFAS No. 140*. This standard amends the derecognition accounting and disclosure guidance included in previously issued standards. This standard eliminates the exemption from consolidation for qualifying special-purpose entities (SPEs) and also requires a transferor to evaluate all existing qualifying SPEs to determine whether they must be consolidated in accordance with ASC Topic 810. This standard also provides more stringent requirements for derecognition of a portion of a financial asset and establishes new conditions for reporting the transfer of a portion of a financial asset as a sale. This standard is effective as of the beginning of the first annual reporting period that begins after November 15, 2009. The Bank is assessing the impact this standard may have on its financial condition, results of operations and cash flows.

**SAN LUIS TRUST BANK**

**NOTES TO FINANCIAL STATEMENTS**

(Continued)

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Impact of Recently Issued Financial Accounting Standards (Continued)

*Transfers and Servicing*

In December 2009, the FASB issued Accounting Standards Update (ASU) No. 2009-16, *Transfers and Servicing (ASC Topic 860): Accounting for Transfers of Financial Assets*, which updates the derecognition guidance in ASC Topic 860 for previously issued SFAS No. 166. This update reflects the Board's response to issues entities have encountered when applying ASC 860, including: (1) requires that all arrangements made in connection with a transfer of financial assets be considered in the derecognition analysis, (2) clarifies when a transferred asset is considered legally isolated from the transferor, (3) modifies the requirements related to a transferee's ability to freely pledge or exchange transferred financial assets, and (4) provides guidance on when a portion of a financial asset can be derecognized. This update is effective for financial asset transfers occurring after the beginning of an entity's first fiscal year that begins after November 15, 2009. Early adoption is prohibited. The Bank is assessing the impact of this standard on its financial condition, results of operations and cash flows.

**2. FAIR VALUE MEASUREMENTS**

Fair Value of Financial Instruments

The carrying amounts and estimated fair values of the Bank's financial instruments are as follows:

	December 31, 2009		December 31, 2008	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
<b>Financial Assets:</b>				
Cash and cash equivalents	\$ 19,745,757	\$ 19,745,757	\$ 1,633,366	\$ 1,633,366
Investment securities				
held-to-maturity	40,000,000	39,417,000	57,373,125	57,463,656
Loans receivable, net	254,060,548	255,825,001	247,345,202	247,242,287
Federal Home Loan Bank Stock	4,606,000	4,606,000	4,221,300	4,221,300
Accrued interest receivable	2,120,344	2,120,344	2,191,185	2,191,185
<b>Financial Liabilities:</b>				
Deposit accounts with no				
stated maturity	\$ 56,515,038	\$ 56,515,038	\$ 47,832,780	\$ 47,832,780
Certificates of deposit	185,613,910	187,434,162	170,590,858	171,952,417
Borrowed funds	62,500,000	63,790,693	71,120,000	72,515,991
Accrued interest payable	160,472	160,472	231,356	231,356

These estimates do not reflect any premium or discount that could result from offering the Bank's entire holdings of a particular financial instrument for sale at one time, nor do they attempt to estimate the value of anticipated future business related to the instruments. In addition, the tax ramifications related to the realization of unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of these estimates.

# SAN LUIS TRUST BANK

## NOTES TO FINANCIAL STATEMENTS

(Continued)

### 2. FAIR VALUE MEASUREMENTS (Continued)

#### Fair Value of Financial Instruments (Continued)

The following methods and assumptions were used to estimate the fair value of financial instruments. For cash and cash equivalents, variable-rate loans, accrued interest receivable and payable, FHLB stock, deposits with no stated maturity and short-term borrowings, the carrying amount is estimated to be fair value. For investment securities held-to-maturity, fair values are based on quoted market prices, quoted market prices for similar securities and indications of value provided by brokers. The fair values for fixed-rate loans are estimated using discounted cash flow analyses, using interest rates currently being offered at each reporting date for loans with similar terms to borrowers of comparable creditworthiness. Fair values for fixed-rate certificates of deposit are estimated using discounted cash flow analyses using interest rates offered at each reporting date by the Bank for certificates with similar remaining maturities. The fair values of commitments are estimated using the fees currently charged to enter into similar agreements and are not significant and, therefore, not included in the above table.

#### Fair Value Hierarchy

The Bank groups its assets and liabilities measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. Valuations within these levels are based upon:

Level 1 – Quoted market prices for identical instruments traded in active exchange markets.

Level 2 – Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable or can be corroborated by observable market data.

Level 3 – Model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect the Bank's estimates of assumptions that market participants would use on pricing the asset or liability. Valuation techniques include management judgment and estimation which may be significant.

#### *Assets Recorded at Fair Value*

##### Recurring Basis

The Bank did not have any financial assets or liabilities required to be measured at fair value on a recurring basis at December 31, 2009 or 2008.

**SAN LUIS TRUST BANK**

**NOTES TO FINANCIAL STATEMENTS**

(Continued)

**2. FAIR VALUE MEASUREMENTS (Continued)**

Fair Value Hierarchy (Continued)

*Assets Recorded at Fair Value (Continued)*

Non-recurring Basis

The following table presents information about the Bank's assets and liabilities measured at fair value on a nonrecurring basis as of December 31, 2009:

The Bank may be required, from time to time, to measure certain assets at fair value on a non-recurring basis. These include assets that are measured at the lower of cost or market value that were recognized at fair value which was below cost at the reporting date.

<u>Description</u>	<u>Fair Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total Losses</u>
Impaired loans	\$18,251,662		\$18,251,662		\$ 7,817,000
Other real estate	<u>4,010,648</u>		<u>4,010,648</u>		<u>1,200,050</u>
Total assets measured at fair value on a non-recurring basis	<u>\$22,262,310</u>	<u>\$ -</u>	<u>\$22,262,310</u>	<u>\$ -</u>	<u>\$ 9,017,050</u>

The fair value of impaired loans is based on the fair value of the collateral, obtained through property appraisals, for all collateral dependent loans and for other impaired loans is estimated using a discounted cash flow model.

The fair value of other real estate is based on the values obtained through property appraisals.

If the Bank determines that the fair value of an impaired loan is less than the recorded investment in the loan, the carrying value is adjusted through a charge-off or additional specific loan loss provisions recorded through the allowance for loan losses. Total losses of \$7,817,000 represent impairment charges recognized during the year ended December 31, 2009, related to impaired loans at December 31, 2009.

Other real estate has been adjusted to estimated fair value, less estimated selling costs. At the time of foreclosure, assets are recorded at the lower of the carrying amount of the loan or the estimated fair value less estimated selling costs. Any write-downs based on the asset's fair value at the date of acquisition are charged to the allowance for loan losses. After foreclosure, management periodically obtains updated valuations of the foreclosed assets and, if additional impairments are deemed necessary, the impairment is recorded in other real estate expenses on the statement of operations. Total losses of \$1,200,050 represent impairment charges recognized during the year ended December 31, 2009, related to other real estate at December 31, 2009.

**SAN LUIS TRUST BANK**

**NOTES TO FINANCIAL STATEMENTS**

(Continued)

**2. FAIR VALUE MEASUREMENTS (Continued)**

Fair Value Hierarchy (Continued)

*Assets Recorded at Fair Value (Continued)*

Non-recurring Basis (Continued)

At December 31, 2008, impaired loans and other real estate recorded at fair value totaled \$6,198,188 and \$4,908,773, respectively. Impaired loans and real estate owned were determined to be collateral dependent and categorized as Level 2 as the fair value of the underlying collateral is based on property appraisals.

**3. INVESTMENT SECURITIES**

The following tables show the amortized cost and the estimated fair value of investment securities at December 31, 2009 and 2008:

Held-to-Maturity

	2009			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Government agencies	<u>\$ 40,000,000</u>	<u>\$ -</u>	<u>\$ (583,000)</u>	<u>\$ 39,417,000</u>

	2008			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Government agencies	<u>\$ 57,373,125</u>	<u>\$ 90,531</u>	<u>\$ -</u>	<u>\$ 57,463,656</u>

Proceeds from maturities, principle repayments or calls of investment securities totaled \$57,373,125 with no gains or losses realized for the year ended December 31, 2009. Proceeds from maturities, principle repayments or calls of investment securities totaled \$34,200,000 with no gains or losses realized for the year ended December 31, 2008. There were no sales or transfers of held-to-maturity investment securities during 2009 and 2008.

**SAN LUIS TRUST BANK**

**NOTES TO FINANCIAL STATEMENTS**

(Continued)

**3. INVESTMENT SECURITIES (Continued)**

Held-to-Maturity (Continued)

Investment securities with unrealized losses at December 31, 2009 are summarized and classified according to the duration of the loss period as follows:

	December 31, 2009					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Debt securities:						
U.S. Government agencies	\$ 39,417,000	\$ (583,000)	\$ -	\$ -	\$ 39,417,000	\$ (583,000)

There were no securities in an unrealized loss position at December 31, 2008.

U.S. Government Agencies

At December 31, 2009, the Bank held three U.S. Government agency securities all of which were in a loss position for less than twelve months. The unrealized losses on our investments in a direct obligation of U.S. Government agency were caused by interest rate increases. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Bank has the ability and intent to hold these investments until a recovery of fair value, which may be maturity, the Bank does not consider these investments to be other-than-temporarily impaired at December 31, 2009.

Contractual Maturities

The amortized cost and estimated fair value of held-to-maturity investment securities at December 31, 2009 by contractual maturity are shown below. Expected maturities will differ from contractual maturities because the issuers of the securities may have the right to call or prepay obligations with or without call or prepayment penalties.

	2009	
	Amortized Cost	Estimated Fair Value
After ten years	\$ 40,000,000	\$ 39,417,000

All investment securities have been pledged to secure a borrowing arrangement (see Note 8).

**SAN LUIS TRUST BANK**

**NOTES TO FINANCIAL STATEMENTS**

(Continued)

**4. LOANS AND ALLOWANCE FOR LOAN LOSSES**

Loans receivable are summarized as follows:

	December 31,	
	2009	2008
Real estate:		
Mortgage	\$ 213,844,967	\$ 195,950,304
Construction	20,721,130	29,242,765
Commercial	20,240,037	22,192,596
Consumer	6,540,664	5,367,992
	261,346,798	252,753,657
Less:		
Deferred loan origination fees, net	(285,044)	(396,036)
Allowance for loan losses	(7,001,206)	(5,012,419)
	<b>\$ 254,060,548</b>	<b>\$ 247,345,202</b>

Salaries and employee benefits totaling \$113,768 and \$215,452 were deferred as loan origination costs for the years ended December 31, 2009 and 2008, respectively.

Certain loans have been pledged to secure borrowing arrangements (see Note 8).

Changes in the allowance for loan losses were as follows:

	Year Ended December 31,	
	2009	2008
Balance, beginning of year	\$ 5,012,419	\$ 3,630,347
Provision for loan losses	10,608,420	4,328,383
Losses charged to the allowance	(8,801,633)	(2,946,311)
Recoveries	182,000	
Balance, end of year	<b>\$ 7,001,206</b>	<b>\$ 5,012,419</b>

At December 31, 2009 and 2008, nonaccrual loans totaled \$27,134,761 and \$6,198,188, respectively. Accruing loans that were past due 90 days or more totaled \$1,735,000 at December 31, 2009. There were no loans past due 90 days or more and still accruing interest at December 31, 2008. Interest foregone on nonaccrual loans totaled \$976,959 and \$489,662 for the years ended December 31, 2009 and 2008, respectively.

**SAN LUIS TRUST BANK**

**NOTES TO FINANCIAL STATEMENTS**

(Continued)

**4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)**

At December 31, 2009 and 2008, the recorded investment in impaired loans totaled \$49,234,294 and \$6,198,188, respectively. There was \$4,637,148 of specific allowance for loan losses on \$15,963,601 of impaired loans at December 31, 2009. There was no specific allowance for loan losses on impaired loans at December 31, 2008. The average recorded investments in impaired loans for the years ended December 31, 2009 and 2008 was \$32,785,000 and \$9,234,554, respectively. There was no interest income recognized on a cash basis for impaired loans for the years ended December 31, 2009 and 2008, respectively.

Included in the impaired loans above are loans in the amount of \$10,228,233 that were considered to be troubled debt restructurings at December 31, 2009. There were no outstanding commitments to lend additional funds to any of these borrowers.

**5. BANK PREMISES AND EQUIPMENT**

Bank premises and equipment consisted of the following:

	<u>December 31,</u>	
	<u>2009</u>	<u>2008</u>
Land and improvements	\$ 595,850	\$ 595,850
Buildings	1,178,180	1,153,969
Furniture and equipment	<u>785,160</u>	<u>683,846</u>
	2,559,190	2,433,665
Less: accumulated depreciation and amortization	<u>(818,803)</u>	<u>(711,386)</u>
	<u>\$ 1,740,387</u>	<u>\$ 1,722,279</u>

Depreciation and amortization included in occupancy and equipment expense totaled \$107,418 and \$101,481 for the years ended December 31, 2009 and 2008, respectively.

**SAN LUIS TRUST BANK**

**NOTES TO FINANCIAL STATEMENTS**

(Continued)

**6. INTEREST-BEARING DEPOSITS**

Interest-bearing deposits consisted of the following:

	December 31,	
	2009	2008
Savings	\$ 1,722,911	\$ 1,985,338
Money market	13,964,039	10,682,585
Interest checking accounts	31,047,657	27,091,220
Time, \$100,000 or more	27,680,422	35,148,055
Other time	32,698,313	56,986,995
Brokered deposits	22,017,270	29,845,091
Wholesale funds	103,217,905	48,610,717
	<b>\$ 232,348,517</b>	<b>\$ 210,350,001</b>

A summary of time deposits by maturity is as follows:

Year Ending December 31,	
2010	\$ 115,225,811
2011	64,894,838
2012	5,093,613
2013	399,648
	<b>\$ 185,613,910</b>

Interest expense recognized on interest-bearing deposits for the years ended December 31, 2009 and 2008 consisted of the following:

	2009	2008
Savings	\$ 34,056	\$ 79,417
Money market	206,935	301,937
Interest checking accounts	582,266	821,633
Time, \$100,000 or more	1,175,843	1,519,399
Other time	1,127,681	1,685,115
Brokered deposits	839,471	1,902,959
Wholesale funds	2,154,164	816,071
	<b>\$ 6,120,416</b>	<b>\$ 7,126,531</b>

**SAN LUIS TRUST BANK**

**NOTES TO FINANCIAL STATEMENTS**

(Continued)

**7. INCOME TAXES**

The provision for (benefit from) income taxes consisted of the following:

	<u>Federal</u>	<u>State</u>	<u>Total</u>
<u>2009</u>			
Current	\$ (2,849,790)	\$ (31,086)	\$ (2,880,876)
Deferred	<u>(437,583)</u>	<u>(663,650)</u>	<u>(1,101,233)</u>
Benefit from income taxes	<u>\$ (3,287,373)</u>	<u>\$ (694,736)</u>	<u>\$ (3,982,109)</u>
<u>2008</u>			
Current	\$ 1,147,016	\$ 441,000	\$ 1,588,016
Deferred	<u>(363,000)</u>	<u>(138,000)</u>	<u>(501,000)</u>
Provision for income taxes	<u>\$ 784,016</u>	<u>\$ 303,000</u>	<u>\$ 1,087,016</u>

Deferred tax assets (liabilities) are included in accrued interest receivable and other assets on the balance sheet and consisted of the following:

	<u>December 31,</u>	
	<u>2009</u>	<u>2008</u>
Deferred tax assets:		
California net operating loss	\$ 864,000	
Allowance for loan losses	2,063,000	\$ 1,913,000
Other real estate	377,000	176,000
Charitable contributions	25,000	
Non-accrued interest	<u>31,000</u>	
Total deferred tax assets	<u>3,360,000</u>	<u>2,089,000</u>
Deferred tax liabilities:		
Future liability of state deferred tax assets	(430,000)	(88,000)
Federal Home Loan Bank stock dividends	(95,000)	(95,000)
Deferred loan fee income	(712,000)	(876,000)
Premises and equipment	<u>(80,000)</u>	<u>(88,000)</u>
Total deferred tax liabilities	<u>(1,317,000)</u>	<u>(1,147,000)</u>
Net deferred tax asset	<u>\$ 2,043,000</u>	<u>\$ 942,000</u>

At December 31, 2009, the Bank had California State net operating loss carry-forwards (NOLs) of \$7.9 million. The California State NOLs begin to expire in 2030.

**SAN LUIS TRUST BANK**

**NOTES TO FINANCIAL STATEMENTS**

(Continued)

**7. INCOME TAXES (Continued)**

Management believes that it is more likely than not that the Bank will realize the above deferred tax assets in future periods; therefore, no valuation allowance has been provided against our deferred tax assets.

The (benefit from) provision for income tax expense differs from amounts computed by applying the statutory Federal income tax rate to income before income taxes. The reasons for these differences are as follows:

	2009		2008	
	Amount	Rate %	Amount	Rate %
Federal income tax (benefit) expense, at statutory rate	\$(3,205,528)	34.0	\$ 970,314	34.0
State franchise (benefit) tax, net of Federal tax effect	(674,519)	7.2	202,624	7.1
Other	(102,062)	1.1	(85,922)	(3.0)
Total income tax (benefit) expense	\$(3,982,109)	42.2	\$ 1,087,016	38.1

The Bank files income tax returns in the U.S. Federal and California jurisdictions. None of the Bank's tax returns have been examined by the taxing authorities, nor has the Bank been notified of any pending examinations.

There are no unrecognized tax benefits for uncertain tax positions at December 31, 2009 and 2008.

With few exceptions, the Bank is no longer subject to tax examination by U.S. federal taxing authorities for years ended before December 31, 2006 and by state and local taxing authorities for years ended before December 31, 2005.

**8. BORROWING ARRANGEMENTS**

Federal Funds Line of Credit

At December 31, 2008, the Bank had an \$8,000,000 unsecured borrowing arrangement with one of its correspondent banks to meet short-term liquidity needs, at interest rates that vary with market conditions. Borrowings outstanding under this arrangement totaled \$120,000 at December 31, 2008, and matured the next business day.

Federal Home Loan Bank Advances

The Bank had outstanding advances from the FHLB at December 31, 2009 in the amount of \$62,500,000, maturing at various dates through June 10, 2013. Interest is payable monthly at interest rates ranging from 1.41% to 3.24%. At December 31, 2009, the FHLB has a blanket lien over all of the Bank's loans. In addition, specific mortgage loans with a balance of approximately \$91,115,000 and FHLB stock of \$4,606,000 at December 31, 2009 were pledged to the FHLB as collateral for advances.

## SAN LUIS TRUST BANK

### NOTES TO FINANCIAL STATEMENTS

(Continued)

#### 8. BORROWING ARRANGEMENTS (Continued)

##### Federal Home Loan Bank Advances (Continued)

At December 31, 2009, securities with amortized costs of \$40,000,000 and estimated market values of \$39,417,000 were pledged to secure public deposits and FHLB borrowings.

The Bank had outstanding advances from the FHLB at December 31, 2008 in the amount of \$71,000,000, maturing at various dates through September 28, 2011. Interest is payable monthly at interest rates ranging from 2.46% to 3.46%. Specific mortgage loans with a balance of approximately \$82,772,000 and FHLB stock of \$4,221,300 at December 31, 2008 were pledged to the FHLB as collateral for advances.

At December 31, 2008, securities with amortized costs of \$57,373,125 and estimated market values of \$57,463,656 were pledged to secure public deposits and FHLB borrowings.

At December 31, 2009 and 2008, the Bank had available borrowing capacity of \$19,883,000 and \$8,745,000, respectively, at the FHLB.

#### 9. COMMITMENTS AND CONTINGENCIES

##### Federal Reserve Requirements

Banks are required to maintain reserves with the Federal Reserve Bank equal to a percentage of their reservable deposits. The amount of such reserve balances at December 31, 2009 and 2008 was \$1,005,000 and \$278,000, respectively.

##### Correspondent Banking Agreements

The Bank maintains funds on deposit with other federally insured financial institutions under correspondent banking agreements. Those insured financial institutions have elected to participate in the FDIC sponsored Transaction Account Guarantee Program. Under that program, through June 30, 2010, all noninterest-bearing transaction accounts are fully guaranteed by the FDIC for the entire amount in the account. Coverage under the Transaction Account Guarantee Program is in addition to and separate from the coverage available under the FDIC's general deposit insurance rules. Uninsured deposits totaled \$32,801 and \$150,236 as of December 31, 2009 and 2008.

**SAN LUIS TRUST BANK**

**NOTES TO FINANCIAL STATEMENTS**

(Continued)

**9. COMMITMENTS AND CONTINGENCIES** (Continued)

Financial Instruments With Off-Balance-Sheet Risk

The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments represent commitments to originate fixed and variable rate loans, lines of credit, letters of credit and loans in process, and involve, to varying degrees, elements of interest rate risk and credit risk in excess of the amount recognized in the Bank's balance sheet. The Bank's exposure to credit loss in the event of nonperformance by the other party for commitments to extend credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments to originate loans, lines of credit and letters of credit as it does for on-balance sheet instruments.

The following financial instruments represent off-balance-sheet credit risk:

	<u>December 31,</u>	
	<u>2009</u>	<u>2008</u>
Commitments to extend credit	\$ 29,989,041	\$ 40,395,293
Standby letters of credit	\$ 648,342	\$ 1,104,656

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies, but may include accounts receivable, crops, inventory, equipment, income-producing commercial properties, farm land and residential properties.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. The credit risk involved in issuing standby letters of credit is essentially the same as that involved in extending loans to customers. The fair value of the liability related to these standby letters of credit, which represents the fees received for issuing the guarantees, was not significant at December 31, 2009 and 2008. The Bank recognizes these fees as revenues over the term of the commitment or when the commitment is used.

At December 31, 2009, consumer loan commitments represent approximately 3% of total commitments. Commercial loan commitments represent approximately 4% of total commitments and are generally secured by various assets of the borrower. Real estate loan commitments represent the remaining 93% of total commitments and are generally secured by property with a loan-to-value ratio not to exceed 80%. In addition, the majority of the Bank's commitments have variable interest rates.

**SAN LUIS TRUST BANK**

**NOTES TO FINANCIAL STATEMENTS**

(Continued)

**9. COMMITMENTS AND CONTINGENCIES (Continued)**

Concentrations of Credit Risk

The Bank grants real estate mortgage, real estate construction, commercial and consumer loans to customers in San Luis Obispo and surrounding counties. Although the Bank has a diversified loan portfolio, a substantial portion of its portfolio is secured by residential and commercial real estate.

At December 31, 2009 and 2008, in management's judgment, a concentration of loans existed in real estate related loans of which approximately 90% and 89%, respectively, of the Bank's loans were real estate related. A substantial decline in the performance of the economy in general or a continuing decline in real estate values in the Bank's primary market area, in particular, could have an adverse impact on the collectibility of these loans. Personal and business income represent the primary source of repayment for a majority of these loans.

Operating Lease

The Bank has one property lease on office space located at 1208 Osos Street. The lease expires in 2010 and has a two-year renewal option, with rent increasing 5% annually at that point. The future rental commitment under the lease during its initial term is as follows:

<u>Year Ending</u> <u>December 31,</u>	
2010	\$ <u>24,700</u>

Rental expense included in occupancy expense totaled \$32,350 and \$25,815 for the years ended December 31, 2009 and 2008, respectively.

Contingencies

The Bank is involved in legal proceedings arising in the normal course of business. In the opinion of management, the outcomes of such proceedings will not have a material adverse effect on the Bank's financial position or results of operations.

## SAN LUIS TRUST BANK

### NOTES TO FINANCIAL STATEMENTS

(Continued)

#### 10. SHAREHOLDERS' EQUITY

##### Regulatory Order

On November 2, 2009, the Directors of the Bank, agreed to enter into a Cease and Desist Order (the "Order") with their primary regulator, the OTS. The Order requires the Bank to meet numerous requirements over and above those typically placed on banks. These requirements include: (1) Capital. The Bank must maintain capital ratios above normal requirements: a Tier 1 Core Capital ratio of at least 8% and a Total Risk-Based Capital ratio of at least 12%. If those capital levels are not met, the Bank must formulate a Contingency Plan which could result in its sale or liquidation. (2) Business Plan. The Bank must formulate a comprehensive three-year business plan. (3) Management Plan. The Bank must formulate a Management Plan to strengthen their Board of Directors and management. (4) Internal Asset Review. The Bank must revise its Internal Asset Review Policy. (5) Allowance for Loan Losses. The Bank must revise its Allowance for Loan Loss Policy. (6) Loan Modifications. The Bank must enhance its Loan Modification Policy. (7) Liquidity. The Bank must formulate a comprehensive Liquidity Plan. (8) Classified Asset Reduction. The Bank must formulate a plan to reduce classified assets. (9) Risk Concentration. The Bank must develop a policy to monitor and control asset concentration risk. All of the plans and policies required by the Order must be approved by the OTS. (10) Dividend Restriction. The Bank may not pay dividends on its common stock without the prior approval of the OTS. (11) Brokered Deposit Restriction. The Bank may not accept or renew brokered deposits.

Management and the Board of Directors have taken action to comply with the articles of the Order, including the adoption of new policies and procedures to address the matters noted above, the completion of a comprehensive management assessment, and the adoption of a capital plan that is integrated with the Bank's business plan. The Bank has made substantial progress toward addressing the real estate related issues within its loan portfolio and the management team was strengthened with the addition of two experienced bank executives.

##### Dividend Restrictions

Upon declaration by the Board of Directors, all shareholders of record will be entitled to receive dividends. The California Financial Code restricts the total dividend payment of any state banking association in any calendar year to the lesser of (1) the bank's retained earnings or (2) the bank's net income for its last three fiscal years, less distributions made to shareholders during the same three-year period. At December 31, 2009, no retained earnings were free of such restrictions. In addition, due to the regulatory order above, the Bank cannot pay dividends or any other capital distributions without receiving prior approval from the OTS.

##### Regulatory Capital

The Bank is subject to certain regulatory capital requirements administered by the FDIC and the OTS. Failure to meet these minimum capital requirements can initiate certain mandatory and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements.

**SAN LUIS TRUST BANK**

**NOTES TO FINANCIAL STATEMENTS**

(Continued)

**10. SHAREHOLDERS' EQUITY (Continued)**

Regulatory Capital (Continued)

Under capital adequacy guidelines, the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. These quantitative measures are established by regulation and require that minimum amounts and ratios of total and Tier 1 capital to risk-weighted assets and of Tier 1 capital to end of period assets be maintained. Capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

The Bank is also subject to additional capital guidelines under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 core capital ratios as set forth in the following table and may not be subject to any written agreement to meet and maintain a specific capital level for any capital measure. The Bank will be considered "adequately capitalized" under these guidelines as a result of the Order. There are no conditions or events since that notification that management believes have changed the Bank's category.

Under the terms of the order between the Bank and the OTS as described previously, the Bank is subject to an 8% Tier 1 core capital ratio and a 12% total risk-based capital ratio as set forth in the following table. The Bank was not in compliance with either ratio at December 31, 2009.

The Bank's actual and required capital amounts and ratios are presented as follows (dollars in thousands):

	December 31,			
	2009		2008	
	Amount	Ratio	Amount	Ratio
<u>Tier 1 Core Capital Ratio</u>				
San Luis Trust Bank	\$ 25,149	7.6%	\$ 31,138	9.7%
Minimum requirement under the Order	\$ 26,453	8.0%	N/A	N/A
Minimum requirement for "Well-Capitalized" institution	\$ 16,532	5.0%	\$ 16,105	5.0%
Minimum regulatory requirement	\$ 13,225	4.0%	\$ 12,884	4.0%
<u>Tier 1 Risk-Based Capital Ratio</u>				
San Luis Trust Bank	\$ 25,149	10.3%	\$ 31,138	12.0%
Minimum requirement for "Well-Capitalized" institution	\$ 14,600	6.0%	\$ 15,528	6.0%
Minimum regulatory requirement	\$ 9,733	4.0%	\$ 10,352	4.0%
<u>Total Risk-Based Capital Ratio</u>				
San Luis Trust Bank	\$ 28,243	11.6%	\$ 34,396	13.3%
Minimum requirement under the Order	\$ 29,200	12.0%	N/A	N/A
Minimum requirement for "Well-Capitalized" institution	\$ 24,333	10.0%	\$ 25,880	10.0%
Minimum regulatory requirement	\$ 19,466	8.0%	\$ 20,704	8.0%

**SAN LUIS TRUST BANK**

**NOTES TO FINANCIAL STATEMENTS**

(Continued)

**10. SHAREHOLDERS' EQUITY (Continued)**

(Loss) Earnings Per Share

A reconciliation of the numerators and denominators of the basic and diluted (loss) earnings per share computations is as follows:

	Year Ended December 31,	
	2009	2008
Basic (Loss) Earnings Per Share:		
Net (loss) income	<u>\$ (5,445,915)</u>	<u>\$ 1,766,850</u>
Weighted average shares outstanding	<u>4,366,927</u>	<u>4,362,785</u>
Net (loss) income per share	<u>\$ (1.25)</u>	<u>\$ 0.40</u>

**11. STOCK-BASED COMPENSATION**

Stock Options

Following is a summary of the combined activity of the Plans for the years ended December 31, 2009 and 2008:

	Number of Stock Options Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)
Options outstanding at January 1, 2008	144,000	\$ 4.00	
Options exercised	(6,000)	\$ 3.21	
Options forfeited	<u>(80,000)</u>	\$ 6.88	
Options outstanding at December 31, 2008	58,000	\$ 4.75	
Options outstanding at December 31, 2009	<u>58,000</u>	\$ 4.75	<u>3.27 years</u>
Options exercisable at December 31, 2009	<u>58,000</u>	<u>\$ 4.75</u>	<u>3.27 years</u>

There were no options exercised during the year ended December 31, 2009. The total intrinsic value of options exercised in the year ended December 31, 2008 was \$11,586. Cash received from options exercised for the year ended December 31, 2008 was \$19,239. The actual tax benefit realized for the tax deductions from options exercised was not significant for the year ended December 31, 2008.

**SAN LUIS TRUST BANK**

**NOTES TO FINANCIAL STATEMENTS**

(Continued)

**12. OTHER EXPENSES**

Other expenses consisted of the following:

	<u>Year Ended December 31,</u>	
	2009	2008
Deposit insurance premiums	\$ 1,036,862	\$ 242,049
Professional fees	353,000	342,002
Other real estate expenses	288,668	
Director fees	275,362	254,250
Data processing	239,148	285,762
Foreclosure costs	233,351	228,492
Supplies	115,125	117,899
Advertising	85,246	173,698
Postage	22,565	26,678
Other	718,373	646,294
	<b>\$ 3,367,701</b>	<b>\$ 2,317,124</b>

**13. RELATED PARTY TRANSACTIONS**

During the normal course of business, the Bank enters into transactions with related parties, including directors and executive officers. These transactions include borrowings from the Bank and are on substantially the same terms and conditions as those prevailing for comparable transactions with unrelated parties.

The following is a summary of the aggregate activity involving related party borrowers during 2009:

Balance, January 1, 2009	\$ 1,827,880
Disbursements	166,626
Amounts repaid	(526,657)
Balance, December 31, 2009	<b>\$ 1,467,849</b>
Undisbursed commitments to related parties at December 31, 2009	<b>\$ 2,049,540</b>

The Bank held deposits of approximately \$2,797,182 and \$2,738,405 for related parties including officers, directors, and major shareholders at December 31, 2009 and 2008, respectively.

**SAN LUIS TRUST BANK**

**NOTES TO FINANCIAL STATEMENTS**

(Continued)

**14. EMPLOYEE BENEFIT PLANS**

Employee Stock Ownership Plan

Effective January 1, 2002, the Bank sponsored a non-leveraged employee stock ownership plan (ESOP) that covers all employees who have completed a twelve month period of employment in which they work at least one thousand hours and are at least twenty-one years of age. Years of service with the Bank before the effective date of the Plan do not apply toward satisfying the requirement.

Contributions to the ESOP are invested primarily in San Luis Trust Bank stock; however, the contributions may be invested temporarily in savings accounts or certain other investments, as defined. The amount of the contribution, if any, is decided annually by the Board of Directors. Employee contributions are not permitted. Dividends on shares held by the ESOP are recorded as a reduction of retained earnings. Contributions and earnings of the Plan are allocated each year to eligible employees based upon their proportionate share of total compensation for the year. After three years of service, employees become twenty percent vested in the value of their allocated contributions and earnings, and twenty percent per year thereafter. After six years of service, eligible employees are fully vested. An employee can elect distribution in stock or in cash when the value of their allocated contributions and earnings exceeds \$5,000. If the Plan does not have the cash available for distribution, the employee's stock will be sold. If the stock cannot be sold, the Bank will either make a contribution or loan the required cash to the ESOP.

The Bank contributed \$5,000 and \$26,750 for the years ended December 31, 2009 and 2008, respectively, which was recognized in the income statement as compensation expense.

The total ESOP shares at December 31 2009 and 2008 were 159,415 and 158,715, respectively.