

UNITED SECURITY BANCSHARES
Form 10-K
April 04, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 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, 2010.

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: 000-32987

UNITED SECURITY BANCSHARES
(Exact name of registrant as specified in its charter)

CALIFORNIA 91-2112732
(State or other jurisdiction of incorporation or (I.R.S. Employer Identification No.)
organization)

2126 Inyo Street, Fresno, California 93721
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code (559) 248-4943

Securities registered pursuant to Section 12(b) of the Act: Common Stock, no par value on Nasdaq
(Title of Class)

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

Indicate by check mark whether the registrant is a well-known seasoned issuer, as defined in Rule 405 of the
Securities Act.

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the
Securities 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 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

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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 registrants knowledge, in the 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 the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer Small reporting company

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

Aggregate market value of the Common Stock held by non-affiliates as of the last business day of the registrant's most recently completed second fiscal quarter - June 30, 2010: \$32,434,746

Shares outstanding as of February 28, 2011: 13,003,840

DOCUMENTS INCORPORATED BY REFERENCE

Certain portions of the Definitive Proxy Statement for the 2011 Meeting of Shareholders is incorporated by reference Part III, Items 10, 11, 12, 13 and 14 into Part III.

UNITED SECURITY BANCSHARES
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PART 1

Certain matters discussed or incorporated by reference in this Annual Report of Form 10-K including, but not limited to, those described in "Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations", are forward-looking statements as defined under the Securities Litigation Reform Act of 1995 that are subject to risks and uncertainties that could cause actual results to differ materially from those projected in the forward-looking statements. Such risks and uncertainties include, among others, (1) competitive pressure in the banking industry increases significantly; (2) changes in the interest rate environment which may reduce margins and devalue assets; (3) general economic conditions, either nationally or regionally, are less favorable than expected, resulting in, among other things, a deterioration in credit quality; (4) changes in the regulatory environment; (5) failure to comply with the regulatory agreement under which the Company is subject; (6) changes in business conditions and inflation; (7) changes in securities markets; (8) asset/liability matching risks and liquidity risks; (9) potential impairment of goodwill and other intangible assets; (10) loss of key personnel; and (11) operational interruptions including data processing systems failure and fraud. Therefore, the information set forth therein should be carefully considered when evaluating the business prospects of the Company.

Item 1 - Business

General

United Security Bancshares (the "Company") is a California corporation incorporated during March of 2001 and is registered with the Board of Governors of the Federal Reserve System as a bank holding company under the Bank Holding Company Act of 1956, as amended. The Company's stock is listed on NASDAQ under the symbol "UBFO". United Security Bank (the "Bank") is a wholly-owned bank subsidiary of the Company and was formed in 1987. United Security Bancshares Capital Trust I (the "Trust") was formed during June of 2001 as a Delaware business trust for the sole purpose of issuing Trust Preferred securities. The Trust was originally formed as a subsidiary of the Company, but was deconsolidated during 2004 pursuant to the adoption of ASC 810 (as revised), "Consolidation of Variable Interest Entities". During July 2007, the Trust Preferred Securities issued under USB Capital Trust I were redeemed, and upon retirement, the USB Capital Trust I was dissolved. During July the Company formed United Security Bancshares Capital Trust II and issued \$15.0 million in Trust Preferred Securities with terms similar to those originally issued under USB Capital Trust I, except at a lower interest rate. At present, the Company does not engage in any material business activities other than ownership of the Bank.

United Security Bank

On June 12, 2001, the Bank became the wholly owned subsidiary of United Security Bancshares, through a tax-free holding company reorganization, accounted for on a basis similar to the pooling of interest method. In the transaction, each share of Bank stock was exchanged for a share of Company stock on a one-to-one basis.

The Bank is a California state-chartered bank headquartered in Fresno, California. It is also a member of the Federal Reserve System ("Fed member"). The Bank originally commenced business on December 21, 1987 as a national bank and, during the fourth quarter of 1998, filed an application with the California Department of Financial Institutions and other regulatory authorities to become a state-chartered bank. The shareholders approved the conversion in January of 1999, and the Bank was granted approval to operate as a state-chartered bank on February 3, 1999. The Bank's operations are currently subject to federal and state laws applicable to state-chartered, Fed member banks and its deposits are insured up to the applicable limits by the Federal Deposit Insurance Corporation (the "FDIC"). The Bank is also subject to the Federal Deposit Insurance Act and regulatory reporting requirements of the FDIC. As a state-chartered bank and a member of the Federal Reserve System, the Bank is subject to supervision and regular examinations by the Board of Governors of the Federal Reserve System (the "FRB") and the California Department of

Financial Institutions (the “DFI”). In addition, the Bank is required to file reports with the FRB and provide such additional information as the FRB may require.

USB Investment Trust Inc. was incorporated effective December 31, 2001 as a special purpose real estate investment trust (“REIT”) under Maryland law. The REIT is a subsidiary of the Bank and was funded with \$133.0 million in real estate-secured loans contributed by the Bank. USB Investment Trust was originally formed to give the Bank flexibility in raising capital, and reduce the expenses associated with holding the assets contributed to USB Investment Trust. For further discussion of the REIT, refer to Item 7 – Management’s Discussion and Analysis of Financial Condition and Results of Operations – Income Taxes.

Effective April 23, 2004, the Company completed a merger with Taft National Bank headquartered in Taft, California. Taft National Bank (“Taft”) was merged into United Security Bank and Taft’s two branches, one located in Taft and the other located in Bakersfield, California, operate as branches of United Security Bank. The total consideration paid to Taft shareholders was 241,447 shares of the Company’s Common Stock valued at just over \$6 million. In the merger, the Company acquired \$15.4 million in cash and short-term investments \$23.3 million in loans, and \$48.2 million in deposits. This transaction was accounted for using the purchase method of accounting, and resulted in the purchase price being allocated to the assets acquired and liabilities assumed from Taft based on the fair value of those assets and liabilities, with resultant goodwill of \$1.6 million and core deposits intangibles of \$1.9 million. Goodwill is not amortized but is reviewed at least annually for impairment, while core deposit intangibles are being amortized over a period of approximately 7 years. At the time of the merger, the Company sought opportunities to expand its market area to the south with the expectation that the Bakersfield area would have significant growth given its strategic location just north of Los Angeles. The two branches purchased have grown since the merger in 2004, with loans totaling \$58.3 million, and deposits totaling \$68.5 million at December 31, 2010. Like much of the rest of the San Joaquin Valley, the Bakersfield area has been impacted to a large degree by the slowdown in residential real estate markets and resulting depressed real estate prices. Of the \$51.0 million in total impaired loans reported by the Company at December 31, 2010, \$19.5 million was related to the Bakersfield operation with a specific reserve of \$4.3 million. The Company believes there was no impairment on either the goodwill or core deposit intangible related to the Taft merger.

On February 16, 2007, the Company completed its merger with Legacy Bank, N.A., located in Campbell, California, with the acquisition of 100 percent of Legacy's outstanding common shares. At merger, Legacy Bank's one branch was merged with and into United Security Bank, a subsidiary of the Company. The purchase of Legacy Bank provided the Company with an opportunity to expand its market area into Santa Clara County and to serve a growing small business niche and individual client base built by Legacy. At the time of the merger, Legacy had \$62.5 million in net loans and \$69.6 million in total deposits. At December 31, 2010 total loans and deposits related to the Campbell branch totaled \$37.8 million and \$22.6 million, respectively, and have decreased as the result of declines in lending markets in that area as well as significant competition for deposits. Impaired loans related to the Campbell branch at December 31, 2010 totaled \$2.0 million with a related specific reserve of \$591,000. The Company believes that as the economy recovers from the recent significant downturn, there will be increased opportunities to expand business within the greater Campbell area particularly in lending to small-to-medium sized businesses. The total value of the merger transaction was \$21.5 million, and the shareholders of Legacy Bank received merger consideration consisting of 976,411 shares of common stock of the Company. The merger transaction was accounted for as a purchase transaction, and resulted in the purchase price being allocated to the assets acquired and liabilities assumed from Legacy Bank based on the fair value of those assets and liabilities, with resultant goodwill of \$8.8 million and core deposits intangibles of \$1.9 million. Goodwill is not amortized but is reviewed at least annually for impairment, while core deposit intangibles are being amortized over a period of approximately 7 years. The Company recognized goodwill impairment charges of \$1.4 million and \$3.0 million and impairment charges related to core deposit intangibles of \$81,000 and \$57,000 for the years ended December 31, 2010 and December 31, 2009, respectively. The Company recognized no impairment charges related to goodwill or core deposit intangibles prior to 2009.

During November 2007, the Company purchased the recurring contractual revenue stream and certain fixed assets from ICG Financial, LLC. Additionally, the Company hired all but one of the former employees of ICG Financial, LLC and its subsidiaries. The total purchase price was \$414,000 including \$378,000 for the recurring revenue stream and \$36,000 for the fixed assets. As a department of the Bank, USB Financial Services provides wealth management, employee benefit, insurance and loan products, as well as consulting services for a variety of clients, utilizing employees hired from ICG Financial LLC. At the time of the purchase, the Company believed the wealth management and related services provided by USB Financial Services would enhance the products and services offered by the Company, and increase noninterest income. The original capitalized cost of \$378,000 for the recurring contractual revenue stream was fully amortized at December 31, 2010. While the addition of USB Financial Services has broadened the products and services offered by the Company, the operation has not performed as well as originally anticipated resulting in marginal or no profitability over the past several years. The staff of the department has been reduced mostly through attrition, and the Company has recognized impairment charges of \$25,000 and \$24,000 for the years ended December 31, 2009 and 2008, respectively, related to the recurring revenue stream, some of which has ended earlier than the three-year anticipated life.

At December 31, 2010, the Bank operates three branches (including its main office), one construction lending office, and one financial services office in Fresno and one branch each, in Oakhurst, Caruthers, San Joaquin, Firebaugh, Coalinga, Bakersfield, Taft, and Campbell. In addition, the Company and Bank have administrative headquarters located at 2126 Inyo Street, Fresno, California, 93721. The Company operates as one operating segment.

At December 31, 2010, 2009, and 2008, the consolidated Company had total assets of approximately \$678.2, \$693.2 million, and \$761.1 million, respectively. For the year ended December 31, 2010, the Company reported a net loss of \$4.5 million, as compared to a net loss of \$4.5 million and net income of \$4.1 million for the years ended December 2009 and 2008, respectively. At December 31, 2010, the consolidated Company had approximately \$424.5 million in net loans, \$557.5 million in deposits, and \$73.3 million in shareholders' equity.

Effective March 23, 2010, United Security Bancshares (the "Company") and its wholly owned subsidiary, United Security Bank (the "Bank"), entered into a written agreement with the Federal Reserve Bank of San Francisco (see "Regulatory Action" included below Supervision and Regulation for further information on terms of the written agreement). As a result of the agreement, the Company will, among other things, continue to focus its attention on reducing the level of problem assets while maintaining adequate liquidity and capital, and reducing its dependence on brokered and other wholesale deposits.

The Company has slowed its loan growth significantly over the past three years as a result of the economic downturn, and will continue to do so as a result of the recent agreement with the Federal Reserve Bank and California Department of Financial Institutions (referred to collectively herein as Federal Reserve Bank unless otherwise noted). While total loans declined 6.6% between December 31, 2008 and December 31, 2009, and declined 13.1% between December 31, 2009 and December 31, 2010, real estate construction and development loans declined 30.4% and 38.1% between those periods, and decreased as a percentage of total loans from 27.7% of total loans at December 31, 2008 to 14.8% of total loans at December 31, 2010. During the same three-year period, nonperforming assets and related loan losses were increasing, with loan loss provisions of \$12.5 million, \$13.4 million and \$9.5 million for the years ended December 31, 2010, 2009, and 2008, respectively. The largest impact of nonperforming assets was in the real estate construction and development area with significant slowdowns in housing starts combined with swift and severe declines in housing prices in the Company's market area as well as the rest of the country during 2008 thru 2010. Management's focus over the past three years, as a result of the depressed economy as well as the recent agreement with the Federal Reserve Bank, has been to concentrate its efforts on reducing the level of nonperforming assets rather than developing new business and growing the loan portfolio. This has been challenging in an economic environment where real estate construction all but stopped in late 2008 and early 2009, and housing prices continued to decline quarter after quarter, while unemployment and other economic factors grew worse. Lending policies and procedures have been enhanced, exposure to real estate loans have been reduced, and loan modifications, including rate and maturity concessions, and forbearance agreements, have been utilized more frequently to minimize loss exposure in the loan portfolio.

While loan growth prior to 2007 was funded to some degree by brokered deposits and other wholesale funding sources, the current state of the economy and the financial condition of the Company have made it increasingly important to continue to develop core deposits and reduce the Company's dependence on brokered and other wholesale funding sources, including lines of credit the Federal Reserve Bank and the FHLB. The Company increased its efforts early in 2009 to develop core deposit growth with employee training throughout the entire organization and a deposit-gathering program that incented employees to bring in new deposits from our local market area and establish more extensive relationships with our customers. The Company continues its deposit gathering program and has committed additional resources to its efforts during 2010 including two full time employees dedicated to business development. As a result of the formal agreement with the Federal Reserve Bank issued in March 2010, the Bank will reduce its dependence on wholesale funding sources, including brokered deposits, to a level more in-line with peers. The Bank, as part of its Liquidity Improvement Plan, will continue to reduce levels of brokered deposits to peer levels over the coming year.

While we still have a higher percentage of brokered deposits than peers at December 31, 2010, efforts to restructure the balance sheet through reducing the level of total assets, and specifically real estate loans, are proving successful. Total wholesale borrowings and brokered deposits decreased from \$169.4 million at December 31, 2009 to \$113.5 million at December 31, 2010, representing a decrease of \$55.9 million, and the Company improved its liquidity positions with an increase in fed funds sold and other overnight investments of \$11.6 million at December 31, 2009 to \$84.6 million at December 31, 2010.

The following discussion of the Company's services should be read in conjunction with "MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS."

Bank Services

As a state-chartered commercial bank, United Security Bank offers a full range of commercial banking services primarily to the business and professional community and individuals located in Fresno, Madera, Kern, and Santa Clara Counties.

The Bank offers a wide range of deposit instruments including personal and business checking accounts and savings accounts, interest-bearing negotiable order of withdrawal ("NOW") accounts, money market accounts and time certificates of deposit. Most of the Bank's deposits are attracted from individuals and from small and medium-sized business-related sources. Time deposits have provided a significant portion of the Bank's deposit base amounting to 35.8%, 40.8% and 36.3% of total deposits as December 31, 2010, 2009, and 2008, respectively. A portion of those time deposits are brokered deposits which are considered wholesale funding sources generally from out of the Bank's market area. Brokered deposits comprised 14.6%, 23.0%, 18.0% of total deposits as December 31, 2010, 2009, and 2008, respectively. As a result of the formal agreement with the Federal Reserve Bank issued in March 2010, the Bank will reduce its dependence on wholesale funding sources, including brokered deposits, to a level more in-line with peers which is currently approximately 4% of total deposits. The Bank, as part of its Liquidity Improvement Plan, will reduce levels of brokered deposits to peer levels over a period of approximately two years.

The Bank also engages in a full complement of lending activities, including real estate mortgage (35.7% of total loans at December 31, 2010), commercial and industrial (36.0% of total loans at December 31, 2010), real estate construction (14.8% of total loans at December 31, 2010), as well as agricultural (10.5% of total loans at December 31, 2010), lease financing (0.1% of total loans at December 31, 2010), and consumer loans (2.9% of total loans at December 31, 2010), with particular emphasis on short and medium-term obligations. Approximately 45.2%, 48.3%, 50.5%, of the loan portfolio was comprised of commercial real estate loans at December 31, 2010, 2009, and 2008, respectively. Approximately 64% of the Bank's loans are secured by real estate at December 31, 2010. A loan may be secured (in whole or in part) by real estate even though the purpose of the loan is not to facilitate the purchase or development of real estate. At December 31, 2010, the Bank had loans (net of unearned fees) outstanding of \$441.0 million, which represented approximately 79% of the Bank's total deposits and approximately 65% of its total assets.

Real estate mortgage loans are secured by deeds of trust primarily on commercial property. Repayment of real estate mortgage loans is generally from the cash flow of the borrower. Commercial and industrial loans have a high degree of industry diversification. Loans may be originated in the Company's market area, or participated with other financial institutions outside the Company's market area. A substantial portion of the Company's commercial and industrial loans are secured by accounts receivable, inventory, leases or other collateral. The remainder, are unsecured; however extensions of credit are predicated on the financial capacity of the borrower to repay. Repayment of commercial loans is generally from the cash flow of the borrower. Real estate construction loans consist of loans to residential contractors, which are secured by single-family residential properties. All real estate loans have established equity requirements. Repayment of real estate construction loans is generally from long-term mortgages with other lending institutions. Agricultural loans are generally secured by land, equipment, inventory and receivables. Repayment of agricultural loans is generally from the expected cash flow of the borrower.

Although the Bank has a high concentration of commercial real estate loans, the Bank is not in the business of making residential mortgage loans to individuals. Residential mortgage loans totaled \$23.8 million or 5.4% of the total portfolio at December 31, 2010. The Bank does not originate, or have in its loans portfolio, any subprime, Alt-A, or option adjustable rate loans. The Bank does originate interest-only loans which are generally revolving lines of credit to commercial and agricultural businesses or for real estate development where the borrowers business may be seasonal or cash flows may be restricted until the completion of the project. In addition, the Bank has restructured certain loans to allow the borrower to continue to perform on the loan under a troubled debt restructuring plan. Interest-only loans comprised 38.4% 48.1% and 57.4% of total loans at December 31, 2010, 2009, and 2008, respectively.

The Bank does purchase loan participations from, and does sell loan participations to, other financial institutions. The underwriting standards for loan participations or purchases are the same as non-participated loans, and are subject to the same limitations, collateral requirements, and borrower requirements. The Bank has reduced its level of loan participations over the past several years. Loan participations purchased comprised 3.9%, 4.7% and 6.6% of the total loan portfolio at December 31, 2010, 2009, and 2008, respectively. Loan participations sold comprised 2.0%, 3.1% and 5.4% of the total loan portfolio at December 31, 2010, 2009, and 2008, respectively. During the past year, participation lending activity has decreased and currently the Company is participating in few, if any, participation sales or purchases.

In the normal course of business, the Bank makes various loan commitments and incurs certain contingent liabilities. At December 31, 2010 and 2009, loan commitments of the Bank totaled \$67.9 million and \$84.0 million, respectively, and letters of credit totaled \$1.8 million and \$4.0 million, respectively. Of the \$67.9 million in loan commitments outstanding at December 31, 2010, \$24.9 million or 36.6% were for loans with maturities of one year or less. Due to the nature of the business of the Bank's customers, there are no seasonal patterns or absolute predictability to the utilization of unused loan commitments; therefore the Bank is unable to forecast the extent to which these commitments will be exercised within the current year. The Bank does not believe that any such utilization will

constitute a material liquidity demand. The Company does however have collateralized and uncollateralized lines of credit which could be utilized if such loan commitments were to be exercised in excess of normal expectations.

In addition to the loan and deposit services discussed above, the Bank also offers a wide range of specialized services designed to attract and service the needs of commercial customers and account holders. These services include online banking, safe deposit boxes, ATM services, payroll direct deposit, cashier's checks, traveler's checks, money orders, and foreign drafts. In addition, the Bank offers a variety of specialized financial services, including wealth management, employee benefit, insurance and loan products, as well as consulting services for a variety of clients. The Bank does not operate a trust department; however, it makes arrangements with its correspondent bank to offer trust services to its customers on request. Most of the Bank's business originates within Fresno, Madera, Kern, and Santa Clara Counties. Neither of the Bank's business or liquidity is seasonal, and there has been no material effect upon the Bank's capital expenditures, earnings or competitive position as a result of federal, state or local environmental regulation.

Lending Policies

The following is a summary of the Bank's loan policies.

- § Loan Documentation – All loan documentation is prepared by a centralized loan servicing department or by legal counsel based on the terms contained in the approved Credit Authorizations. The documentation, upon completion, is reviewed by a third party (Bank employee) in the loan servicing department prior to forwarding to the relationship managers, who then review the documents to ensure that they have been correctly prepared in accordance with the credit approval before execution by the borrowers.
- § Purchased Participations – The Bank independently underwrites, using the Bank's same guidelines for direct originations, and reviews the loan documentation of participation loans originated by other lenders for acceptability.
- § Verification of Information – The Bank, principally a commercial business lender, has not and does not make any “No Doc” or “Stated Income” loans. In the underwriting of a commercial loan request, the Bank performs an enterprise analysis of the financial information for trends, verifies major assets and liabilities, and obtains Dun and Bradstreet Credit reports on the entities and credit bureau reports on the principals of the entity. Regarding construction lending, the analyses have been enhanced to investigate and analyze real estate projects being financed by other lenders.
- § The Company is not dependent on any individual customer, entity, or group of related entities for deposits nor have a significant percentage of loans to borrowers.
- § Unsecured - Whether unsecured or secured, guarantees are usually obtained from the principals or from 3rd party guarantors if necessary for additional financial support. Unsecured loans totaled \$59.3 million, \$78.7 million and \$91.6 million at December 31, 2010, 2009, and 2008, respectively.
- § Historic policy on renewals - The renewal or extension of existing performing lines of credit or loans has not been changed; the credits are re-underwritten for the renewal period. The restructure of lines of credit or loans may occur based on the occurrence of pre-determined event or time, as part of the original underwriting. The renewal or restructuring of criticized credits has changed since the March 2010 FRB Agreement. The restructure or renewal is certified to the Board of Directors that the renewal is necessary to improve and protect the Bank's ultimate interest in the collection of the credit or maximize its potential for collection, that the renewal reflects prudent underwriting based on reasonable repayment terms and is adequately secured, that the Bank has performed a comprehensive credit analysis indicating the borrower has the willingness and ability to repay the debt as per the terms of the restructure plan and that the Bank's Loan Committee, designated by the Board, believes that the renewal will be repaid in accordance with the terms.
- § Additional Loans to nonaccrual borrowers. – The Bank as a general rule does not make additional loans to borrowers that are past due in principal or interest more than 90-days. However, in selected and limited instances as part of the workout or restructure of non-performing assets, to effect repayment, additional secured advances may be made.
- § Lending Limits – The Bank approves revolving lines of credit or loans for each borrower with terms and limits. Consideration is given for the aggregate direct borrowing exposure of the borrower, as well as, their indirect liability, plus the indirect liability of any guarantor. Overall, the Bank has established normal “House” lending limits at 50% of the Legal Lending Limit. The Legal Lending Limit is calculated for unsecured loans at 15% of total regulatory capital, and for secured loans at 25% of total regulatory capital. The Board of Directors must approve any borrowing relationship that exceeds the House Lending Limit.

Competition and Market Share

The banking business in California generally, and in the market area served by the Company specifically, is highly competitive with respect to both loans and deposits. The Company competes for loans and deposits with other commercial banks, savings and loan associations, finance companies, money market funds, credit unions and other financial institutions, including a number that are substantially larger than the Company. Deregulation of the banking industry, increased competition from non-bank entities for the cash balances of individuals and businesses, and continuing developments in the computer and communications industries have had, and most likely will continue to have, a significant impact on the Company's competitive position. With the enactment of interstate banking legislation in California, bank holding companies headquartered outside of California will continue to enter the California market and provide competition for the Company. Additionally, with the Gramm-Leach-Bliley Act of 1999, traditional competitive barriers between insurance companies, securities underwriters, and commercial banks have been eased, allowing a greater number of financial intermediaries to offer a wider assortment of financial services. Many of the major commercial banks operating in the Company's market areas offer certain services such as trust and international banking services, which the Company does not offer directly. In addition, banks with larger capitalization have larger lending limits and are thereby able to serve larger customers.

The Company's primary market area at December 31, 2010 was located in Fresno, Madera, and Kern Counties, in which approximately 30 FDIC-insured financial institutions compete for business. Santa Clara County was added during February 2007 with the Legacy Bank acquisition, in which approximately 50 FDIC-insured financial institutions compete for business. The following table sets forth information regarding deposit market share and ranking by county as of June 30, 2010, which is the most current information available.

	Rank	Share
Fresno County	8th	4.62%
Madera County	10th	3.98%
Kern County	14th	1.06%
Total of Fresno, Madera, Kern Counties	9th	3.34%
Santa Clara County	43rd	0.04%

Supervision and Regulation

The Company

The Company is a bank holding company within the meaning of the Bank Holding Company Act of 1956, as amended (the "BHC Act"), and is registered as such with the FRB. A bank holding company is required to file with the FRB annual reports and other information regarding its business operations and those of its subsidiaries and is also subject to examination by the FRB.

The BHC Act requires, among other things, prior approval before acquiring, directly or indirectly, ownership or control of any voting shares of any bank, if after such acquisition it would directly or indirectly own or control more than 5% of the voting stock of that bank, unless it already owns a majority of the voting stock of that bank. The BHC Act also provides that the FRB shall not approve any acquisition that would result in or further the creation of a monopoly, or the effect of which may be substantially to lessen competition, unless the anticompetitive effects of the proposed transaction are clearly outweighed by the probable effect in meeting the convenience and needs of the community served.

Furthermore, under the BHC Act, a bank holding company is, with limited exceptions, prohibited from (i) acquiring direct or indirect ownership or control of more than 5% of the voting shares of any company which is not a bank or (ii) engaging in any activity other than managing or controlling banks. With the prior approval of the FRB, however, a bank holding company may own shares of a company engaged in activities which the FRB has determined to be so closely related to banking or managing or controlling banks as to be proper incident thereto. Amendments to the BHC Act expand the circumstances under which a bank holding company may acquire control of all or substantially all of the assets of a bank located outside the State of California.

The BHC Act requires a bank holding company to serve as a source of financial and managerial strength to its subsidiary banks. It is the FRB's policy that a bank holding company should stand ready to use available resources to provide adequate capital funds to subsidiary banks during periods of financial stress and should maintain the financial flexibility and capital raising capacity to obtain additional resources for assisting a subsidiary bank. Under certain conditions, the FRB may conclude that certain actions of a bank holding company, such as payment of cash dividends, would constitute unsafe and unsound banking practices because they violate the FRB's "source of strength" doctrine.

A bank holding company and its subsidiaries are prohibited from certain tie-in arrangements in connection with any extension of credit, sale or lease of property or furnishing of services. For example, with certain exceptions, a bank

may not condition an extension of credit on a promise by its customer to obtain other services by it, its holding company or other subsidiaries, or on a promise by its customer not to obtain services from a competitor. In addition, federal law imposes certain restrictions between the Company and its subsidiaries, including the Bank. As an affiliate of the Bank, the Company is subject, with certain exceptions, to provisions of federal law imposing limitations on, and requiring collateral for, extensions of credit by the Bank to its affiliates.

As a public company, United Security Bancshares is subject to the Sarbanes-Oxley Act of 2002. The Sarbanes-Oxley Act amends the Securities and Exchange Act of 1934, and is intended to protect investors by, among other things, improving the reliability of financial reporting, increasing management accountability, and increasing the independence of Directors and the Company's external accountants.

The Company is subject to the periodic reporting requirements of the Securities Exchange Act of 1934, as amended, which include but are not limited to the filing of annual, quarterly and other current reports with the SEC.

The Bank

The Bank as a state-chartered bank is subject to regulation, supervision and regular examination by the California Department of Financial Institutions. In addition, The Bank is also a member of the Federal Reserve System and, as such, is subject to applicable provisions of the Federal Reserve Act and regulations issued there under and is subject to regulation, supervision and regular examination by the Federal Reserve Bank. The Bank is subject to California law, insofar as they are not preempted by federal banking law. Deposits of the Bank are insured by the FDIC up to the applicable limits in an amount up to \$250,000 per customer, and, as such, the Bank is subject to the regulations of the FDIC and the Federal Deposit Insurance Act. As a consequence of the extensive regulation of commercial banking activities in California and the United States, the Bank's business is particularly susceptible to changes in California and federal legislation and regulation, which may have the effect of increasing the cost of doing business, limiting permissible activities or increasing competition.

Various other requirements and restrictions under the laws of the United States and the State of California affect the operations of the Bank. Federal and California statutes and regulations relate to many aspects of the Bank's operations, including capital requirements and disclosure requirements to depositors and borrowers, requirements to maintain reserves against deposits, limitations on interest rates payable on deposits, loans, investments, and restrictions on borrowings and on payment of dividends. The DFI regulates the number and location of branch offices of a state-chartered bank, and may permit a bank to maintain branches only to the extent allowable under state law for state banks. California law presently permits a bank to locate a branch in any locality in the state. Additionally, California law exempts banks from California usury laws.

Capital Standards. The FRB has risk-based capital adequacy guidelines intended to provide a measure of capital adequacy that reflects the degree of risk associated with a banking organization's operations for both transactions reported on the balance sheet as assets, and transactions, such as letters of credit and recourse arrangements, which are reported as off-balance-sheet items. Under these guidelines, nominal dollar amounts of assets and credit equivalent amounts of off-balance-sheet items are multiplied by one of several risk adjustment percentages, which range from 0% for assets with low credit risk, such as certain U.S. government securities, to 100% for assets with relatively higher credit risk, such as business loans.

A banking organization's risk-based capital ratios are obtained by dividing its qualifying capital by its total risk-adjusted assets and off-balance-sheet items. The regulators measure risk-adjusted assets and off-balance-sheet items against both total qualifying capital (the sum of Tier 1 capital and limited amounts of Tier 2 capital) and Tier 1 capital. Tier 1 capital consists of common stock, retained earnings, noncumulative perpetual preferred stock and minority interests in certain subsidiaries, less most other intangible assets. Tier 2 capital may consist of a limited amount of the allowance for loan and lease losses and certain other instruments with some characteristics of equity. The inclusion of elements of Tier 2 capital is subject to certain other requirements and limitations of the federal banking agencies. Since December 31, 1992, the FRB and the FDIC have required a minimum ratio of qualifying total capital to risk-adjusted assets and off-balance-sheet items of 8%, and a minimum ratio of Tier 1 capital to risk-adjusted assets and off-balance-sheet items of 4%.

In addition to the risk-based guidelines, the FRB requires banking organizations to maintain a minimum amount of Tier 1 capital to average total assets, referred to as the leverage ratio. For a banking organization rated in the highest of the five categories used by regulators to rate banking organizations, the minimum leverage ratio of Tier 1 capital to total assets is 3%. It is improbable; however, that an institution with a 3% leverage ratio would receive the highest rating by the regulators since a strong capital position is a significant part of the regulators' ratings. For all banking

organizations not rated in the highest category, the minimum leverage ratio is 4%. In addition to these uniform risk-based capital guidelines and leverage ratios that apply across the industry, the FRB and FDIC have the discretion to set individual minimum capital requirements for specific institutions at rates significantly above the minimum guidelines and ratios.

A bank that does not achieve and maintain the required capital levels may be issued a capital directive by the FDIC to ensure the maintenance of required capital levels. As discussed above, the Company is required to maintain certain levels of capital, as is the Bank. The regulatory capital guidelines as well as the actual capitalization for the Bank and the Company as of December 31, 2010 are as follows:

	Requirement to be:		December 31, 2010	
	Adequately Capitalized	Well Capitalized	Company	Bank
Tier 1 leverage capital ratio	4.0%	5.0%	11.50%	11.04%
Tier 1 risk-based capital ratio	4.0%	6.0%	14.90%	14.35%
Total risk-based capital ratio	8.0%	10.0%	16.17%	15.58%

Prompt Corrective Action. Federal banking agencies possess broad powers to take corrective and other supervisory action to resolve the problems of insured depository institutions, including those institutions that fall below one or more prescribed minimum capital ratios described above. An institution that, based upon its capital levels, is classified as well capitalized, adequately capitalized, or undercapitalized may be treated as though it were in the next lower capital category if the appropriate federal banking agency, after notice and opportunity for hearing, determines that an unsafe or unsound condition or an unsafe or unsound practice warrants such treatment. At each successive lower capital category, an insured depository institution is subject to more restrictions.

In addition to measures taken under the prompt corrective action provisions, commercial banking organizations may be subject to potential enforcement actions by the federal regulators for unsafe or unsound practices in conducting their businesses or for violations of any law, rule, regulation, or any condition imposed in writing by the agency or any written agreement with the agency. Enforcement actions may include the imposition of a conservator or receiver, the issuance of a cease-and-desist order that can be judicially enforced, the termination of insurance of deposits (in the case of a depository institution), the imposition of civil money penalties, the issuance of directives to increase capital, the issuance of formal and informal agreements, the issuance of removal and prohibition orders against institution-affiliated parties and the enforcement of such actions through injunctions or restraining orders based upon a judicial determination that the agency would be harmed if such equitable relief was not granted. Additionally, a holding company's inability to serve as a source of strength to its subsidiary banking organizations could serve as an additional basis for a regulatory action against the holding company.

Premiums for Deposit Insurance. The deposit insurance fund of the FDIC insures our customer deposits up to prescribed limits for each depositor. The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 in a comprehensive manner revised the deposit insurance assessment system including the specific mandate that the FDIC require the base on which deposit insurance assessments are charged be revised from one based on domestic deposits to one based on assets. Among other things with respect to the FDIC insurance fund, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010,

- raised the minimum designated reserve ratio (“DDR”) which the FDIC must set each year, to 1.35 percent (from the former minimum of 1.15 percent) and removed the upper limit on the DRR (which was formerly capped at 1.5 percent) and therefore on the size of the fund;
- required that the fund reserve ratio reach 1.35 percent by September 30, 2020 (rather than 1.15 percent by the end of 2016, as formerly required);

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required that, in setting assessments, the FDIC “offset the effect of requiring that the reserve ratio reach 1.35 percent by September 30, 2020 rather than 1.15 percent by the end of 2016 on insured depository institutions with total consolidated assets of less than \$10,000,000,000”;

- eliminated the requirement that the FDIC provide dividends from the fund when the reserve ratio is between 1.35 percent and 1.5 percent; and
- continued the FDIC’s authority to declare dividends when the reserve ratio at the end of a calendar year is at least 1.5 percent, but granted the FDIC sole discretion in determining whether to suspend or limit the declaration or payment of dividends.

In February 2011, the FDIC adopted conforming regulations mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 that (i) modifies the definition of an institution's deposit insurance assessment base, (ii) changes the assessment rate adjustments (and includes the unsecured debt adjustment, which lowers an institution's assessment rate to recognize the buffer that long-term unsecured and subordinated debt provides the FDIC's Deposit Insurance Fund), (iii) revises the deposit insurance assessment rate schedules in light of the new assessment base and altered related adjustments; to implement the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 dividend provisions; (iv) revises the large insured depository institution assessment system to differentiate for risk and determine account losses from large institution failures that the FDIC may incur; and to (vi) make technical and other changes to the FDIC's assessment rules. The new rules are effective April 1, 2011, and the assessment rate would range between a minimum of 2 basis points and a maximum of 45 basis points. In addition, the FDIC Board may increase or decrease such total base assessment rates up to a maximum increase of 2 basis points or a fraction thereof or a maximum decrease of 2 basis points or a fraction thereof (after aggregating increases and decreases), as the Board deems necessary. In setting assessment rates, the Board shall take into consideration the following:

- estimated operating expenses of the Deposit Insurance Fund;
- case resolution expenditures and income of the Deposit Insurance Fund;
- the projected effects of assessments on the capital and earnings of the institutions paying assessments to the Deposit Insurance Fund;
- the risk factors and other factors taken into account pursuant to 12 USC 1817(b)(1); and
- any other factors the Board may deem appropriate.

The new rules would likely lower the overall assessment for smaller banks such as the Bank. However, due to the significant losses at failed banks and expected losses for banks that will fail, there are no assurances that FDIC insurance fund assessments on the Bank will not increase, and such increased assessments may materially adversely affect the profitability of the Bank.

Any increase in assessments or the assessment rate could have a material adverse effect on our business, financial condition, results of operations or cash flows, depending on the amount of the increase. Furthermore, the FDIC is authorized to raise insurance premiums under certain circumstances.

The FDIC is authorized to terminate a depository institution's deposit insurance upon a finding by the FDIC that the institution's financial condition is unsafe or unsound or that the institution has engaged in unsafe or unsound practices or has violated any applicable rule, regulation, order or condition enacted or imposed by the institution's regulatory agency. The termination of deposit insurance for the bank would have a material adverse effect on our business, financial condition, results of operations and/or cash flows.

Federal Home Loan Bank System. The Bank is a member of the Federal Home Loan Bank of San Francisco (the "FHLB-SF"). Among other benefits, each Federal Home Loan Bank ("FHLB") serves as a reserve or central bank for its members within its assigned region. Each FHLB is financed primarily from the sale of consolidated obligations of the FHLB system. Each FHLB makes available loans or advances to its members in compliance with the policies and procedures established by the Board of Directors of the individual FHLB. The FHLB-SF utilizes a single class of stock with a par value of \$100 per share, which may be issued, exchanged, redeemed and repurchased only at par value. As an FHLB member, the Bank is required to own FHLB –SF capital stock in an amount equal to the greater of:

- § a membership stock requirement with an initial cap of \$25 million (100% of "membership asset value" as defined), or
- § an activity based stock requirement (based on percentage of outstanding advances).

The FHLB – SF capital stock is redeemable on five years written notice, subject to certain conditions. At December 31, 2010 the Bank owned 36,970 shares of the FHLB-SF capital stock.

Federal Reserve. The FRB requires all depository institutions to maintain non-interest bearing reserves at specified levels against their transaction accounts and non-personal time deposits. At December 31, 2010, the Bank was in compliance with these requirements.

Federal Reserve Action against the Company and the Bank dated March 10, 2010

During March 2010, the Federal Reserve Bank took regulatory action against the Company and the Bank. As a result, effective March 23, 2010, United Security Bancshares (the "Company") and its wholly owned subsidiary, United Security Bank (the "Bank"), entered into a written agreement with the Federal Reserve Bank of San Francisco. Under the terms of the agreement, the Company and the Bank agreed, among other things, to strengthen board oversight of management and the Bank's operations; submit an enhanced written plan to strengthen credit risk management practices and improve the Bank's position on the past due loans, classified loans, and other real estate owned; maintain a sound process for determining, documenting, and recording an adequate allowance for loan and lease losses; improve the management of the Bank's liquidity position and funds management policies; maintain sufficient capital at the Company and Bank level; and improve the Bank's earnings and overall condition. The Company and Bank have also agreed not to increase or guarantee any debt, purchase or redeem any shares of stock, declare or pay any cash dividends, or pay interest on the Company's junior subordinated debt or trust preferred securities, without prior written approval from the Federal Reserve Bank.

The Agreement's major components and requirements for the Bank are as follows:

- Strengthen board oversight of the Bank's management and operations by the Bank submitting a written plan to the Federal Reserve Bank to address and include (i) the actions that the board will take to improve the Bank's conditions and maintain effect control over, and supervision of the Bank's major operations and activities, (ii) the responsibility of the board to monitor management's adherence to approved policies and procedures, and applicable laws and regulations; and (iii) a description of the information and reports that are regularly reviewed by the board in its oversight of the operations and management of the Bank;

- Strengthen credit risk management practices of the Bank by the Bank submitting a written plan to the Federal Reserve Bank to address and include (i) the responsibility of the board of directors to establish appropriate risk tolerance guidelines and risk limits; (ii) timely and accurate identification and quantification of credit risk within the loan portfolio; (iii) strategies to minimize credit losses and reduce the level of problem assets; (iv) procedures for the on-going review of the investment portfolio to evaluate other-than temporary-impairment (“OTTI”) and accurate accounting for OTTI; (v) stress testing of commercial real estate loan and portfolio segments; and (vi) measures to reduce the amount of other real estate owned;
- Strengthen asset quality at the Bank by (i) not extending, renewing, or restructuring any credit to or for the benefit of any borrower, including any related interest of the borrower, whose loans or other extensions of credit were criticized in the Report of Examination or in any subsequent report of examination, without appropriate underwriting analysis, documentation, board or committee approval and certification that the board or committee reasonably believes that the extension of credit will not impair the Bank’s interest in obtaining repayment of the already outstanding credit and that the extension of credit or renewal will be repaid according to its terms, (ii) submitting to the Federal Reserve Bank an acceptable written plan designed to improve the Bank’s position through repayment, amortization, liquidation, additional collateral, or other means on each loan or other asset in excess of \$1.5 million including other real estate owned that is past due as to principal or interest more than 90 days, on the Bank’s problem loan list, or were adversely classified in the Report of Examination or subsequent report of examination;
- Improve management of the Bank’s allowance for loan losses by (i) eliminating from its books, by charge-off or collection, all assets or portions of assets classified “loss” in the Report of Examination that have not been previously collected in full or charged off within 10 days of the Agreement, and within 30 days from the receipt of any federal or state report of examination, charge off all assets classified “loss” unless otherwise approved in writing by the Federal Reserve Bank, (ii) maintain a sound process for determining, documenting, and recording an adequate allowance for loan and lease losses (“ALLL”) in accordance with regulatory reporting instructions and relevant supervisory guidance, and (iii) within 60 days of the date of the Agreement, submitting to the Federal Reserve Bank an acceptable written program for the maintenance of an adequate ALLL, including provision for a review of the ALLL by the board on at least a quarterly calendar basis and remedying any deficiency found in the ALLL in the quarter it is discovered, and the board maintaining written documentation of its review of the ALLL;
- Maintain sufficient capital at the Company and Bank by submitting to the Federal Reserve Bank an acceptable written plan to maintain sufficient capital at the Company, on a consolidated basis, and the Company and the Bank shall jointly submit to the Reserve Bank an acceptable written plan to maintain sufficient capital at the Bank, as a separate legal entity on a stand-alone basis that (i) complies with the applicable bank and bank holding company capital maintenance regulations and regulatory guidelines and that also considers the adequacy of the Bank’s capital, (ii) takes into account the volume of classified credits, concentrations of credit, ALLL, current and projected asset growth, and projected retained earnings, the source and timing of additional funds to fulfill the Company’s and the Bank’s future capital requirements, and a provision to notify the Federal Reserve Bank when either entity falls below the capital ratios in the accepted plan;
- Submit a revised business plan and budget to the Federal Reserve Bank for 2010 and subsequent calendar years that the Bank is subject to the Agreement to improve the Bank’s earnings and overall condition, which plan at a minimum provides a realistic and comprehensive budget for the remainder of calendar year 2010, and description of the operating assumptions that form the basis for, and adequately support, major projected income, expense, and balance sheet components;
- Not make certain distributions, dividends, and payments, specifically that (i) the Company and Bank agreeing not to declare or pay any dividends without the prior written approval of the Federal Reserve Bank and the Director of the

Division of Banking Supervision and Regulation of the Board of Governors (“Director”), (ii) the Company not taking any other form of payment representing a reduction in capital from the Bank without the prior written approval of the Federal Reserve Bank, and (iii) the Company and its nonbank subsidiaries not making any distributions of interest, principal, or other sums on subordinated debentures or trust preferred securities without the prior written approval of the Federal Reserve Bank and the Director;

- Not incur debt or redeem stock, specifically, that except with the prior written approval of the Federal Reserve Bank, the Company each agree not to incur, increase, or guarantee any debt or purchase or redeem any shares of its stock;

- Correct violations of the laws by (i) the Bank immediately taking all necessary steps to correct all violations of law and regulation cited in the Report of Examination, (ii) the board of the Bank taking the necessary steps to ensure the Bank's future compliance with all applicable laws and regulations, (iii) complying with the notice provisions of Section 32 of the FDI Act (12 U.S.C. § 1831i) and Subpart H of Regulation Y of the Board of Governors of the Federal Reserve System (12 C.F.R. §§ 225.71 et seq) prior to appointing any new director or senior executive officer, or changing the responsibilities of any senior executive officer so that the officer would assume a different senior executive officer position, and (iv) complying with the restrictions on indemnification and severance payments of Section 18(k) of the FDI Act (12 U.S.C. § 1828(k)) and Part 359 of the FDIC's regulations (12 C.F.R. Part 359);
- Comply with the Agreement by (i) appointing a compliance committee of the Bank ("Compliance Committee") within 10 days of the date of the Agreement to monitor and coordinate the Bank's compliance with the provisions of the Agreement, which Compliance Committee is composed of a majority of outside directors who are not executive officers or principal shareholders of the Bank and which is to meet at least monthly and report its findings to the board of directors of the Bank, and (ii) the Company and Bank within 30 days after the end of each calendar quarter following the date of the Agreement submitting to the Federal Reserve Bank written progress reports detailing the form and manner of all actions taken to secure compliance with the Agreement and the results of such actions.

To view a copy of the Agreement with the Federal Reserve Bank of San Francisco, see the Company's Form 8-K filed with the Securities and Exchange Commission on March 25, 2010.

In addition to the submission of the plans referred to in the Agreement to the Federal Reserve Bank for approval, and implementation of those plans, the Bank is required within 30 days after the end of each calendar quarter to submit written progress reports to the Federal Reserve Bank detailing actions taken to secure compliance with the Agreement. On April 28, 2010, July 30, 2010, and October 30, 2010, respectively, the Bank submitted progress reports to the Federal Reserve for the first, second, and third quarters of 2010. As of the January 30, 2011 progress report submitted for the fourth quarter of 2010 the Company and the Bank believe they are in compliance with the Agreement, including remediation of technical violations of laws and regulations regarding stale loan appraisals and the various deadlines in the Agreement.

Regulatory Order from the California Department of Financial Institutions

During May of 2010, the California Department of Financial Institutions issued a written order (the "Order") pursuant to section 1913 of the California Financial Code to the Bank as a result of a regulatory examination that was conducted by the Federal Reserve and the California Department of Financial Institutions in June 2009. The Order issued by the California Department of Financial Institutions is basically similar to the written agreement with the Federal Reserve Bank of San Francisco, except for certain additional requirements. The additional requirements in the Order for the Bank are as follows:

- Develop and adopt a capital plan to maintain a ratio of tangible shareholders' equity to total tangible assets equal to or greater than 9.5% and include in such capital plan a capital contingency plan for raising additional capital in the event of various contingencies;
- Maintain a ratio of tangible shareholders' equity to total tangible assets equal to or greater than 9.5%
- Maintain an adequate allowance for loan losses and remedy any deficiency in the allowance for loan losses in the calendar quarter in which it is discovered; and
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Not establish any new branches or other offices without the prior written consent of the Commissioner of the California Department of Financial Institutions;

- Provide progress reports within 30 days after the end of each calendar quarter following the date of the Order to the California Department of Financial Institutions detailing the form and manner of all actions taken to secure compliance with the Order and Agreement and the results of such actions.

The Bank is currently in full compliance with the requirements of the Order including its deadlines.

Effect of Governmental Policies and Recent Legislation

Banking has traditionally been a business that depends on rate differentials. In general, the difference between the interest rate paid by the Company on its deposits and other borrowings and the interest rate received on loans extended to its customers and securities held in the Company's portfolio comprise the major portion of the Company's earnings. These rates are highly sensitive to many factors which are beyond the control of the Company. Accordingly, the earnings and growth of the Company are subject to the influence of domestic and foreign economic conditions, including, but not limited to, inflation, recession and unemployment.

Impact of Monetary Policies. The earnings and growth of the Company are affected not only by general economic conditions, both domestic and foreign, but also by the monetary and fiscal policies of the United States government and its agencies, particularly the Federal Reserve Board (“FRB”). The FRB implements national monetary policies (with objectives such as to curb inflation and combat recession) by its open market operations in United States Government securities, by adjusting the required level of reserves for financial institutions subject to reserve requirements, and by varying the discount rates applicable to borrowing by banks which are members of the Federal Reserve System. 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. The FRB’s policies have had a significant effect on the operating results of commercial banks and are expected to continue to do so in the future. The nature and timing of any future changes in monetary policies are not predictable. In addition, adverse economic conditions could make a higher provision for loan losses a prudent course and could cause higher loan charge-offs, thus adversely affecting the Company’s net income.

Extensions of Credit to Insiders and Transactions with Affiliates. The Federal Reserve Act and FRB Regulation O place limitations and conditions on loans or extensions of credit to:

- § a bank’s or bank holding company’s executive officers, directors and principal shareholders (i.e., in most cases, those persons who own, control or have power to vote more than 10% of any class of voting securities),
- § any company controlled by any such executive officer, director or shareholder, or
- § any political or campaign committee controlled by such executive officer, director or principal shareholder.

Loans and leases extended to any of the above persons must comply with loan-to-one-borrower limits, require prior full board approval when aggregate extensions of credit to the person exceed specified amounts, must be made on substantially the same terms (including interest rates and collateral) as, and follow credit-underwriting procedures that are not less stringent than, those prevailing at the time for comparable transactions with non-insiders, and must not involve more than the normal risk of repayment or present other unfavorable features. In addition, Regulation O provides that the aggregate limit on extensions of credit to all insiders of a bank as a group cannot exceed the bank’s unimpaired capital and unimpaired surplus. Regulation O also prohibits a bank from paying an overdraft on an account of an executive officer or director, except pursuant to a written pre-authorized interest-bearing extension of credit plan that specifies a method of repayment or a written pre-authorized transfer of funds from another account of the officer or director at the bank.

Consumer Protection Laws and Regulations. The banking regulatory agencies are focusing greater attention on compliance with consumer protection laws and their implementing regulations. Examination and enforcement have become more intense in nature, and insured institutions have been advised to monitor carefully compliance with such laws and regulations. The Company is subject to many federal and state consumer protection and privacy statutes and regulations, some of which are discussed below.

The Community Reinvestment Act (the “CRA”) is intended to encourage insured depository institutions, while operating safely and soundly, to help meet the credit needs of their communities. The CRA specifically directs the federal regulatory agencies, in examining insured depository institutions, to assess a bank’s record of helping meet the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with safe and sound banking practices. The CRA further requires the agencies to take a financial institution’s record of meeting its community credit needs into account when evaluating applications for, among other things, domestic branches, mergers or acquisitions, or holding company formations. The agencies use the CRA assessment factors in order to provide a rating to the financial institution. The ratings range from a high of “outstanding” to a low of “substantial noncompliance.” In its last examination for CRA compliance, as of September 2010, the Bank was rated “satisfactory.”

The Equal Credit Opportunity Act (the “ECOA”) generally prohibits discrimination in any credit transaction, whether for consumer or business purposes, on the basis of race, color, religion, national origin, sex, marital status, age (except in limited circumstances), receipt of income from public assistance programs, or good faith exercise of any rights under the Consumer Credit Protection Act.

The Truth in Lending Act (the “TILA”) is designed to ensure that credit terms are disclosed in a meaningful way so that consumers may compare credit terms more readily and knowledgeably. As a result of the TILA, all creditors must use the same credit terminology to express rates and payments, including the annual percentage rate, the finance charge, the amount financed, the total of payments and the payment schedule, among other things.

The Fair Housing Act (the “FH Act”) regulates many practices, including making it unlawful for any lender to discriminate in its housing-related lending activities against any person because of race, color, religion, national origin, sex, handicap or familial status. A number of lending practices have been found by the courts to be, or may be considered, illegal under the FH Act, including some that are not specifically mentioned in the FH Act itself.

The Home Mortgage Disclosure Act (the “HMDA”), in response to public concern over credit shortages in certain urban neighborhoods, requires public disclosure of information that shows whether financial institutions are serving the housing credit needs of the neighborhoods and communities in which they are located. The HMDA also includes a “fair lending” aspect that requires the collection and disclosure of data about applicant and borrower characteristics as a way of identifying possible discriminatory lending patterns and enforcing anti-discrimination statutes.

The Right to Financial Privacy Act (the “RFPA”) imposes a new requirement for financial institutions to provide new privacy protections to consumers. Financial institutions must provide disclosures to consumers of its privacy policy, and state the rights of consumers to direct their financial institution not to share their nonpublic personal information with third parties.

Finally, the Real Estate Settlement Procedures Act (the “RESPA”) requires lenders to provide noncommercial borrowers with disclosures regarding the nature and cost of real estate settlements. Also, RESPA prohibits certain abusive practices, such as kickbacks, and places limitations on the amount of escrow accounts.

Penalties for noncompliance or violations under the above laws may include fines, reimbursement and other penalties. Due to heightened regulatory concern related to compliance with CRA, ECOA, TILA, FH Act, HMDA, RFPA and RESPA generally, the Company may incur additional compliance costs or be required to expend additional funds for investments in its local communities.

From time to time, legislation is enacted which has the effect of increasing the cost of doing business, limiting or expanding permissible activities or affecting the competitive balance between banks and other financial institutions. Proposals to change the laws and regulations governing the operations and taxation of banks and other financial institutions are frequently made in Congress, in the California legislature and before various bank regulatory agencies. The likelihood of any major change and the impact such change may have on the Company is impossible to predict. Certain of the potentially significant changes which have been enacted recently and other which are currently under consideration by Congress or various regulatory agencies or professional agencies are discussed below.

Recent Legislation and Other Changes

Federal and state laws affecting banking are enacted from time to time, and similarly federal and state regulations affecting banking are also adopted from time to time. The following include some of the recent laws and regulations affecting banking.

The 2010 Tax Relief Act was enacted on December 17, 2010. The 2010 Tax Relief Act extends the Bush era tax cuts for individual federal income tax rates through 2012, including keeping the capital gains and dividend rates remain at 0 or 15 percent. In addition, the 2010 Tax Relief Act provides for continuation of education incentives through 2012, including expanded Coverdell accounts and definition of education expenses, expanded exclusion for employer-provided educational assistance of up to \$5,250, expanded student loan interest deduction, exclusion from income of amounts received under certain scholarship programs, and American Opportunity Tax Credit of up to \$2,500 for tuition expenses.

The 2010 Tax Relief Act also provides alternative minimum tax relief by increasing the exemption amounts for 2010 to \$47,450 (individuals) and \$72,450 (married filing jointly) and for 2011 to \$48,450 (individuals) and \$74,450

(married filing jointly). It also allows the nonrefundable personal credits against the AMT. Temporary gift and estate tax is also included in the 2010 Tax Relief Act. The gift and estate exemption was increased to \$5 million per person and \$10 million per couple and a top tax rate of 35 percent for the estate, gift, and generation skipping transfer taxes for two years, through 2012. The exemption amount is also indexed beginning in 2012. The change is effective January 1, 2010, but allows an election to choose no estate tax and modified carryover basis for estates arising on or after January 1, 2010 and before January 1, 2011. The law sets a \$5 million generation-skipping transfer tax exemption and zero percent rate for the 2010 year.

The 2010 Tax Relief Act also extends on a temporary basis the bonus depreciation for taxable years 2011 and 2012. For small businesses, the maximum amount and phase-out threshold under section 179 for taxable years 2012 are set at \$125,000 and \$500,000 respectively, indexed for inflation. The law also provided a one-year reauthorization of federal UI benefits and cuts FICA taxes for employees to 4.2 percent and those self employed to 10.4 percent on self-employment income up to \$106,800.

The Small Business Jobs Act of 2010 (“SBA Jobs Act”) enacted in September 2010 provides numerous tax breaks for small businesses including start up small businesses, and more importantly for insured financial institutions eligibility for participation in a U S Treasury program that will provide a maximum \$30 billion for purchases of preferred stock and other debt instruments issued by eligible financial institutions for the purpose of increasing credit availability for small businesses.

In addition, there are important changes to various SBA loan administration programs to aid small businesses under the SBA Jobs Act. The SBA Jobs Act provides for increasing maximum individual loan limits of SBA loans, extending the higher government guarantee level and waiver of borrower fees for certain SBA loans, and allowing alternative underwriting measures, specifically net worth and net income to allow more small businesses to participate in certain SBA loans.

The Dodd-Frank Act, signed into law in July, 2010, will significantly change the current bank regulatory structure and affect the lending, investment, trading and operating activities of financial institutions and their holding companies. The Dodd-Frank Act creates of a new interagency council, the Financial System Oversight Council that is charged with identifying and monitoring the systemic risk to the U.S. economy posed by systemically significant, large financial companies, including bank holding companies and non-bank financial companies. The Office of Thrift Supervision will be eliminated and its powers distributed among the Office of the Comptroller of the Currency, the Federal Reserve Board and the FDIC. The legislation also establishes a floor for capital of insured depository institutions that cannot be lower than the standards in effect today, and directs the federal banking regulators to implement new leverage and capital requirements within 18 months that take into account off-balance sheet activities and other risks, including risks relating to securitized products and derivatives.

The Dodd-Frank Act also creates a new Consumer Financial Protection Bureau with broad powers to supervise and enforce consumer protection laws. The Consumer Financial Protection Bureau has broad rulemaking authority for a wide range of consumer protection laws that apply to all banks and savings institutions such as the Bank, including the authority to prohibit “unfair, deceptive or abusive” acts and practices. The Consumer Financial Protection Bureau has examination and enforcement authority over all banks and savings institutions with more than \$10 billion in assets. Banks and savings institutions with \$10 billion or less in assets will be examined by their applicable bank regulators. The new legislation also weakens the federal preemption available for national banks and federal savings associations, and gives state attorneys general the ability to enforce applicable federal consumer protection laws.

The legislation also broadens the base for FDIC insurance assessments. Assessments will now be based on the average consolidated total assets less tangible equity capital of a financial institution. The Dodd-Frank Act also permanently increases the maximum amount of deposit insurance for banks, savings institutions and credit unions to \$250,000 per depositor, retroactive to January 1, 2008, and non-interest bearing transaction accounts have unlimited deposit insurance through December 31, 2013. The Dodd-Frank Act also repeals the prohibition on payment of interest on demand deposits.

Many of the provisions of the Dodd-Frank Act will not take effect for at least a year, and the legislation requires various federal agencies to promulgate numerous and extensive implementing regulations over the next several years. Although the substance and scope of these regulations cannot be determined at this time, it is expected that the legislation and implementing regulations, particularly those provisions relating to the new Consumer Financial Protection Bureau, will increase the Bank’s operating and compliance costs as it is likely that the Bank’s existing regulatory agencies will adopt the same or similar consumer protections as the new Consumer Financial Protection Bureau will adopt.

The Electronic Funds Transfer Act (the “EFTA”) provides a basic framework for establishing the rights, liabilities, and responsibilities of consumers who use electronic funds transfer (“EFT”) systems. The EFTA is implemented by the

Federal Reserve's Regulation E, which governs transfers initiated through ATMs, point-of-sale terminals, payroll cards, automated clearinghouse ("ACH") transactions, telephone bill-payment plans, or remote banking services. Regulation E was amended in January 2010 to require consumers to opt in (affirmatively consent) to participation in the Bank's overdraft service program for ATM and one-time debit card transactions before overdraft fees may be assessed on the consumer's account. Notice of the opt-in right must be provided to all existing and new customers who are consumers, and the customer's affirmative consent must be obtained, before charges may be assessed on the consumer's account for paying such overdrafts.

The new rule provides bank customers with an ongoing right to revoke consent to participation in an overdraft service program for ATM and one-time debit card transactions, as opposed to being automatically enrolled in such a program. The new rule also prohibits banks from conditioning the payment of overdrafts for checks, ACH transactions, or other types of transactions that overdraw the consumer's account on the consumer's opting into an overdraft service for ATM and one-time debit card transactions. For customers who do not affirmatively consent to overdraft service for ATM and one-time debit card transactions, a bank must provide those customers with the same account terms, conditions, and features that it provides to consumers who do affirmatively consent, except for the overdraft service for ATM and one-time debit card transactions.

The mandatory compliance date for the Regulation E amendments is July 1, 2010 provided that the Bank may continue to assess overdraft service fees or charges on existing customer accounts prior to August 15, 2010, without obtaining the consumer's affirmative consent. The Bank's compliance with the new Regulation E amendments may have an impact on the Bank's revenue from overdraft service fees and non-sufficient funds ("NSF") charges.

In May 2009 the Helping Families Save Their Homes Act of 2009 was enacted to help consumers avoid mortgage foreclosures on their homes through certain loss mitigation actions including special forbearance, loan modification, pre-foreclosure sale, deed in lieu of foreclosure, support for borrower housing counseling, subordinate lien resolution, and borrower relocation. The new law permits the Secretary of Housing and Urban Development (HUD), for mortgages either in default or facing imminent default, to: (1) authorize the modification of such mortgages; and (2) establish a program for payment of a partial claim to a mortgagee who agrees to apply the claim amount to payment of a mortgage on a 1- to 4-family residence. In implementing the law, the Secretary of HUD is authorized to (1) provide compensation to the mortgagee for lost income on monthly mortgage payments due to interest rate reduction; (2) reimburse the mortgagee from a guaranty fund in connection with activities that the mortgagee is required to undertake concerning repayment by the mortgagor of the amount owed to HUD; (3) make payments to the mortgagee on behalf of the borrower, under terms defined by HUD; and (4) make mortgage modification with terms extended up to 40 years from the modification date. The new law also authorizes the Secretary of HUD to: (1) reassign the mortgage to the mortgagee; (2) act as a Government National Mortgage Association (GNMA, or Ginnie Mae) issuer, or contract with an entity for such purpose, in order to pool the mortgage into a Ginnie Mae security; or (3) resell the mortgage in accordance with any program established for purchase by the federal government of insured mortgages. The new law also amends the Foreclosure Prevention Act of 2008, with respect to emergency assistance for the redevelopment of abandoned and foreclosed homes (neighborhood stabilization), to authorize each state that has received certain minimum allocations and has fulfilled certain requirements, to distribute any remaining amounts to areas with homeowners at risk of foreclosure or in foreclosure without regard to the percentage of home foreclosures in such areas.

Also in May 2009, the Credit Card Act of 2009 was enacted to help consumers and ban certain practices of credit card issuers. The new law allows interest rate hikes on existing balances only under limited conditions, such as when a promotional rate ends, there is a variable rate or if the cardholder makes a late payment. Interest rates on new transactions can increase only after the first year. Significant changes in terms on accounts cannot occur without 45 days' advance notice of the change. The new law bans raising interest rates on customers based on their payment records with other unrelated credit issuers (such as utility companies and other creditors) for existing credit card balances, though card issuers would still be allowed to use universal default on future credit card balances if they give at least 45 days' advance notice of the change. The new law allows consumers to opt out of certain significant changes in terms on their accounts. Opting out means cardholders agree to close their accounts and pay off the balance under the old terms. They have at least five years to pay the balance. Credit card issuers will be banned from issuing credit cards to anyone under 21, unless they have adult co-signers on the accounts or can show proof they have enough income to repay the card debt. Credit card companies must stay at least 1,000 feet from college campuses if they are offering free pizza or other gifts to entice students to apply for credit cards.

The new law requires card issuers to give card account holders "a reasonable amount of time" to make payments on monthly bills. That means payments would be due at least 21 days after they are mailed or delivered. Credit card issuers would no longer be able to set early morning or other arbitrary deadlines for payments. When consumers have accounts that carry different interest rates for different types of purchases payments in excess of the minimum amount due must go to balances with higher interest rates first. Consumers must "opt in" to over-limit fees. Those who opt out would have their transactions rejected if they exceed their credit limits, thus avoiding over-limit fees. Fees charged for going over the limit must be reasonable. Finance charges on outstanding credit card balances would be computed based on purchases made in the current cycle rather than going back to the previous billing cycle to calculate interest charges. Fees on credit cards cannot exceed 25 percent of the available credit limit in the first year of the card. Credit

card issuers must disclose to cardholders the consequences of making only minimum payments each month, namely how long it would take to pay off the entire balance if users only made the minimum monthly payment. Issuers must also provide information on how much users must pay each month if they want to pay off their balances in 36 months, including the amount of interest.

On February 17, 2009, the American Recovery and Reinvestment Act of 2009 (“ARRA”) was enacted to provide stimulus to the struggling US economy. ARRA authorizes spending of \$787 billion, including about \$288 billion for tax relief, \$144 billion for state and local relief aid, and \$111 billion for infrastructure and science. In addition, ARRA includes additional executive compensation restrictions for recipients of funds from the US Treasury under the Troubled Assets Relief Program of the Emergency Economic Stimulus Act of 2008 (“EESA”). The provisions of EESA amended by the ARRA include (i) expanding the coverage of the executive compensation limits to as many as the 25 most highly compensated employees of a TARP funds recipient and its affiliates for certain aspects of executive compensation limits and (ii) specifically limiting incentive compensation of covered executives to one-third of their annual compensation which is required to be paid in restricted stock that does not vest until all of the TARP funds are no longer outstanding (note that if TARP warrants remain outstanding and no other TARP instruments are outstanding, then such warrants would not be considered outstanding for purposes of this incentive compensation restriction. In addition, the board of directors of any TARP recipient is required under EESA, as amended to have a company-wide policy regarding excessive or luxury expenditures, as identified by the Treasury, which may include excessive expenditures on entertainment or events; office and facility renovations; aviation or other transportation services; or other activities or events that are not reasonable expenditures for staff development, reasonable performance incentives, or other similar measures conducted in the normal course of the business operations of the TARP recipient.

On February 10, 2009, the U. S. Treasury, the Federal Reserve Board, the FDIC, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision all announced a comprehensive set of measures to restore confidence in the strength of U.S. financial institutions and restart the critical flow of credit to households and businesses. This program is intended to restore the flows of credit necessary to support recovery.

The core program elements include:

- A new Capital Assistance Program to help ensure that our banking institutions have sufficient capital to withstand the challenges ahead, paired with a supervisory process to produce a more consistent and forward-looking assessment of the risks on banks' balance sheets and their potential capital needs.
- A new Public-Private Investment Fund on an initial scale of up to \$500 billion, with the potential to expand up to \$1 trillion, to catalyze the removal of legacy assets from the balance sheets of financial institutions. This fund will combine public and private capital with government financing to help free up capital to support new lending.
- A new Treasury and Federal Reserve initiative to dramatically expand – up to \$1 trillion – the existing Term Asset-Backed Securities Lending Facility (TALF) in order to reduce credit spreads and restart the securitized credit markets that in recent years supported a substantial portion of lending to households, students, small businesses, and others.
- An extension of the FDIC's Temporary Liquidity Guarantee Program to October 31, 2009. A new framework of governance and oversight to help ensure that banks receiving funds are held responsible for appropriate use of those funds through stronger conditions on lending, dividends and executive compensation along with enhanced reporting to the public.

In October 2008, the President signed the Emergency Economic Stabilization Act of 2008 (“EESA”), in response to the global financial crisis of 2008 authorizing the United States Secretary of the Treasury with authority to spend up to \$700 billion to purchase distressed assets, especially mortgage-backed securities, under the Troubled Assets Relief Program (“TARP”) and make capital injections into banks under the Capital Purchase Program. EESA gives the government the unprecedented authority to buy troubled assets on balance sheets of financial institutions under the Troubled Assets Relief Program and increases the limit on insured deposits from \$100,000 to \$250,000 through December 31, 2009 (this became permanent in 2010.) Some of the other provisions of EESA are as follows:

- accelerated from 2011 to 2008 the date that the Federal Reserve Bank could pay interest on deposits of banks held with the Federal Reserve to meet reserve requirements;
- to the extent that the U. S. Treasury purchases mortgage securities as part of TARP, the Treasury shall implement a plan to minimize foreclosures including using guarantees and credit enhancements to support reasonable loan modifications, and to the extent loans are owned by the government to consent to the reasonable modification of such loans;
- limits executive compensation for executives for TARP participating financial institutions including a maximum corporate tax deduction limit of \$500,000 for each of the top five highest paid executives of such institution, requiring clawbacks of incentive compensation that were paid based on inaccurate or false information, limiting golden parachutes for involuntary and certain voluntary terminations to 2.99x their average annual salary and bonus for the last five years, and prohibiting the payment of incentive compensation that encourages management to take unnecessary and excessive risks with respect to the institution;
- extends the mortgage debt forgiveness provision of the Mortgage Forgiveness Debt Relief Act of 2007 by three years (2012) to ease the income tax burden on those involved with certain foreclosures; and
- qualified financial institutions may count losses on FNMA and FHLMC preferred stock against ordinary income, rather than capital gain income.

On February 10, 2009, the Treasury Secretary announced a new comprehensive financial stability legislation (the “Financial Stability Plan”), which earmarked the second \$350 billion of unused funds originally authorized under the

EESA. The major elements of the Financial Stability Plan included: (i) a capital assistance program that has invested in convertible preferred stock of certain qualifying institutions, (ii) a consumer and business lending initiative to fund new consumer loans, small business loans and commercial mortgage asset-backed securities issuances, (iii) a public/private investment fund intended to leverage public and private capital with public financing to purchase up to \$500 billion to \$1 trillion of legacy “toxic assets” from financial institutions, and (iv) assistance for homeowners by providing up to \$75 billion to reduce mortgage payments and interest rates and establishing loan modification guidelines for government and private programs.

On October 22, 2009, the Federal Reserve Board issued a comprehensive proposal on incentive compensation policies intended to ensure that the incentive compensation policies of banking organizations do not undermine the safety and soundness of such organizations by encouraging excessive risk-taking. The proposal, which covers all employees that have the ability to materially affect the risk profile of an organization, either individually or as part of a group, is based upon the key principles that a banking organization's incentive compensation arrangements should (i) provide incentives that do not encourage risk-taking beyond the organization's ability to effectively identify and manage risks, (ii) be compatible with effective internal controls and risk management, and (iii) be supported by strong corporate governance, including active and effective oversight by the organization's board of directors. The proposal also contemplates a detailed review by the Federal Reserve Board of the incentive compensation policies and practices of a number of "large, complex banking organizations." Any deficiencies in compensation practices that are identified may be incorporated into the organization's supervisory ratings, which can affect its ability to make acquisitions or perform other actions. In addition, the proposal provides that enforcement actions may be taken against a banking organization if its incentive compensation arrangements or related risk-management control or governance processes pose a risk to the organization's safety and soundness and the organization is not taking prompt and effective measures to correct the deficiencies. Similarly, on January 12, 2010, the FDIC announced that it would seek public comment through advance notice of rule making on whether banks with compensation plans that encourage risky behavior should be charged at higher deposit assessment rates than such banks would otherwise be charged.

On September 3, 2009, the U.S. Treasury issued a policy statement entitled "Principles for Reforming the U.S. and International Regulatory Capital Framework for Banking Firms." The statement was developed in consultation with the U.S. bank regulatory agencies and sets forth eight "core principles" intended to shape a new international capital accord. Six of the core principles relate directly to bank capital requirements. The statement contemplates changes to the existing regulatory capital regime that would involve substantial revisions to, if not replacement of, major parts of the Basel I and Basel II and affect all regulated banking organizations and other systemically important institutions. The statement calls for higher and stronger capital requirements for bank and non-bank financial firms that are deemed to pose a risk to financial stability due to their combination of size, leverage, interconnectedness and liquidity risk. The statement suggested that changes to the regulatory capital framework be phased in over a period of several years with a recommended schedule providing for a comprehensive international agreement by December 31, 2010, with the implementation of reforms by December 31, 2012, although it does remain possible that U.S. bank regulatory agencies could officially adopt, or informally implement, new capital standards at an earlier date. Following the issuance of the statement, on December 17, 2009, the Basel committee issued a set of proposals (the "Capital Proposals") that would significantly revise the definitions of Tier 1 capital and Tier 2 capital, with the most significant changes being to Tier 1 capital. Most notably, the Capital Proposals would disqualify certain structured capital instruments, such as trust preferred securities, from Tier 1 capital status. The Capital Proposals would also re-emphasize that common equity is the predominant component of Tier 1 capital by adding a minimum common equity to risk-weighted assets ratio and requiring that goodwill, general intangibles and certain other items that currently must be deducted from Tier 1 capital instead be deducted from common equity as a component of Tier 1 capital. The Capital Proposals also leave open the possibility that the Basel committee will recommend changes to the minimum Tier 1 capital and total capital ratios of 4.0% and 8.0%, respectively. Concurrently with the release of the Capital Proposals, the Basel committee also released a set of proposals related to liquidity risk exposure (the "Liquidity Proposals"). The Liquidity Proposals have three key elements, including the implementation of (i) a "liquidity coverage ratio" designed to ensure that a bank maintains an adequate level of unencumbered, high-quality assets sufficient to meet the bank's liquidity needs over a 30-day time horizon under an acute liquidity stress scenario, (ii) a "net stable funding ratio" designed to promote more medium and long-term funding of the assets and activities of banks over a one-year time horizon, and (iii) a set of monitoring tools that the Basel committee indicates should be considered as the minimum types of information that banks should report to supervisors and that supervisors should use in monitoring the liquidity risk profiles of supervised entities.

In June 2009, the Administration proposed a wide range of regulatory reforms that, if enacted, may have significant effects on the financial services industry in the United States. Significant aspects of the Administration's proposals included, among other things, proposals (i) that any financial firm whose combination of size, leverage and interconnectedness could pose a threat to financial stability be subject to certain enhanced regulatory requirements, (ii) that federal bank regulators require loan originators or sponsors to retain part of the credit risk of securitized exposures, (iii) that there be increased regulation of broker-dealers and investment advisers, (iv) for the creation of a federal consumer financial protection agency that would, among other things, be charged with applying consistent regulations to similar products (such as imposing certain notice and consent requirements on consumer overdraft lines of credit), (v) that there be comprehensive regulation of OTC derivatives, (vi) that the controls on the ability of banking institutions to engage in transactions with affiliates be tightened, and (vii) that financial holding companies be required to be "well-capitalized" and "well-managed" on a consolidated basis. The Congress, state lawmaking bodies and federal and state regulatory agencies continue to consider a number of wide-ranging and comprehensive proposals for altering the structure, regulation and competitive relationships of the nation's financial institutions, including rules and regulations related to the broad range of reform proposals set forth by the Obama administration described above. Along with amendments to the Administration's proposal there are separate comprehensive financial reform bills intended to address in part or whole or vary in part or in whole from the proposals set forth by the Administration were introduced in both houses of Congress in the second half of 2009 and in 2010 and remain under review by both the U.S. House of Representatives and the U.S. Senate.

In California, SB931 enacted in 2010 requires the holder of a first mortgage or deed of trust that is secured by 1-4 family residential real property to accept as full payment, the proceeds of a short sale to which it agrees to in writing, and obligates the holder to discharge the remaining amount of a borrower's indebtedness on such mortgage or deed of trust (excludes borrowers that are corporate entities or political subdivisions), except to the extent the borrower has committed fraud or waste upon the property.

The enactment of AB 2325 in 2010 requires foreclosure consultants register and become certificated by the Department of Justice. The definition of foreclosure consultant includes one who arranges or attempts to arrange for the audit of any obligation secured by a lien on a residence in foreclosure.

The enactment of SB1427 in 2010 provides that prior to imposing a fine or penalty for failure to maintain a vacant property in California that is subject to a notice of default or that has been purchased at a foreclosure sale or acquired through foreclosure under a mortgage or deed of trust that a governmental entity shall provide the owner of that property with a notice of violation and an opportunity to correct the violation.

The enactment of AB329 in 2009, the Reverse Mortgage Elder Protection Act of 2009 prohibits a lender or any other person who participates in the origination of the mortgage from participation in, being associated with, or employing any party that participates in or is associated with any other financial or insurance activity or referring a prospective borrower to anyone for the purchase of other financial or insurance products; and imposes certain disclosure requirements on the lender.

The enactment of AB1160 in 2009, requires a supervised financial institution in California that negotiates primarily in any of a number of specified languages in the course of entering into a contract or agreement for a loan or extension of credit secured by residential real property, to deliver, prior to the execution of the contract or agreement, and no later than 3 business days after receiving the written application, a specified form in that language summarizing the terms of the contract or agreement; provides for administrative penalties for violations; and requires the California Department of Corporations and the Department of Financial Institutions to create a form for providing translations and make it available in Spanish, Chinese, Tagalog, Vietnamese and Korean. The statute becomes operative on July 1, 2010, or 90 days after issuance of the form, whichever occurs later.

The enactment of AB 1291 in 2009 makes changes to the California Unclaimed Property Law including (among other things): allowing electronic notification to customers who have consented to electronic notice; requiring that notices contain certain information and allow the holder to provide electronic means to enable the owner to contact the holder in lieu of returning the prescribed form to declare the owner's intent; authorizing the holder to give additional notices; and requiring, beginning January 1, 2011, a banking or financial organization to provide a written notice regarding escheat at the time a new account or safe deposit box is opened.

The enactment of SB306 makes specified changes to clarify existing law related to filing a notice of default on residential real property in California, including (among other things): clarifying that the provisions apply to mortgages and deeds of trust recorded from January 1, 2003 through December 31, 2007, secured by owner-occupied 3 4 residential real property containing no more than 4 dwelling units; revising the declaration to be filed with the notice of default; specifying how the loan servicers have to maximize net present value under their pooling and servicing agreements applies to certain investors; specifying how and when the notice to residents of property subject to foreclosure is to be mailed; and extending the time during which the notice of sale must be recorded from 14 to 20 days. The bill also makes certain changes related to short-pay agreements and short-pay demand statements.

On February 20, 2009, Governor Schwarzenegger signed ABX2 7 and SBX2 7, which established the California Foreclosure Prevention Act. The California Foreclosure Prevention Act modifies the foreclosure process to provide additional time for borrowers to work out loan modifications while providing an exemption for mortgage loan

servicers that have implemented a comprehensive loan modification program. Civil Code Section 2923.52 requires an additional 90 day period beyond the period already provided before a Notice of Sale can be given in order to allow all parties to pursue a loan modification to prevent foreclosure of loans meeting certain criteria identified in that section.

A mortgage loan servicer who has implemented a comprehensive loan modification program may file an application for exemption from the provisions of Civil Code Section 2923.52. Approval of this application provides the mortgage loan servicer an exemption from the additional 90-day period before filing the Notice of Sale when foreclosing on real property covered by the new law.

California Assembly Bill 1301 was signed by the Governor on July 16, 2008 and became law on January 1, 2009. Among other things, the bill eliminated unnecessary applications that consume time and resources of bank licensees and which in many cases are now perfunctory. All of current Article 5 – “Locations of Head Office” of Chapter 3, and all of Chapter 4 – “Branch Offices, Other Places of Business and Automated Teller Machines” were repealed. A new Chapter 4 – “Bank Offices” was added. The new Chapter 4 requires notice to the California Department of Financial Institutions (“DFI”) the establishment of offices, rather than the current application process. Many of the current branch applications are perfunctory in nature and/or provide for a waiver of application. Banks, on an exception basis, may be subject to more stringent requirements as deemed necessary. As an example, new banks, banks undergoing a change in ownership and banks in less than satisfactory condition may be required to obtain prior approval from the DFI before establishing offices if such activity is deemed to create an issue of safety and soundness. The bill eliminated unnecessary provisions in the Banking Law that are either outdated or have become undue restrictions to bank licensees. Chapter 6 – “Powers and Miscellaneous Provisions” was repealed. A new Chapter 6 - “Restrictions and Prohibited Practices” was added. This chapter brings together restrictions in bank activities as formerly found in Chapter 18 – “Prohibited Practices and Penalties.” However, in bringing the restrictions into the new chapter, various provisions were updated to remove the need for prior approval by the DFI Commissioner. The bill renumbered current Banking Law sections to align like sections. Chapter 4.5 – “Authorizations for Banks” was added. The purpose of the chapter is to provide exceptions to certain activities that would otherwise be prohibited by other laws outside of the Financial Code. The bill added Article 1.5 - “Loan and Investment Limitations” to Chapter 10 – “Commercial Banks.” This article is new in concept and acknowledges that investment decisions are business decisions – so long as there is a diversification of the investments to spread any risk. The risk is diversified in this article by placing a limitation on the loans and investments that can be made to any one entity. This section is a trade-off for elimination of applications to the DFI for approval of investments in securities, which were repealed.

Other changes AB 1301 made to the Banking Law:

- Authorized a bank or trust acting in any capacity under a court or private trust to arrange for the deposit of securities in a securities depository or federal reserve bank, and provided how they may be held by the securities depository;
- Reduced from 5% to 1% the amount of eligible assets to be maintained at an approved depository by an office of a foreign (other nation) bank for the protection of the interests of creditors of the bank’s business in this state or for the protection of the public interest;
 - Enabled the DFI to issue an order against a bank licensee parent or subsidiary;
- Provided that the examinations may be conducted in alternate examination periods if the DFI concludes that an examination of the state bank by the appropriate federal regulator carries out the purpose of this section, but the DFI may not accept two consecutive examination reports made by federal regulators;
- Provided that the DFI may examine subsidiaries of every California state bank, state trust company, and foreign (other nation) bank to the extent and whenever and as often as the DFI shall deem advisable;
 - Enabled the DFI issue an order or a final order to now include any bank holding company or subsidiary of the bank, trust company, or foreign banking corporation that is violating or failing to comply with any applicable law, or is conducting activities in an unsafe or injurious manner;
- Enabled the DFI to take action against a person who has engaged in or participated in any unsafe or unsound act with regard to a bank, including a former employee who has left the bank.

It is impossible to predict what effect the enactment of certain of the above-mentioned legislation will have on the Company. Moreover, it is likely that other bills affecting the business of banks may be introduced in the future by the United States Congress or California legislature.

Employees

At December 31, 2010, the Company employed 132 persons on a full-time equivalent basis. The Company believes its employee relations are excellent.

Available Information

The Company files period reports and other reports under the Securities and Exchange Act of 1934 with the Securities and Exchange Commission (SEC). These reports, as well as the Company's Code of Ethics, are posted and are available at no cost on the Company's website at <http://www.unitedsecuritybank.com> as soon as reasonably practical after the Company files such reports with the SEC. The Company's periodic and other reports filed with the SEC are also available at the SEC's website (<http://www.sec.gov>).

Item 1A. Risk Factors

There are risk factors that may affect the Company's business and impact the results of operations, some of which are beyond the control of the Company.

We are operating subject to the terms and conditions of an Agreement entered into with the Federal Reserve Bank of San Francisco and Order issued by the California Department of Financial Institutions.

On March 23, 2010, the Company and the Bank voluntarily entered into a written agreement (“Agreement”) with the Federal Reserve Bank of San Francisco, and on May 17, 2010 the Bank consented to the issuance of a final order by the California Department of Financial Institutions (the “Order”).

The Order and Agreement are substantially similar. Each establishes timeframes for the completion of remedial measures identified by the regulators as important to improve our financial soundness. Some of the specific provisions in the Order and/or Agreement include us being required to:

- Strengthen board oversight of the Bank’s management and operations;
- Strengthen credit risk management practices of the Bank;
- Strengthen asset quality at the Bank by (i) not extending, renewing, or restructuring certain credits, and (ii) submitting to the Federal Reserve Bank an acceptable written plan designed to improve the Bank’s position through repayment, amortization, liquidation, additional collateral, or other means on each loan or other asset in excess of \$1.5 million including other real estate owned that is past due as to principal or interest more than 90 days, on the Bank’s problem loan list, or were adversely classified in the Report of Examination or subsequent report of examination;
- Improve management of the Bank’s allowance for loan losses;
- Maintain sufficient capital at the Company and Bank;
- Submit a revised business plan and budget to the Federal Reserve Bank for 2010 and subsequent calendar years that the Bank is subject to the Agreement to improve the Bank’s earnings and overall condition;
- Not make certain distributions, dividends, and payments, specifically that (i) the Company and Bank agreeing not to declare or pay any dividends without the prior written approval of the Federal Reserve Bank, (ii) the Company not taking any other form of payment representing a reduction in capital from the Bank without the prior written approval of the Federal Reserve Bank, and (iii) the Company and its nonbank subsidiaries not making any distributions of interest, principal, or other sums on subordinated debentures or trust preferred securities without the prior written approval of the Federal Reserve Bank;
- Not incur debt or redeem stock, specifically, that except with the prior written approval of the Federal Reserve Bank, the Company each agree not to incur, increase, or guarantee any debt or purchase or redeem any shares of its stock;
- Correct violations of the laws by (i) the Bank immediately taking all necessary steps to correct all violations of law and regulation cited in the Report of Examination, (ii) the board of the Bank taking the necessary steps to ensure the Bank’s future compliance with all applicable laws and regulations, (iii) complying with the notice provisions of applicable federal banking law prior to appointing any new director or senior executive officer, or changing the responsibilities of any senior executive officer so that the officer would assume a different senior executive officer position, and (iv) complying with the restrictions on indemnification and severance payments of federal bank law and regulations;
 - Comply with the Agreement by (i) appointing a compliance committee of the Bank (“Compliance Committee”) within 10 days of the date of the Agreement to monitor and coordinate the Bank’s compliance with the provisions of the Agreement, which Compliance Committee is composed of a majority of outside directors who are not executive officers or principal shareholders of the Bank and which is to meet at least

monthly and report its findings to the board of directors of the Bank, and (ii) the Company and Bank within 30 days after the end of each calendar quarter following the date of the Agreement submitting to the Federal Reserve Bank written progress reports detailing the form and manner of all actions taken to secure compliance with the Agreement and the results of such actions;

- Develop and adopt a capital plan for the California Department of Financial Institutions to maintain a ratio of tangible shareholders' equity to total tangible assets equal to or greater than 9.5% and include in such capital plan a capital contingency plan for raising additional capital in the event of various contingencies;
- Maintain at the Bank a ratio of tangible shareholders' equity to total tangible assets equal to or greater than 9.5%;
- Maintain at the Bank an adequate allowance for loan losses and remedy any deficiency in the allowance for loan losses in the calendar quarter in which it is discovered;
- Not establish any new branches or other offices of the Bank without the prior written consent of the Commissioner of the California Department of Financial Institutions; and

- Provide progress reports within 30 days after the end of each calendar quarter following the date of the Order to the California Department of Financial Institutions detailing the form and manner of all actions taken to secure compliance with the Order and Agreement and the results of such actions.

Any material failure to comply with any provisions of the Order or Agreement, including the failure of the Board of Directors to provide adequate oversight of the management of the Bank and Company, could result in enforcement actions by our regulators, including, in some cases, the assessment of civil money penalties against us, enforcement of the agreements through court proceedings, or in the worse case, placing us into receivership with the FDIC. If the Bank is placed into FDIC receivership, we would be required to cease operations and you could lose your entire investment. While we intend to take such actions as may be necessary to enable us to comply with the requirements of the Order and Agreement, there can be no assurance that we will be able to comply fully with their provisions, or to do so within the timeframes required, that compliance with the Order and Agreement will not be more time consuming or more expensive than anticipated, that compliance with the Order and Agreement will enable us to resume profitable operations, or that efforts to comply with the Order and Agreement will not have adverse effects on our operations and financial condition. In addition, the material failure to comply the provisions of the Order or Agreement relating to the Company or Bank's financial condition or results of operations may result in the weakening of the Company's and Bank's financial condition, losses, or improper financial reporting of the Company's financial condition and results of operations. Compliance with the Agreement's provisions as to restrictions on borrowing and growth through branching may restrict the ability of the Bank to grow and may limit the amount of growth and potential future earnings of the Bank. Also compliance with the Agreement's provisions may require the Company and Bank to incur higher expenses in connection with such compliance. Additional, if the Company is not allowed by bank regulators to pay interest on the subordinated debentures of its trust preferred securities for 20 consecutive quarters, there will be an event of default on the trust preferred securities, and the trustee of the indenture of the subordinated debentures may bring an action against the Company for nonpayment.

We have determined that we have material weaknesses related to our internal control over financial reporting.

In connection with our assessment of internal control over financial reporting for the quarter ended December 31, 2010, management identified certain material weaknesses in internal control over financial reporting related to the allowance for loan losses and the completeness and accuracy of the provision for loan losses, as well as material weaknesses related to the valuation of OREO properties. In response to the material weaknesses identified by the Company, the Company has taken certain remedial measures that the Company believes will correct the design and operational effectiveness of such internal controls; however, we cannot guarantee that such remedial measures will actually correct the design and operational effectiveness of such internal controls and that in the future we will not discover additional material weaknesses in internal control over financial reporting.

Difficult market conditions and economic trends have adversely affected the banking industry and could continue to adversely affect the Company's business, financial condition, results of operations and cash flows.

The Company is operating in a challenging and uncertain economic environment, including generally uncertain conditions nationally and locally in its markets. Financial institutions continue to be affected by declines in the real estate market that have negatively impacted the credit performance of construction, commercial real estate loans, and residential mortgage loans and resulted in significant write-downs of assets by many financial institutions. Concerns over the stability of the financial markets and the economy have resulted in decreased lending by financial institutions to their customers and to each other. The Company retains direct exposure to the residential and commercial real estate markets, and it is affected by these events. Continued declines in real estate values, home sales volumes and financial stress on borrowers as a result of the uncertain economic environment, including job losses, could have an adverse affect on the Company's borrowers or their customers, which could adversely affect the Company's business, financial condition, results of operations and cash flows.

The Company's ability to assess the creditworthiness of customers and to estimate the losses inherent in its credit portfolio is made more complex by these difficult market and economic conditions. The Company also expects to face increased regulation and government oversight as a result of these downward trends. This increased government action may increase the Company's costs and limit its ability to pursue certain business opportunities. In addition, the Company may be required to pay even higher FDIC deposit insurance premiums than the recently increased level, because financial institution failures resulting from the depressed market conditions and other factors have depleted and may continue to deplete the deposit insurance fund and reduce its ratio of reserves to insured deposits.

A prolonged national economic recession or further deterioration of these conditions in the Company's markets could drive losses beyond that which is provided for in its allowance for credit losses and result in the following consequences:

- increases in loan delinquencies;
- increases in nonperforming assets and foreclosures;
- decreases in demand for the Company's products and services, which could adversely affect its liquidity position; and
- decreases in the value of the collateral securing the Company's loans, especially real estate, which could reduce customers' borrowing power.

A worsening of these conditions would likely exacerbate the adverse effects of these difficult economic conditions on the Company, its customers and the other financial institutions in its market. As a result, the Company may experience increases in foreclosures, delinquencies and customer bankruptcies, as well as more restricted access to funds.

The U.S. Treasury and the FDIC have initiated programs to address economic stabilization, yet the efficacy of these programs in stabilizing the economy and the banking system at large are uncertain.

Liquidity risk could impair the Company's ability to fund operations and jeopardize its financial condition.

Liquidity is essential to the Company's business. An inability to raise funds through deposits, borrowings, the sale of loans and other sources could have a substantial negative effect on its liquidity. The Company's access to funding sources in amounts adequate to finance its activities or on terms which are acceptable to it could be impaired by factors that affect the Company specifically or the financial services industry or economy in general. As a result of the March 2010 agreement between the Federal Reserve Bank and the Company, the Company is required to submit to the Federal Reserve Bank an acceptable plan to improve management of the Bank's liquidity position and funds management practices. The Bank will be required to enhance the monitoring, measurement, and reporting of the Bank's liquidity position to the Board, while reducing the reliance on brokered and other wholesale funding sources, enhancing written contingency funding plans, and maintaining sufficient liquidity to meet the Company's contractual obligations. Failure to accomplish these requirements could result in additional regulatory enforcement actions, and could impair or severely damage the ongoing operations of the Company. The Company could experience liquidity shortfalls if it were to dispose of brokered deposits pursuant to the March 2010 agreement and were not able to replace them with other funding sources, or was not able to reduce assets quickly enough to cover liquidity shortfalls.

The Company's financial performance is subject to interest rate risk.

The Company's operations are greatly influenced by general economic conditions and by related monetary and fiscal policies of the federal government. Deposit flows and the funding costs are influenced by interest rates of competing investments and general market rates of interest. Lending activities are affected by the demand for loans, which in turn is affected by the interest rates at which such financing may be offered and by other factors affecting the availability of funds.

The Company's performance is substantially dependent on net interest income, which is the difference between the interest income received from interest-earning assets and the interest expense incurred in connection with our interest-bearing liabilities. To reduce the Company's exposure to interest rate fluctuations, management seeks to manage the balances of interest sensitive assets and liabilities, and maintain appropriate maturity and repricing parameters for these assets and liabilities. A mismatch between the amount of rate sensitive assets and rate sensitive liabilities in any time period may expose the Company to interest rate risk. Generally, if rate sensitive assets exceed rate sensitive liabilities, the net interest margin will be positively impacted during a rising rate environment and negatively impacted during a declining rate environment. When rate sensitive liabilities exceed rate sensitive assets, the net interest margin will generally be positively impacted during a declining rate environment and negatively impacted during a rising rate environment.

Increases in the level of interest rates may reduce the overall level of loans originated by the Company, and, thus, the amount of loan and commitment fees earned, as well as the market value of investment securities and other interest-earning assets. Moreover, fluctuations in interest rates may also result in disintermediation, which is the flow of funds away from depository institutions into direct investments, such as corporate securities and other investment vehicles which, because of the absence of federal deposit insurance, generally pay higher rates of return than depository institutions.

The continued deterioration of local economic conditions in the Company's market area could hurt profitability.

The Company's operations are located primarily in Fresno, Madera, Kern, and Santa Clara Counties, and are concentrated in Fresno County and surrounding areas. As a result of this geographic concentration, the Company's financial results depend largely upon economic conditions in these areas. The local economy in the Company's market areas rely heavily on agriculture, real estate, professional and business services, manufacturing, trade and tourism. The significant economic downturn experienced in the sub-prime lending and credit markets since the later part of 2007, has negatively impacted the Company's operations and financial condition, and may further worsen with prolonged or further deterioration of local and state-wide economic conditions. Poor economic conditions could cause the Company to incur additional losses associated with higher default rates and decreased collateral values in the loan portfolio.

Concentrations in commercial and industrial loans, real estate-secured commercial loans, and real estate construction loans, may expose the Company to increased lending risks, especially in the event of a recession.

The Company has significant concentrations in commercial real estate and real estate construction loans. As of December 31, 2010, 29.8%, and 14.8% of the Company's loan portfolio was concentrated in these two categories, respectively. In addition, the Company has many commercial loans to businesses in the construction and real estate industry. There has been significant volatility in real estate values in the Company's market area in recent years, and an extended real estate recession affecting these market areas would likely reduce the security for many of the Company's loans and adversely affect the ability of many of borrowers to repay loan balances due the Company and require increased provisions to the allowance for loan losses. Therefore, the Company's financial condition and results of operations may continue to be adversely affected by a decline in the value of the real estate securing the Company's loans.

If the Company forecloses on collateral property, we may be subject to the increased costs associated with the ownership of real property, resulting in reduced revenues.

The Company has and may continue to foreclose on collateral property to protect its investment and may thereafter own and operate such property, in which case we will be exposed to the risks inherent in the ownership of real estate. The amount that the Company, as a mortgagee, may realize after a default is dependent upon factors outside of the Company's control, including, but not limited to: (i) general or local economic conditions; (ii) neighborhood values; (iii) interest rates; (iv) real estate tax rates; (v) operating expenses of the mortgaged properties; (vi) environmental remediation liabilities; (vii) ability to obtain and maintain adequate occupancy of the properties; (viii) zoning laws; (ix) governmental rules, regulations and fiscal policies; and (x) acts of God. Certain expenditures associated with the ownership of real estate, principally real estate taxes, insurance, and maintenance costs, may adversely affect the income from the real estate, and as a result, the Company may be required to dispose of the real property at a loss. The foregoing expenditures and costs could adversely affect the Company's ability to generate revenues, resulting in reduced levels of profitability.

The small to medium-sized businesses that the Company lends to may have fewer resources to weather a downturn in the economy, which may impair a borrower's ability to repay a loan to the Company that could materially harm the Company's operating results.

The Company targets its business development and marketing strategy primarily to serve the banking and financial services needs of small to medium-sized businesses. These small to medium-sized businesses frequently have smaller market share than their competition, may be more vulnerable to economic downturns, often need substantial additional capital to expand or compete and may experience significant volatility in operating results. Any one or more of these factors may impair the borrower's ability to repay a loan. In addition, the success of a small to medium-sized business often depends on the management talents and efforts of one or two persons or a small group of persons, and the death, disability or resignation of one or more of these persons could have a material adverse impact on the business and its ability to repay a loan. Economic downturns and other events that negatively impact the Company's market areas could cause the Company to incur substantial credit losses that could negatively affect the Company's results of operations, financial condition and cash flows.

The Company faces strong competition, which may adversely affect its operating results.

In recent years, competition for bank customers, the source of deposits and loans for the Company has greatly intensified. This competition includes:

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larger regional and national banks and other FDIC insured depository institutions in many of the communities the Company serves;

- finance companies, investment banking and brokerage firms, and insurance companies that offer bank-like products;
- credit unions, which can offer highly competitive rates on loans and deposits because they receive tax advantages not available to commercial banks; and
- technology-based financial institutions including large national and super-regional banks offering on-line deposit, bill payment, and mortgage loan application services.

Some of the financial services organizations with which the Company competes are not subject to the same degree of regulation as is imposed on bank holding companies and federally insured financial institutions. As a result, these non-bank competitors have certain advantages over the Company in accessing funding and in providing various banking-related services.

By virtue of their larger capital position, regional and national banks have substantially larger lending limits than the Company, and can provide certain services to their customers which the Company is not able to offer directly, such as trust and international services. Many of these larger banks also operate with greater economies of scale which result in lower operating costs than the Company on a per-unit basis.

Other existing single or multi-branch community banks, or new community bank start-ups, have marketing strategies similar to United Security Bancshares. These other community banks can open new branches in the communities the Company serves and compete directly for customers who want the high level of service community banks offer. Other community banks also compete for the same management personnel and the same potential acquisition and merger candidates. Ultimately, competition can drive down the Company's interest margins and reduce profitability, as well as make it more difficult for the Company to achieve its growth objectives.

The Company may need to raise additional capital in the future and such capital may not be available when needed or at all.

The Company may need to raise additional capital in the future to provide it with sufficient capital resources and liquidity to meet its commitments and business needs. In addition, the Company may elect to raise additional capital to support its business or to finance acquisitions, if any. The Company's ability to raise additional capital, if needed, will depend on, among other things, conditions in the capital markets at that time, which are outside of its control of the Company, and its financial performance. The economic downturn and significantly increased levels of nonperforming assets at the Company has placed additional strain on the Company's capital position. The Company may experience additional loan losses and lower levels of net income which may require increased levels of capital in the future. As a result of the March 2010 agreement between the Federal Reserve Bank and the Company, the Company is required to submit to the Federal Reserve Bank an acceptable plan to maintain sufficient capital at both the Bank and the Company to comply with current regulatory guidelines taking into account the current level of classified assets, concentrations of credit, current and projected assets growth, and projected retained earnings.

The Company cannot be assured that such capital will be available to it on acceptable terms or at all given the current financial position of the Company and the state of the overall economy. Any occurrence that may limit its access to the capital markets, such as failure to comply with the Federal Reserve Bank regulatory agreement, a decline in the confidence of investors, depositors of the Banks or counterparties participating in the capital markets, may adversely affect the Company's capital costs and its ability to raise capital and, in turn, its liquidity. An inability to raise additional capital on acceptable terms when needed could have a material adverse effect on the Company's business, financial condition and results of operations, and may also result in additional regulatory enforcement actions that could impair or severely damage the ongoing operations of the Company.

The Company could experience loan losses, which exceed the overall allowance for loan losses.

The risk of credit losses on loans and leases varies with, among other things, general economic conditions, the type of loan being made, the creditworthiness of the borrower, and, in the case of collateralized loans, the value and marketability of the collateral. The Company maintains an allowance for loan losses based upon, among other things, historical experience, an evaluation of economic conditions, and regular reviews of delinquencies and loan portfolio quality. Based upon such factors, management makes various assumptions and determinations about the ultimate collectability of the loan portfolio and provides an allowance for losses based upon a percentage of the outstanding balances and for specific loans where their collectability is considered to be questionable. As a result of the March 2010 agreement between the Federal Reserve Bank and the Company, the Company is required to submit to the Federal Reserve Bank an acceptable program to maintain an adequate allowance for loan and lease losses including a sound process for determining, documenting, and recording an adequate allowance for loan and lease losses. In addition, the Bank was required to eliminate or charge-off all assets classified as "loss" in the most recent examination by the Federal Reserve, a requirement which has been complied with.

As of December 31, 2010, the Company's allowance for loan losses was approximately \$16.5 million representing 3.75% of net outstanding loans. Although management believes that the allowance is adequate, there can be no absolute assurance that it will be sufficient to cover future loan losses given the current level of classified loans. In

addition, if the Company after implementing its new program to determine and maintain an adequate reserve for loan and lease losses, needs to increase its provision for loan and lease losses, such additional provision will result in an additional loss for the Company. Although the Company uses the best information available to make determinations with respect to adequacy of the allowance for loan losses, future adjustments may be necessary if economic conditions change substantially from the assumptions used or if negative developments occur with respect to non-performing or performing loans. If management's assumptions or conclusions prove to be incorrect and the allowance for loan losses is not adequate to absorb future losses, or if Company's regulatory agencies require an increase in the allowance for loan losses, the Company's earnings, and potentially its capital, could be significantly and adversely impacted.

The Company is Subject to Other-than-temporary Impairment Risk

The Company recognizes an impairment charge when the decline in the fair value of equity, debt securities and cost-method investments below their cost basis are judged to be other-than-temporary. Significant judgment is used to identify events or circumstances that would likely have a significant adverse effect on the future use of the investment. The Company considers various factors in determining whether an impairment is other-than-temporary, including the severity and duration of the impairment, forecasted recovery, the financial condition and near-term prospects of the investee, and our ability and intent to hold the investment for a period of time sufficient to allow for any anticipated recovery in market value. Information about unrealized gains and losses is subject to changing conditions. The values of securities with unrealized gains and losses will fluctuate, as will the values of securities that we identify as potentially distressed. Our current evaluation of other-than-temporary impairments reflects our intent to hold securities for a reasonable period of time sufficient for a forecasted recovery of fair value. However, our intent to hold certain of these securities may change in future periods as a result of facts and circumstances impacting a specific security. If our intent to hold a security with an unrealized loss changes, and we do not expect the security to fully recover prior to the expected time of disposition, we will write down the security to its fair value in the period that our intent to hold the security changes.

The process of evaluating the potential impairment of goodwill and other intangibles is highly subjective and requires significant judgment. The Company estimates its expected future cash flows from its various businesses and determines the carrying value of these businesses. The Company exercises judgment in assigning and allocating certain assets and liabilities to these businesses. The Company then compares the carrying value, including goodwill and other intangibles, to the discounted future cash flows. If the total of future cash flows is less than the carrying amount of the assets, an impairment loss is recognized based on the excess of the carrying amount over the fair value of the assets. Estimates of the future cash flows associated with the assets are critical to these assessments. Changes in these estimates based on changed economic conditions or business strategies could result in material impairment charges in future periods.

If the goodwill that the Company recorded in connection with a business acquisition becomes impaired, it could require charges to earnings, which would have a negative impact on the Company's financial condition, results of operations and cash flows.

Goodwill represents the amount of acquisition cost over the fair value of net assets the Company acquired in the purchase of another financial institution. The Company reviews goodwill for impairment at least annually, or more frequently if events or changes in circumstances indicate the carrying value of the asset might be impaired.

The Company determines impairment by comparing the implied fair value of the reporting unit goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. Any such adjustments are reflected in the Company's results of operations in the periods in which they become known. At December 31, 2010, the Company's goodwill totaled \$6.0 million after recognizing a goodwill impairment loss of \$1.4 million during the year ended December 31, 2010. Given the current economic environment, there can be no assurance that the Company's future evaluations of goodwill will not result in additional findings of impairment and related write-downs, which may have a material adverse effect on its financial condition, results of operations and cash flows.

The regulatory environment under which the Company operates may have an adverse impact on the banking industry.

The Company is subject to extensive regulatory supervision and oversight from both federal and state authorities. Regulatory oversight of the Company is provided by the Federal Reserve Bank (FRB) and the California Department of Financial Institutions (DFI). Future legislation and government may adversely impact the Company and the

commercial banking industry in general. Future regulatory changes may also alter the structure and competitive relationship among financial institutions.

The Company may be exposed to compliance risk resulting from violations or nonconformity with laws, rules, regulations, internal policies and procedures, or ethical standards set forth by regulatory authorities. The Company may also be subject to compliance risk in situations where laws or rules governing certain products or activities of the Company's customers may be uncertain or untested. Compliance risk exposes the Company to fines, civil money penalties, payment of damages, and the potential voiding of contracts. Compliance risk can result in diminished reputation, reduced franchise value, limited business opportunities, and reduced growth potential.

Increase in FDIC insurance premiums may negatively affect profitability.

The FDIC insures deposits at FDIC insured financial institutions, including the Bank. The FDIC charges the insured financial institutions premiums to maintain the Deposit Insurance Fund at a certain level. Current economic conditions have increased bank failures and expectations for further failures, in which case the FDIC insures payment of deposits up to insured limits from the Deposit Insurance Fund. In late 2008, the FDIC announced an increase in insurance premium rates of seven basis points, beginning with the first quarter of 2009. Additional changes, beginning April 1, 2009, were to require riskier institutions to pay a larger share of premiums by factoring in rate adjustments based on secured liabilities and unsecured debt levels.

On May 22, 2009, the FDIC adopted a final rule that imposed a special assessment for the second quarter of 2009 of five basis points on each insured depository institution's assets minus its Tier 1 capital as of June 30, 2009, which was collected on September 30, 2009. The Company expensed \$334,000 during the second quarter for this special assessment. In November 2009, the FDIC approved a final rule to require all insured depository institutions including the Bank to prepay three years of FDIC assessments in the fourth quarter of 2009, except in the event such prepayment is waived by the FDIC. Although the three-year prepayment assessment was waived for the Bank by the FDIC, insurance premiums paid quarterly have increased substantially during the later part of 2009, and may increase in future periods.

In general, we are unable to control the amount of premiums that we are required to pay for FDIC insurance. If there are additional failures of FDIC-insured institutions, we may be required to pay even higher FDIC premiums. The announced increases and any future increases in FDIC insurance premiums may materially adversely affect our results of operations.

If the Company lost a significant portion of its low-cost core deposits, it would negatively impact profitability.

The Company's profitability depends in part on its success in attracting and retaining a stable base of low-cost deposits. As of December 31, 2010, noninterest-bearing checking accounts comprised 25.1% of the Company's deposit base, and interest-bearing checking and money market accounts comprised an additional 10.76% and 21.7%, respectively. The Company considers these deposits to be core deposits. If the Company lost a significant portion of these low-cost deposits, it would negatively impact its profitability and long-term growth objectives. While Management generally does not believe these deposits are sensitive to interest-rate fluctuations, the competition for these deposits in the Company's market area is strong and if the Company were to lose a significant portion of these low-cost deposits, it would negatively affect business operations.

The Company participated in the FDIC's Transaction Account ("TAG") Program; A voluntary program under which participating financial institutions could obtain unlimited FDIC insurance coverage for all noninterest-bearing transaction accounts without limitation, and coverage for all interest-bearing accounts which pay (or will never pay more than) 0.50%. The TAG program expired on December 31, 2010. However, the Dodd-Frank Wall Street Reform and Consumer Protection Act provide unlimited FDIC insurance for noninterest-bearing transaction accounts in all banks effective on December 31, 2010 and continuing through December 31, 2012. If after December 31, 2012, the TAG program was not continued, the Company could lose some, or a substantial portion, of those deposits which would not otherwise be subject to FDIC insurance coverage. The loss of noninterest-bearing or low-cost deposits could adversely impact the Company's liquidity position and the Company would need to seek higher-cost funding sources which could impair the Company financial position and results of operations.

As a result of the March 2010 regulatory agreement between the Federal Reserve and the Company, the Company will reduce its reliance on brokered deposits and other wholesale funding over the next two years to near peer levels. Reductions in brokered deposits may be difficult to replace with other types of deposit accounts. As a result, the

Company may be limited in its ability to grow assets, and may experience liquidity constraints if unable to effectively replace maturing brokered deposits and other wholesale funding sources.

The Company relies on dividends from its subsidiaries for most of its revenue.

United Security Bancshares is a separate and distinct legal entity from its subsidiaries. The Company receives substantially all of its revenue from dividends from its subsidiary, United Security Bank. These dividends are the principal source of funds to pay dividends on common stock and interest on the Company's junior subordinated debt. Various federal and/or state laws and regulations limit the amount of dividends that United Security Bank and certain non-bank subsidiaries may pay to United Security Bancshares. Also, United Security Bancshares' right to participate in a distribution of assets upon a subsidiary's liquidation or reorganization is subject to the prior claims of the subsidiary's creditors. As a result of the written agreement with the Federal Reserve Bank entered into March 23, 2010, the United Security Bank is unable to pay dividends to United Security Bancshares, and United Security Bancshares is not able to pay dividends on common stock, or pay interest on its junior subordinated debt. This could have a negative impact on the Company's business, financial condition and results of operations. Under regulatory restraints, the Bank is currently precluded from paying dividends to the Company and may be precluded from doing so into the foreseeable future.

We have deferred interest payments on our trust preferred securities which prevents us from paying dividends on our capital stock until those payments are brought current.

We have not paid any cash dividends on our common stock since the second quarter of 2008 and do not expect to resume cash dividends on our common stock for the foreseeable future. In order to preserve capital, at September 30, 2009 we deferred quarterly payments of interest on our junior subordinated debentures issued in connection with our trust preferred securities beginning with the quarterly payment due October 1, 2009. As a result of the of the March 2010 agreement between the Federal Reserve Bank and the Company and the May 2010 Order between the California Department of Financial Institutions and the Company, the Company is currently prohibited from paying interest on its trust preferred securities, and is also prohibited from paying cash dividends on its common stock. The terms of the debentures related to the trust preferred securities permit us to defer payment of interest for up to 20 consecutive quarters. Interest continues to accrue while interest payments are deferred. Under the terms of the trust preferred securities we are prohibited from paying cash dividends on our capital stock (including common stock) during the deferral period.

The holders of the Company's junior subordinated debentures have rights that are senior to those of the Company's shareholders.

On July 25, 2007 the Company issued \$15.5 million of floating rate junior subordinated debentures in connection with a \$15.0 million trust preferred securities issuance by its subsidiary, United Security Bancshares Capital Trust II. The junior subordinated debentures mature in July 2037.

The Company conditionally guarantees payments of the principal and interest on the trust preferred securities. The Company's junior subordinated debentures are senior to holders of common stock. As a result, the Company must make payments on the junior subordinated debentures (and the related trust preferred securities) before any dividends can be paid on our common stock and, in the event of bankruptcy, dissolution or liquidation, the holders of the debentures must be satisfied before any distributions can be made to the holders of common stock. Effective September 30, 2009, the Company elected to defer distributions on our junior subordinated debentures (and the related trust preferred securities) for up to five years, during which time no cash dividends may be paid to holders of common stock. As a result of the March 2010 agreement between the Federal Reserve Bank and the Company, and the May 2010 Order between the California Department of Financial Institutions and the Company, the Company is currently prohibited from paying interest on its junior subordinated debentures.

Possible Control by Certain Persons

In that Mr. Dennis Woods, Chairman and CEO of the Company beneficially owns approximately 7.3% of the outstanding shares of Company common stock, the named executive officers of the Company as a group (excluding Mr. Woods) beneficially owns approximately 5.4% of the outstanding shares of Company common stock, and the directors of the Company as a group (excluding Mr. Woods) beneficially owns 16.8% of the outstanding shares of Company common stock, these persons will be able to control certain corporate governance matters. Such matters may include the selection of nominees for the board of directors and the supervision of management. The officers and directors also have the ability to control other matters requiring shareholders' approval including the election of directors which may result in the entrenchment of management.

Item 1B. - Unresolved Staff Comments

The Company had no unresolved staff comments at December 31, 2010.

Item 2 - Properties

The Bank's Main bank branch is located at 2151 West Shaw Avenue, Fresno, California. The Company owns the building and leases the land under a sublease dated December 1, 1986 between Central Bank and USB. The current sublessor under the master ground lease is Bank of the West, which acquired the position through the purchase of Central Bank. The lessor under the ground lease (Master Lease) is Thomas F. Hinds. The lease expires on December 31, 2015 and the Company has options to extend the term for four (4) ten-year periods and one seven (7) year period.

The Company leases the banking premises of approximately 6,450 square feet for its second of three Fresno branches at 7088 N. First Ave, Fresno, California., under a lease which commenced August 2005 for a term of ten years expiring in July 2015. The branch was previously located at 1041 E. Shaw Avenue, Fresno, California, under a lease extension expiring February 28, 2005. The lease was renewed until August 2005. The 7088 N. First location provides space for the relocated branch as well as the Real Estate Construction Department and the Indirect Consumer Lending Department.

The Company leases the Oakhurst bank branch located at the Old Mill Village Shopping Center, 40074 Highway 49, Oakhurst, California. The branch facility consists of approximately 5,000 square feet with a lease term of 15 years ending April 2014, and has two five-year options to extend the lease term after that date.

The Company owns the Caruthers bank branch located at 13356 South Henderson, Caruthers, California, which consists of approximately 5,000 square feet of floor space.

The Company owns the San Joaquin branch facilities located at 21574 Manning Avenue, San Joaquin, California. The bank branch is approximately 2,500 square feet.

The Company owns the Firebaugh bank branch located at 1067 O Street, Firebaugh, California. The premises are comprised of approximately 4,666 square feet of office space situated on land totaling approximately one-third of an acre.

The Company owns the Coalinga bank branch located at 145 East Durian, Coalinga, California. The office building has a total of 6,184 square feet of interior floor space situated on approximately 0.45 acres of land.

The Company leases the Convention Center branch located at 855 "M" Street, Suite 130, Fresno, California. Total space leased is approximately 4,520 square feet, and was occupied during March 2004. The fifteen-year lease expires in March 2019. There are no extension provisions.

The Company owns the Taft branch office premises located at 523 Cascade Place, Taft, California. The branch facilities consist of approximately 9,200 square feet of office space.

The Company owns the branch facilities located at 3404 Coffee Road, Bakersfield, California, which has approximately 6,130 square feet of office space located on 1.15 acres.

The Company leases the Campbell branch located at 1875 S. Bascom Ave. Suite 19, Campbell, California, which has approximately 2,984 square feet. The lease commenced on January 1, 2011 and expires on December 31, 2021.

The Company owns its administrative headquarters at 2126 Inyo Street, Fresno, California and is occupied by the Company's administrative staff and USB financial services. The facility consists of approximately 21,400 square feet. A portion of the premises has been subleased to a third-party under a lease term of approximately seven years.

Item 3 - Legal Proceedings

From time to time, the Company is party to claims and legal proceedings arising in the ordinary course of business. At this time, the management of the Company is not aware of any material pending litigation proceedings to which it is a party or has recently been party to, which will have a material adverse effect on the financial condition or results of operations of the Company.

Item 4 - Reserved

PART II

Item 5 - Market for the Registrant's Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities

Trading History

The Company became a NASDAQ National Market listed company on May 31, 2001, then became a Global Select listed company during 2006, and trades under the symbol UBFO.

The Company currently has four market makers for its common stock. These include, Stone & Youngberg, LLC, Howe Barnes Hoeffler & Arnett, Sandler O'Neill & Partners, and Hill Thompson, Magid & Company. The Company is aware of two other securities dealers: Smith Barney and Dean Witter Reynolds Inc., which periodically act as brokers in the Company's stock.

On March 28, 2006, the Company announced a 2-for-1 stock split of the Company's no-par common stock payable May 1, 2006 effected in the form of a 100% stock dividend. Share information for all periods presented in this 10-K have been restated to reflect the effect of the stock split.

During the third quarter ended September 30, 2008 and the fourth quarter ended December 31, 2008, the Company declared 1% stock dividends. During each of the eight consecutive quarters ended March 31, 2009, June 30, 2009, September 30, 2009, December 31, 2009, March 31, 2010, June 30, 2010, September 30, 2010, and December 31, 2010, the Company again declared 1% stock dividends. Share information for all periods presented in this Form 10-K has been restated to reflect the effect of the 1% stock dividends.

The Company was included in the Russell 2000 Stock Index during June 2006 and remained a member of the Russell 2000 Stock Index until June 2009, when the Company's market capitalization fell below the threshold required to remain on the Index. The inclusion of the Company's stock in the index has provided additional exposure for the Company in equity markets, and increased the transaction volume.

The following table sets forth the high and low closing sales prices by quarter for the Company's common stock, for the years ended December 31, 2010 and 2009.

Quarter	Closing Prices		Volume
	High	Low	
4th Quarter 2010	\$ 4.91	\$ 3.45	821,000
3rd Quarter 2010	\$ 4.51	\$ 3.54	409,000
2nd Quarter 2010	\$ 4.82	\$ 3.53	598,000
1st Quarter 2010	\$ 5.18	\$ 4.28	616,000
4th Quarter 2009	\$ 5.60	\$ 2.50	975,000
3rd Quarter 2009	\$ 6.00	\$ 4.10	1,377,400
2nd Quarter 2009	\$ 9.57	\$ 4.35	2,427,600
1st Quarter 2009	\$ 11.81	\$ 4.72	979,600

At December 31, 2010, there were approximately 811 record holders of common stock of the Company. This does not reflect the number of persons or entities who hold their stock in nominee or street name through various brokerage firms.

Dividends

The Company's shareholders are entitled to cash dividends when and as declared by the Company's Board of Directors out of funds legally available therefore. Dividends paid to shareholders by the Company are subject to restrictions set forth in California General Corporation Law, which provides that a corporation may make a distribution to its shareholders if retained earnings immediately prior to the dividend payout are at least equal the amount of the proposed distribution. As a bank holding company without significant assets other than its equity position in the Bank, the Company's ability to pay dividends to its shareholders depends primarily upon dividends it receives from the Bank. Such dividends paid by the Bank to the Company are subject to certain limitations. See "Management's Discussion and Analysis of Financial and Results of Operations – Regulatory Matters".

The Company distributed a 1% stock dividend to shareholders on January 20, 2010, April 21, 2010, July 21, 2010, October 20, 2010, and January 19, 2011. The Company distributed a 1% stock dividend to shareholders on January 21, 2009, April 22, 2009, July 22, 2009, and then again on October 21, 2009. The Company paid cash dividends to shareholders of \$0.13 per share on January 23, 2008, and April 23, 2008. The Company also distributed a 1% stock

dividend to shareholders on July 23, 2008, and then again on October 22, 2008.

The amount and payment of dividends by the Company to shareholders are set by the Company's Board of Directors with numerous factors involved including the Company's earnings, financial condition and the need for capital for expanded growth and general economic conditions. No assurance can be given that cash or stock dividends will be paid in the future.

Securities Authorized for Issuance under Equity Compensation Plans

The following table sets forth securities authorized for issuance under equity compensation plans as for December 31, 2010.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (column a)	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders	166,577	\$ 14.21	311,115
Equity compensation plans not approved by security holders	N/A	N/A	N/A
Total	166,577	\$ 14.21	311,115

A complete description of the above plans is included in Note 10 of the Company's Financial Statements, in Item 8 of this Annual Report on Form 10K, and is hereby incorporated by reference.

Purchases of Equity Securities by Affiliates and Associated Purchasers

On August 30, 2001, the Company announced that its Board of Directors approved a plan to repurchase, as conditions warrant, up to 280,000 shares (560,000 shares adjusted for May 2006 stock split) of the Company's common stock on the open market or in privately negotiated transactions. The duration of the program was open-ended and the timing of purchases was dependent on market conditions. A total of 215,423 shares (430,846 shares adjusted for May 2006 stock split) had been repurchased under that plan as of December 31, 2003, at a total cost of \$3.7 million.

On February 25, 2004, the Company announced a second stock repurchase plan under which the Board of Directors approved a plan to repurchase, as conditions warrant, up to 276,500 shares (553,000 shares adjusted for May 2006 stock split) of the Company's common stock on the open market or in privately negotiated transactions. As with the first plan, the duration of the new program is open-ended and the timing of purchases will depend on market conditions. Concurrent with the approval of the new repurchase plan, the Board terminated the 2001 repurchase plan and canceled the remaining 64,577 shares (129,154 shares adjusted for May 2006 stock split) yet to be purchased under the earlier plan.

On May 16, 2007, the Company announced another stock repurchase plan to repurchase, as conditions warrant, up to 610,000 shares of the Company's common stock on the open market or in privately negotiated transactions. The repurchase plan represents approximately 5.00% of the Company's currently outstanding common stock. The duration of the program is open-ended and the timing of purchases will depend on market conditions. Concurrent with the approval of the new repurchase plan, the Company canceled the remaining 75,733 shares available under the 2004 repurchase plan.

During the year ended December 31, 2008, 89,001 shares were repurchased at a total cost of \$1.21 million and an average per share price of \$13.70. During the year ended December 31, 2009, 488 shares were repurchased at a total cost of \$3,700 and an average per share price of \$7.50.

Financial Performance

The following performance graph does not constitute soliciting material and should not be deemed filed incorporated by reference into any other Company under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent the Company specifically incorporates the performance graph by reference therein.

Index	Period Ending					
	12/31/05	12/31/06	12/31/07	12/31/08	12/31/09	12/31/10
United Security Bancshares	100.00	161.41	104.27	82.28	32.53	28.93
Russell 2000	100.00	118.37	116.51	77.15	98.11	124.46
Russell 3000	100.00	115.71	121.66	76.27	97.89	114.46
SNL Bank \$500M-\$1B Index	100.00	113.73	91.14	58.40	55.62	60.72

Item 6 - Selected Financial Data

The following table sets forth certain selected financial data for the Bank for each of the years in the five-year periods ended December 31, 2010 and should be read in conjunction with the more detailed information and financial statements contained elsewhere herein (in thousands except per share data and ratios).

(in thousands except per share data and ratios)	December 31,				
	2010	2009	2008	2007	2006
Summary of Year-to-Date Earnings:					
Interest income and loan fees	\$ 32,490	\$ 35,676	\$ 45,147	\$ 57,156	\$ 47,356
Interest expense	4,589	7,327	14,938	20,573	14,175
Net interest income	27,901	28,349	30,209	36,583	33,181
Provision for credit losses	12,475	13,375	9,526	6,231	880
Net interest income after Provision for credit losses	15,426	14,974	20,683	30,372	32,301
Noninterest income	5,939	6,305	8,343	9,681	9,031
Noninterest expense	29,020	27,966	23,351	22,215	19,937
(Loss) income before taxes on income	(7,655)	(6,687)	5,675	17,818	21,395
Taxes on income	(3,216)	(2,150)	1,605	6,561	8,035
Net (loss) income	\$ (4,439)	\$ (4,537)	\$ 4,070	\$ 11,257	\$ 13,360
Per Share Data:					
Net (loss) income – Basic	\$ (0.34)	\$ (0.35)	\$ 0.31	\$ 0.85	\$ 1.07
Net (loss) income – Diluted	\$ (0.34)	\$ (0.35)	\$ 0.31	\$ 0.85	\$ 1.06
Average shares outstanding – Basic	13,003,840	13,003,840	13,047,046	13,173,466	12,531,258
Average shares outstanding - Diluted	13,003,840	13,003,840	13,050,752	13,211,849	12,661,524
Cash dividends paid	\$ 0.00	\$ 0.00	\$ 0.26	\$ 0.50	\$ 0.43
Financial Position at Period-end:					
Total assets	\$ 678,210	\$ 693,235	\$ 761,077	\$ 771,715	\$ 678,314

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Total net loans and leases	424,526	492,692	531,788	583,625	489,764					
Total deposits	557,466	561,660	508,486	634,617	587,127					
Total shareholders' equity	73,270	75,821	79,610	82,431	66,042					
Book value per share	\$ 5.63	\$ 6.07	\$ 6.37	\$ 6.55	\$ 5.51					
Selected Financial Ratios:										
Return on average assets	(0.63	%)	(0.62	%)	0.52	%	1.47	%	2.04	%
Return on average shareholders' equity	(5.67	%)	(5.77	%)	4.93	%	13.73	%	20.99	%
Average shareholders' equity to average assets	11.06	%	10.71	%	10.60	%	10.73	%	9.70	%
Allowance for credit losses as a percentage of total nonperforming loans	35.19	%	29.57	%	25.24	%	45.99	%	57.50	%
Net charge-offs to average loans	2.24	%	1.85	%	0.93	%	0.77	%	0.05	%
Allowance for credit losses as a percentage of period-end loans	3.75	%	2.96	%	2.12	%	1.26	%	0.88	%
Dividend payout ratio	0.00	%	0.00	%	80.12	%	56.39	%	39.16	%

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

Certain matters discussed or incorporated by reference in this Annual Report on Form 10-K are forward-looking statements that are subject to risks and uncertainties that could cause actual results to differ materially from those projected in the forward-looking statements. Such risks and uncertainties include, but are not limited to, those described in Management's Discussion and Analysis of Financial Condition and Results of Operations. Such risks and uncertainties include, but are not limited to, the following factors: i) competitive pressures in the banking industry and changes in the regulatory environment; ii) exposure to changes in the interest rate environment and the resulting impact on the Company's interest rate sensitive assets and liabilities; iii) decline in the health of the economy nationally or regionally which could reduce the demand for loans or reduce the value of real estate collateral securing most of the Company's loans; iv) credit quality deterioration that could cause an increase in the provision for loan losses; v) Asset/Liability matching risks and liquidity risks; volatility and devaluation in the securities markets, vi) failure to comply with the regulatory agreement under which the Company is subject, vii) expected cost savings from recent acquisitions are not realized, and, viii) potential impairment of goodwill and other intangible assets.. Therefore, the information set forth therein should be carefully considered when evaluating the business prospects of the Company.

The Company

On June 12, 2001, the United Security Bank (the "Bank") became the wholly owned subsidiary of United Security Bancshares (the "Company") through a tax-free holding company reorganization, accounted for on a basis similar to the pooling of interest method. In the transaction, each share of Bank stock was exchanged for a share of Company stock on a one-to-one basis. No additional equity was issued as part of this transaction. In the following discussion, references to the Bank are references to United Security Bank. References to the Company are references to United Security Bancshares (including the Bank).

On June 28, 2001, United Security Bancshares Capital Trust I (the "Trust") was formed as a Delaware business trust for the sole purpose of issuing Trust Preferred securities. On July 16, 2001, the Trust completed the issuance of \$15 million in Trust Preferred securities, and concurrently, the Trust used the proceeds from that offering to purchase Junior Subordinated Debentures of the Company. The Company contributed \$13.7 million of the \$14.5 million in net proceeds received from the Trust to the Bank to increase its regulatory capital and used the rest for the Company's business. Effective January 1, 2007, the Company adopted the fair value option for its junior subordinated debt issued by the Trust. As a result of the adoption of the accounting standards related to the fair value option, the Company recorded a fair value adjustment of \$1.3 million, reflected as an adjustment to beginning retained earnings. On July 25, 2007, the Company redeemed the \$15.0 million in subordinated debentures plus accrued interest of \$690,000 and a 6.15% prepayment penalty totaling \$922,500. Concurrently, the Trust Preferred securities issued by Capital Trust I were redeemed. The prepayment penalty of \$922,500 had previously been a component of the fair value adjustment for the junior subordinated debt at the initial adoption of the fair value option.

Effective December 31, 2001, United Security Bank formed a subsidiary Real Estate Investment Trust ("REIT") through which preferred stock was offered to private investors, to raise capital for the bank in accordance with the laws and regulations in effect at the time. The principal business purpose of the REIT was to provide an efficient and economical means to raise capital. The REIT also provided state tax benefits beginning in 2002. On December 31, 2003 the California Franchise Tax Board (FTB) announced certain tax transactions related to real estate investment trusts (REITs) and regulated investment companies (RICs) will be disallowed pursuant to Senate Bill 614 and Assembly Bill 1601, which were signed into law in the 4th quarter of 2003 (For further discussion see Income Taxes section of Results of Operations contained in this Management's Discussion and Analysis of Financial Condition and

Results of Operations).

Effective April 23, 2004, the Company completed its merger with Taft National Bank headquartered in Taft, California. Taft National Bank ("Taft") was merged into United Security Bank and Taft's two branches, one located Taft and the other located in Bakersfield, California, began operating as branches of United Security Bank. The total consideration paid to Taft shareholders was 241,447 shares of the Company's common stock valued at just over approximately \$6.0 million. As a result of the merger, the Company acquired \$15.4 million in cash and short-term investments, \$23.3 million in loans, and \$48.2 million in deposits. The merger was accounted for using the purchase method of accounting, and resulted in the purchase price being allocated to the assets acquired and liabilities assumed from Taft based on the fair value of those assets and liabilities, with resultant goodwill of \$1.6 million and core deposits intangibles of \$1.9 million. Goodwill is not amortized but is reviewed at least annually for impairment, while core deposit intangibles are being amortized over a period of approximately 7 years. The Company has recognized no impairment on either the goodwill or core deposit intangible related to the Taft merger. The two branches purchased during 2004 have grown since the merger in 2004, with loans totaling \$58.3 million, and deposits totaling \$69.5 million at December 31, 2010. Like much of the rest of the San Joaquin Valley, the Bakersfield area has been impacted to a large degree by the slowdown in residential real estate markets and resulting depressed real estate prices. Of the \$58.3 million in total impaired loans reported by the Company at December 31, 2010, \$19.5 million was related to the Bakersfield operation with a specific reserve of \$4.3 million.

On February 16, 2007, the Company completed its merger of Legacy Bank, N.A. with and into United Security Bank, a wholly owned subsidiary of the Company. Legacy Bank which began operations in 2003 operated one banking office in Campbell, California serving small business and retail banking clients. With its small business and retail banking focus, Legacy Bank provides a unique opportunity for United Security Bank to serve a loyal and growing small business niche and individual client base in the San Jose area. Upon completion of the merger, Legacy Bank's branch office began operating as a branch office of United Security Bank. As of February 16, 2007, Legacy Bank had net assets of approximately of \$8.6 million, including net loans of approximately \$62.4 million and deposits of approximately \$69.6 million. At the time of the merger, Legacy had \$62.5 million in net loans and \$69.6 million in total deposits. At December 31, 2010, net loans and total deposits related to the Campbell branch totaled \$37.8 million and \$22.6 million, respectively, and have decreased as the result of declines in lending markets in that area as well as significant competition for deposits. Impaired loans related to the Campbell branch at December 31, 2010 totaled \$2.0 million with a related specific reserve of \$591,000.

In the merger with Legacy Bank, the Company issued 976,411 shares of its stock in a tax free exchange for all of the Legacy Bank common shares. The total value of the transaction was approximately \$21.7 million. The merger transaction was accounted for using the purchase accounting method, and resulted in the purchase price being allocated to the assets acquired and liabilities assumed from Legacy based on the fair value of those assets and liabilities. Fair value adjustments and intangible assets totaled approximately \$12.9 million, including \$8.8 million in goodwill. The allocations of purchase price based upon the fair market value of assets acquired and liabilities assumed were finalized during the fourth quarter of 2007. Goodwill is not amortized but is reviewed at least annually for impairment, while core deposit intangibles are being amortized over a period of approximately 7 years. The Company recognized goodwill impairment charges of \$1.4 million and \$3.0 million for the years ended December 31, 2010, and 2009, respectively. In addition, the Company recognized impairment charges related to core deposit intangibles of \$57,000 during both of the years ended December 31, 2010 and 2009.

During July 2007, the Company formed USB Capital Trust II, a wholly-owned special purpose entity, for the purpose of issuing Trust Preferred Securities. Like USB Capital Trust I formed in July 2001, USB Capital Trust II is a Variable Interest Entity (VIE) and a deconsolidated entity pursuant current accounting standards related to variable interest entities. On July 23, 2007, USB Capital Trust II issued \$15 million in Trust Preferred securities. The securities have a thirty-year maturity and bear a floating rate of interest (repricing quarterly) of 1.29% over the three-month LIBOR rate. Interest is payable quarterly. Concurrent with the issuance of the Trust Preferred securities, USB Capital Trust II used the proceeds of the Trust Preferred securities offering to purchase a like amount of junior subordinated debentures of the Company. The Company is to pay interest on the junior subordinated debentures to USB Capital Trust II, which represents the sole source of dividend distributions to the holders of the Trust Preferred securities. The Company elected at September 30, 2009 to defer quarterly payments of interest on the junior subordinated debentures beginning with the quarterly payment due October 1, 2009. In addition, the Agreement entered into with the Federal Reserve Bank of San Francisco during March 2010 prohibits the Bank from making distributions, including dividends and interest payments, without prior written approval. The terms of the debentures permit the deferment of payment of interest for up to 20 consecutive quarters. Interest continues to accrue while interest payments are deferred. Under the terms of the trust preferred securities the Company is prohibited from paying dividends on its capital stock (including common stock) during the deferral period. The Company may redeem the junior subordinated debentures at anytime before October 2011 at 100.66, or at par anytime after October 2012.

Regulatory Agreement with the Federal Reserve Bank of San Francisco

Effective March 23, 2010, United Security Bancshares (the "Company") and its wholly owned subsidiary, United Security Bank (the "Bank"), entered into a formal written agreement (the "Agreement") with the Federal Reserve Bank of San Francisco. The Agreement was a result of a regulatory examination that was conducted by the Federal Reserve and the California Department of Financial Institutions in June 2009 and is intended to improve the overall condition

of the Bank through, among other things, increased Board oversight; formal plans to monitor and improve processes related to asset quality, liquidity, funds management, capital, and earnings; and the prohibition of certain actions that might reduce capital, including the distribution of dividends or the repurchase of the Company's common stock. The Board of Directors and management believe that as of the filing of the fourth quarter written response to the Agreement, Company is in compliance with the terms of the Agreement. (For more information on the terms of the Agreement see the "Regulatory Matters" section included in this Management's Discussion and Analysis of Financial Condition and Results of Operations.)

The Agreement entered into with the Federal Reserve Bank of San Francisco during March 2010 was a result of a regulatory examination conducted by the Federal Reserve and the California Department of Financial Institutions in June 2009. The following issues related to the June 2010 examination led to the agreement between the Federal Reserve Bank and the Company that corrective action was required:

§ Asset quality continued to deteriorate as adversely classified assets increased over four consecutive target and full-scope examinations conducted from 2006 through the June 2009 exam. The dollar volume of adversely classified assets increased by 16.7% during the six months prior to the exam to \$142.1 million at the June 2009 examination.

§ Below investment grade investment securities classified substandard at the previous examination totaling \$9.1 million increased to \$17.1 million at the June 2010 examination, representing 18.6% of tier 1 capital and reserves as of March 31, 2009. The classified investment securities are comprised of three private-label residential mortgage backed securities that are below investment grade as graded by a national rating agency, were divided between \$16.9 million in substandard and \$163,000 in loss. The portion listed as loss represented the amount identified as other-than-temporary-impairment (OTTI) and had been recognized as loss as of March 31, 2009.

§ During the June 2009 examination, it was the opinion of the Federal Reserve Bank that the Bank's methodology related to the allowance for loan and leases losses was flawed, leading the Federal Reserve Bank to conclude that additional provisions were required to raise reserves to an appropriate level. In addition, weaknesses in the ALLL policy were identified and needed to be addressed, which included improvements in documentation related to identification and analysis of loans under SFAS No. 114 and SFAS No. 5, and more detailed justification for the qualitative factors used in the ALLL process. During the six months ended June 30, 2010, several large lending relationships to developers in the San Joaquin Valley deteriorated significantly, requiring an additional \$1.8 million in ALLL. In addition, during that period, the Bank experienced increases in other problem loans or potentially problem loans including nonaccrual loans and special mention loans, and real estate valuations continued to decline. Regulators required an increase in the reserves as calculated by the Federal Reserve Bank using a model they call the "Atlanta Model." The Atlanta Model calculated an estimated range of allowance for loan losses using a blend of national, regional, and local peer bank data. The reserve calculated by the Bank for June 30, 2009 under GAAP included additions to ALLL required for increases in adversely classified and special mention loans experienced during the first half of 2009, and although at the lower range of ALLL as estimated by the Federal Reserve, corresponded favorably with the Federal Reserve's "Atlanta Model". The reserve adjustment required for the second quarter of 2009 totaled \$6.8 million bringing the ALLL level to \$15.8 million (including reserve for unfunded commitments) at June 30, 2009. The ALLL findings of the Federal Reserve Bank included recommendations to better align actual practices with the regulatory governing policy as well as to provide a more specific framework for analyzing, determining, and supporting the factors used in the ALLL methodology.

§ Earnings performance declined as of June 30, 2009, due in large part to the additional \$6.8 million provision recorded for the second quarter (\$8.2 million year-to-date) resulting in a net loss for the Company of \$4.8 million for the six months ended June 30, 2009. Earnings for the period were also adversely impacted by: a goodwill impairment loss of \$3.0 million (pre-tax and net); year-to-date pre-tax impairment losses of \$403,000 on the real estate mortgage-backed securities; year-to-date pre-tax operating expenses and impairment losses of \$1.3 million related to other real estate owned through foreclosure.

§ Although the Bank's Tier 1 leverage capital, Tier 1 risk-based capital, and total risk-based capital ratios remained above regulatory Prompt Corrective Action guidelines of adequately capitalized banks at 10.8%, 11.3%, and 12.6%, respectively, at June 30, 2009, the Federal Reserve concluded that capital levels were less than adequate to support the Bank's high risk profile resulting primarily from the continued decline in asset quality. At the June 2009 examination adversely classified assets were in excess of 150.0% of Tier 1 capital and reserves.

§ The Bank's liquidity position had tightened since the last examination and was considered marginal at the June 2009 examination. The Bank's tight liquidity position was the result of low levels of liquid assets, high percentage of investment securities pledged against borrowing lines, and higher levels of wholesale borrowings including \$64.0 million borrowed from the Federal Home Loan Bank line and \$71.3 million borrowed from the Federal Reserve Bank discount window. Brokered deposits total \$99.3 million, 19.4% of total deposits at June 30, 2009, and compared unfavorably with the peer group at 6.3%.

§ The Federal Reserve concluded in the June 2009 examination that oversight by the Board of Directors and senior management was not adequate given the escalating risk profile of the Bank's activities. Although the severe economic downturn was a significant factor in the decline in asset quality, the Board of Directors and senior management were deemed responsible for implementing a business strategy which allowed concentrations in higher-risk speculative residential construction lending. The Board of Directors and senior management had taken measures to maintain asset quality, capital, earnings, and liquidity, but had not responded in a timely manner to the rapidly changing real estate conditions. As of March 31, 2009, the concentration in construction and land development loans represented high levels in relation to equity capital and reserves, although the exposures were declining over the prior few years. For example, management increased the ALLL in the second quarter of 2009, ordered new appraisals on property remargined collateral on loans, and was seeking sources for new equity capital. In addition, several transactions to reduce or restructure problem assets were in process. However, these actions had not resulted in material tangible improvements in the overall condition of the Bank as of the June 2009 examination. In addition, the June 2009 examination identified nine technical violations of Regulation Y Subpart B that deal with the failure to obtain the prescribed appraisals or evaluations on loan extensions or renewals. These violations of law were subsequently remedied.

§ The June 2009 examination indicated that risk management practices needed improvement. Management information systems needed to be redesigned and implemented to more accurately measure fundamental exposures, such as the ongoing credit risk posed by the residential construction and land development loan portfolio and the emerging liquidity risks. The Bank needed to continue its efforts to address and reduce the increasing volume of problem assets. While the loan grading process showed improvement over the prior several examinations, the ALLL methodology was identified as flawed in the June 2009 examination. While the Board of Directors and management made some progress to address the findings of the June 2009 examination, management needed to make further progress on improving several key areas to identify, measure, monitor, and control the exposures presented by credit, liquidity, market, operational, reputation, and legal risks.

The result of significant increases in nonperforming assets, both classified loans and OREO, during 2008 and the first half of 2009 increased the overall risk profile of the Bank. The increased risk profile of the Bank included heightened concerns about the Bank's use of brokered and other wholesale funding sources which had been used to fund loan growth and reduce the Company's overall cost of interest bearing liabilities. With loan growth funded materially from wholesale funding sources, liquidity risk increased, and higher levels of nonperforming assets increased risk to equity capital and potential volatility in earnings. In addition, the Federal Reserve Bank identified nine technical violations of Regulation Y Subpart B that deal with the failure to obtain the prescribed appraisals or evaluations on loan extensions or renewals. During the fourth quarter of 2010, the Company identified a material weakness related to the allowance for loan losses and the completeness and accuracy of the provision for loan losses, as well as to the valuation of OREO properties (for further discussion see Item 9A Controls and Procedures.)

As part of the Agreement, the Board of Directors of the Bank has appointed a Compliance Committee to monitor and coordinate the Bank's compliance with the provisions of the Agreement. The Compliance Committee is comprised of the outside Directors and they meet on a monthly basis.

Among other things, the Agreement required the Bank to submit a number of written plans to the Federal Reserve Bank within specified time frames. The following is a list of written plans required to be submitted to the Federal Reserve Bank.

- Plan to Strengthen Board Oversight – Includes actions that the Board of Directors will take to improve the Bank's condition, and maintain effective control and supervision over the Bank's operations including credit risk management, liquidity, and earnings. Also includes the Board's responsibility to monitor adherence to policies and procedures and applicable laws and regulations, and lists information and reports that will enable the Board to perform this oversight function.
- Plan to Strengthen Credit Risk Management Practices – includes the responsibility of Board to establish appropriate risk tolerance guidelines and limits, timely and accurate identification and quantification of credit risk, strategies to minimize credit losses and reduce the level of problem assets, procedures for the ongoing review of the investment portfolio to evaluate other-than-temporary-impairment, stress testing for commercial real estate loans and portfolio segments, and measures to reduce the levels of other real estate owned.
- Plan to Improve Adversely Classified Assets – Includes specific plans and strategies to improve the Bank's asset position through repayment, amortization, liquidation, additional collateral, or other means on each loan, relationship, or other asset in excess of \$1.5 million including OREO, that are past due more than 90 days as of the date of the written agreement.
- Plan for Maintenance of Adequate Allowance for Loan Losses – Includes policies and procedures to ensure adherence to the Bank's revised ALLL methodology, provides for periodic reviews of the methodology as appropriate, and provides for review of ALLL by the Board at least quarterly.
- Capital Plan – Includes guidelines and trigger points to ensure sufficient capital is maintained at the Bank and the Company, and that capital ratios are maintained at a level deemed appropriate under regulatory guidelines given the level of classified assets, concentrations of credit, ALLL, current and projected growth, and projected retained

earnings. Also contains contingency strategies to obtain additional capital as required to fulfill future capital requirements.

- Plan to Improve Liquidity Position – Includes measures to enhance the monitoring, measurement, and reporting of the Bank’s liquidity to the Board, a timetable to reduce the Bank’s reliance on brokered deposits and other wholesale funding, and specific liquidity targets and parameters to meet contractual obligations and unanticipated demands.
- Contingency Funding Plan – Includes adverse scenario planning, and identifies and quantifies available sources of liquidity for each scenario.
- Earnings Plan and Budget – Includes a revised business plan for the remainder of 2010, including operating assumptions that support for projected income, expense, and balance sheet components.

As of June 30, 2010, the Bank had completed and submitted to the Federal Reserve Bank all the plans listed above within the designated timeframes. The Federal Reserve responded on July 27, 2010 by letter that stated “We have reviewed your submissions and acknowledge the steps taken by the Bank and Bancshares to achieve compliance with the Agreement’s provisions. However, we noted that the Plan to Strengthen Board Oversight omitted references to actions to be taken with regard to Bank earnings as required by the first provision.” At the August 24, 2010, regular meeting of the Board, an amended version of the Plan was approved and the amended Plan has been submitted to the Federal Reserve.

In addition to the submission of the above plans to the Federal Reserve Bank for approval, and implementation of the above plans, the Bank is required within 30 days after the end of each calendar quarter to submit written progress reports to the Federal Reserve Bank detailing actions taken to secure compliance with the Agreement. On April 28, 2010, July 30, 2010, and October 30, 2010, respectively, the Bank submitted progress reports to the Federal Reserve for the first, second, and third quarters of 2010. As of the January 31, 2011 the Company submitted a progress report for the fourth quarter of 2010. At this time the Company and the Bank believe they are in compliance with the Agreement, including remediation of technical violations of laws and regulations regarding stale loan appraisals.

Regulatory Order from the California Department of Financial Institutions

During May of 2010, the California Department of Financial Institutions issued a written order (the “Order”) pursuant to section 1913 of the California Financial Code to the Bank as a result of a regulatory examination that was conducted by the Federal Reserve and the California Department of Financial Institutions in June 2009. The Order issued by the California Department of Financial Institutions is basically similar to the written agreement with the Federal Reserve Bank of San Francisco, except for certain additional requirements. The additional requirements in the Order for the Bank are as follows:

- Develop and adopt a capital plan to maintain a ratio of tangible shareholders’ equity to total tangible assets equal to or greater than 9.5% and include in such capital plan a capital contingency plan for raising additional capital in the event of various contingencies;
- Maintain a ratio of tangible shareholders’ equity to total tangible assets equal to or greater than 9.5%
- Maintain an adequate allowance for loan losses and remedy any deficiency in the allowance for loan losses in the calendar quarter in which it is discovered; and
- Not establish any new branches or other offices without the prior written consent of the Commissioner of the California Department of Financial Institutions
- Provide progress reports within 30 days after the end of each calendar quarter following the date of the Order to the California Department of Financial Institutions detailing the form and manner of all actions taken to secure compliance with the Order and Agreement and the results of such actions.

The Bank is currently in full compliance with the requirements of the Order including its deadlines. During the fourth quarter of 2010, the Company identified a material weakness related to the allowance for loan losses and the completeness and accuracy of the provision for loan losses, as well as to the valuation of OREO properties (for further discussion see Item 9A Controls and Procedures.)

(For more information on the Agreement see the “Regulatory Matters” section included in this Management’s Discussion and Analysis of Financial Condition and Results of Operations.)

The Bank currently has eleven banking branches, one construction lending office, and one financial services office, which provide banking and financial services in Fresno, Madera, Kern, and Santa Clara counties. As a community-oriented bank holding company, the Company continues to seek ways to better meet its customers' needs for financial services, and to expand its business opportunities in today's ever-changing financial services environment. The Company's strategy is to be a better low-cost provider of services to its customer base while enlarging its market area and corresponding customer base to further its ability to provide those services.

Current Trends Affecting Results of Operations and Financial Position

The Company's overall operations are impacted by a number of factors, including not only interest rates and margin spreads, which impact results of operations, but also the composition of the Company's balance sheet. One of the primary strategic goals of the Company is to maintain a mix of assets that will generate a reasonable rate of return without undue risk, and to finance those assets with a low-cost and stable source of funds. Liquidity and capital resources must also be considered in the planning process to mitigate risk and allow for growth. Net interest income has declined over the past three years, totaling \$27.9 million, \$28.3 million, and \$30.2 million for the years ended December 31, 2010, 2009, and 2008, respectively. The decline in net interest income between 2009 and 2010 was primarily the result of declines in the volume of interest-earning assets which more than outweighed the increase in net interest margin during 2010, while the decrease in net interest income between 2008 and 2009 was the result of both decreases in interest rates and declines in the average volumes of earning assets and interest-bearing liabilities. Average interest-earning assets decreased approximately \$21.9 million between 2009 and 2010, and decreased \$60.7 million between 2008 and 2009, as the Company reduced the size of the balance sheet and sought to control the rising level of problem assets. Of the \$21.9 million decrease in average earning assets between 2009 and 2010, \$44.4 million was in loans, and an additional \$22.2 million was in investment securities. Offsetting these decreases during 2010 were increases of \$48.1 million in federal funds sold and interest-bearing deposits in the Federal Reserve Bank. During the last three years, the Company's cost of interest-bearing liabilities has declined significantly as market rates of interest declined, with the average cost of interest-bearing liabilities dropping from 2.75% during 2008, to 1.43% during 2009, and then to 0.93% for the year ended December 31, 2010. During that three-year period, the mix of average interest-bearing liabilities changed, with interest-bearing deposits increasing on average by \$45.5 million between the years ended December 31, 2009 and 2010, and decreasing \$36.4 million on average between the years ended December 2008 and 2009. Borrowings decreased \$64.7 million on average between the years ended December 31, 2009 and 2010 as the Company sought to reduce its dependence on wholesale funding sources. Borrowings increased \$8.5 million between the years ended December 31, 2008 and 2009.

The following table summarizes the year-to-date averages of the components of interest-earning assets as a percentage of total interest earning assets, and the components of interest-bearing liabilities as a percentage of total interest-bearing liabilities:

	YTD Average 12/31/10		YTD Average 12/31/09		YTD Average 12/31/08	
Loans	80.42	%	84.66	%	84.11	%
Investment securities	10.16	%	13.31	%	14.41	%
Interest-bearing deposits in other banks	0.40	%	0.93	%	1.40	%
Interest-bearing deposits in FRB	4.18	%	0.51	%	0.00	%
Federal funds sold	4.84	%	0.59	%	0.08	%
Total earning assets	100.00	%	100.00	%	100.00	%
NOW accounts	12.78	%	8.80	%	7.92	%
Money market accounts	23.57	%	22.68	%	22.89	%
Savings accounts	7.20	%	6.86	%	7.50	%
Time deposits	47.22	%	39.94	%	42.51	%
Other borrowings	7.16	%	19.44	%	16.84	%
Trust Preferred Securities	2.07	%	2.28	%	2.34	%
Total interest-bearing liabilities	100.00	%	100.00	%	100.00	%

Although residential real estate markets have shown signs of some improvement over the past twelve months, the severe decline in residential construction and median home prices that began in 2008 and persists to this time has

impacted the Company's operations during the past year with increased levels of nonperforming assets, increased expenses related to foreclosed properties, and decreased profit margins. Although the Company continues its business development and expansion efforts throughout its market area, increased attention has been placed on reducing nonperforming assets and providing customers options to work through this difficult economic period. Options have included a combination of rate and term concessions, as well as forbearance agreements with borrowers. While the level of restructured loans increased during 2009 and 2010 to a balance of \$24.9 million at December 31, 2010, total nonperforming loans have actually decreased approximately \$3.8 million during the year ended December 31, 2010.

Fresno and Kern Counties have both been heavily impacted by the real estate downturn over the past three years. Prices have continued to decline slowly in these areas during 2010 even as they have stabilized or increased in other parts of California. The fundamentals of the Fresno real estate market are more stable than other hard hit areas of inland California. Both commercial and residential vacancy rates have increased during 2008, 2009, and into 2010, and remain significantly below the U.S. average and show little sign of overbuilding, and population growth has been relatively steady and is generally not subject to the volatility experienced in more exurban areas. However, single family home permits in the Fresno area, which declined between 30% and 35% during both 2008 and 2009, have continued to decline in 2010 and foreclosure and negative equity rates for residential mortgages remain among the top 20 metro areas in the U.S. Employment and income growth in the Fresno area remains very slow, and the unemployment in Fresno County has risen from a little over 8% in 2007 to almost 10% in 2008, and almost 15% in 2009, and increased slightly above that in 2010. A high concentration of middle-class jobs in the Fresno area are dependent on state and local governments which are under pressure due to tax and fee revenue in the near term. The next several years will likely remain very challenging for Fresno real estate, but the fundamentals suggest a strong recovery in commercial and residential development in the medium and long-term.

Kern County varies slightly from Fresno County. Kern has performed slightly better in employment and income growth than Fresno, but its real estate markets show greater signs of oversupply and stress from the foreclosure crisis over the past three years. Commercial and residential vacancy rates have risen sharply in the Bakersfield area, and its foreclosure and negative equity rates are consistently in the top 10 in the U.S. Business and residential vacancy rates during the second quarter of 2010 (at approximately 4.2%) are now above the US average after being substantially below average two years ago. The rate of population growth has fallen significantly from near 3% per year to between 1% and 1.5%, but remains above the state average. During 2010, the value of commercial building permits has fallen faster than any other area of California, and single family homes also decline. Due to higher inventories and exposure to foreclosures, it is anticipated that Kern County real estate will be slower to recover than Fresno. On the positive side, the Bakersfield area continues to lead all inland California areas in job growth, and is enjoying the favorable economic climate for its oil industry which complements the agriculture industry in this area.

Compared to most areas in California and the West, Santa Clara County has experienced a steep “V” shaped recession. Santa Clara County has not been as heavily impacted by foreclosures and declines in construction, but experienced a sharp decline in 2009 and has rebounded well in 2010. Santa Clara County is one of the few areas with consistent job and income growth in 2010 based on the strength of its high-tech manufacturing sector that has benefited from increasing business investment. It is one of the few areas where unemployment rates are lower in 2010 than in 2009. Real estate prices have followed a similar pattern, posting some of the highest gains in the U.S. in 2010 after big declines in 2008 and 2009. Foreclosure rates and negative equity rates are comparable to the rest of the U.S., but significantly lower than other areas in the West. Above average job and income growth and very low vacancy rates in both the commercial and residential market mean that Santa Clara County should fare relatively well in a troubled regional real estate market.

As a result of the economic downturn over the past three years, particularly in real estate market, the Company has experienced declines in the loan portfolio. The greatest decreases have been experienced in real estate construction and development loans and commercial and industrial loans, as the Company has reduced its exposure to real estate markets which have been hard hit over the past three years. Loans decreased \$66.9 million between December 31, 2009 and December 31, 2010, and decreased \$36.0 million between December 31, 2008 and December 31, 2009. During these periods, real estate construction and development loans decreased \$40.0 million between December 31, 2009 and December 31, 2010, decreased \$45.9 million between December 31, 2008 and December 31, 2009, as real estate construction has declined significantly in the San Joaquin Valley and California overall. The Company has not made any material additions to the real estate construction and development loan portfolio over the past several years as a result of the depressed real estate markets, and has focused its attention on monitoring existing construction loans in the portfolio. Real estate construction and development loans amounted to 14.8%, 20.7%, and 27.7% of the total loan portfolio at December 31, 2010, 2009, and 2008. Additionally, commercial real estate loans (a component of real estate mortgage loans) amounted to 29.8%, 23.0%, and 15.8%, of the total loan portfolio at December 31, 2010, 2009, 2008, respectively. Residential mortgage loans are not generally a large part of the Company’s loan portfolio, but some residential mortgage loans have been made over the past several years to facilitate take-out loans for construction borrowers when they were not able to obtain permanent financing elsewhere. These loans are generally 30-year amortizing loans with maturities of between three and five years. In addition, the Company purchased two real estate mortgage pools in the past which totaled \$18.4 million, and \$21.0 million at December 31, 2009 and 2008, respectively. These real estate mortgage pools were subsequently sold during the second quarter of 2010. Residential mortgages totaled \$23.7 million or 5.4% of the portfolio at December 31, 2010, 45.8 million or 9.0% of the portfolio at December 31, 2009, and \$41.6 million or 7.7% of the portfolio at December 31, 2008. Loan participations, both sold and purchased, have declined over the past three years as lending originations have slowed significantly and the loan participation market with it. As a result, loan participations purchased have declined from \$36.0 million or 6.6% of the portfolio at December 31, 2008, to \$23.8 million or 4.7% of the portfolio at December 31, 2009, to \$17.0 million or 3.9% of the portfolio at December 31, 2010. In addition, loan participations sold have declined from \$29.4 million or 5.4% of the portfolio at December 31, 2008, to \$15.6 million or 3.1% of the portfolio at December 31,

2009, to \$8.9 million or 2.0% of the portfolio at December 31, 2010.

With market rates of interest remaining at historically low levels for more than a year, the Company continues to experience compressed net interest margins, although margins have increased during the year ended December 31, 2010. The Company's net interest margin was 4.58% for the year ended December 31, 2010, as compared to 4.49% for the year ended December 31, 2009, and 4.36% for the year ended December 31, 2008. With approximately 59% of the loan portfolio in floating rate instruments at December 31, 2010, the effects of low market rates continue to impact loan yields. The Company has successfully sought to mitigate the low-interest rate environment with loan floors included in new and renewed loans over the past year. Loans yielded 6.02% during the year ended December 31, 2010, as compared to 5.83% and 6.81% for the years ended December 31, 2009 and 2008, respectively. The Company's cost of funds has continued to decline over the past year and is largely responsible for the increase in net interest margin experienced during the year ended December 31, 2010. The Company's average cost of funds was 0.93% for the year ended December 31, 2010 as compared to 1.43% and 2.75% for the years ended December 31, 2009 and 2008, respectively. Wholesale borrowing and brokered deposit rates have remained low since late 2008, resulting in overnight and short-term borrowing rates of less than 0.50% during much of the past year. The Company has benefited from the low interest rate environment, and continues to utilize short-term borrowing lines through the Federal Home Loan Bank. Although the Company does not intend to increase its current level of brokered deposits, and in fact as a result of the recent Agreement with the Federal Reserve Bank and Order with the California Department of Financial Institutions, will systematically reduce brokered deposit levels as they mature in the future, the \$81.5 million in brokered deposits at December 31, 2010 continues to provide the Company with a low-cost source of deposits. The Company will continue to utilize these funding sources when possible to maintain prudent liquidity levels, while seeking to increase core deposits when possible.

Total noninterest income of \$5.9 million reported for the year ended December 31, 2010 decreased \$366,000 or 5.8% as compared to the year ended December 31, 2009. Noninterest income continues to be driven by customer service fees, which totaled \$3.8 million for the year ended December 31, 2010, representing a decrease of \$70,000 or 1.8% over the \$3.9 million in customer service fees reported for the year ended December 31, 2009, and a decrease of \$884,000 or 18.1% over the \$4.7 million reported for the year ended December 31, 2008. The decline in customer service fees between 2008 and 2009 are primarily the result of decreases in ATM fees between the two periods resulting from the loss of a contract during 2008 to provide multiple ATM's in a single location. Customer service fees represented 64.2%, 61.6%, and 55.8% of total noninterest income for the years ended December 31, 2010, 2009, and 2008, respectively. Other components of noninterest income have become more volatile during the past several years as many have been nonrecurring or non-sustainable, including gains or losses on other real estate owned through foreclosure or other asset disposals as the Company works to reduce problem assets. Other components of noninterest income recognized during the year ended December 31, 2010 included gains of \$509,000 on the sale of \$17.1 million in two purchased real estate mortgage portfolios, fair value gains of \$316,000 on the Company's junior subordinated debt, as well as \$174,000 from insurance proceeds on an insurance policy held as collateral on a previously charged-off loan.

Noninterest expense increased approximately \$1.1 million or 3.8% between the years ended December 31, 2009 and December 31, 2010, and increased \$5.7 million or 24.3% between the years ended December 31, 2008 and December 31, 2009. Increases experienced during the year ended December 31, 2010 were primarily the result of both increases in OREO impairment charges, as well as increased FDIC insurance assessments costs. Decreases in noninterest expense experienced during the year ended December 31, 2010 included decreases of \$1.6 million in impairment losses on goodwill, with impairment losses of \$1.4 million recognized during 2010 as compared to \$3.0 million recognized during 2009.

Effective September 30, 2009 and beginning with the quarterly interest payment due October 1, 2009, the Company deferred interest payments on the Company's \$15.0 million of junior subordinated debentures relating to its trust preferred securities. This was the result of regulatory restraints which have precluded the Bank from paying dividends to the Holding Company. The Agreement with the Federal Reserve Bank entered into during March 2010 specifically prohibits the Company and the Bank from making any payments on the junior subordinated debt without prior approval of the Federal Reserve Bank. The terms of the debentures and trust indentures allow for the Company to defer interest payments for up to 20 consecutive quarters without default or penalty. During the period that the interest deferrals are elected, the Company will continue to record interest expense associated with the debentures. Upon the expiration of the deferral period, all accrued and unpaid interest will be due and payable. Under the terms of the debenture, the Company is precluded from paying cash dividends to shareholders or repurchasing its stock during the deferral period.

The Company has not paid any cash dividends on its common stock since the second quarter of 2008 and does not expect to resume cash dividends on its common stock for the foreseeable future. Because the Company has elected to defer the quarterly payments of interest on its junior subordinated debentures issued in connection with the trust preferred securities as discussed above, the Company is prohibited under the subordinated debenture agreement from paying cash dividends on its common stock during the deferral period. In addition, pursuant to the Agreement entered into with the Federal Reserve Bank during March of 2010, the Company and the Bank are precluded from paying cash dividends without prior consent of the Federal Reserve Bank. On March 23, 2010, June 22, 2010, September 28, 2010, and December 21, 2010, the Company's Board of Directors declared a one-percent (1%) quarterly stock dividend on the Company's outstanding common stock. The Company believes, given the current uncertainties in the economy and unprecedented declines in real estate valuations in our markets, it is prudent to retain capital in this environment, and better position the Company for future growth opportunities. Based upon the number of outstanding common shares on the record date of April 9, 2010, July 9, 2010, October 8, 2010, and January 7, 2011, respectively, an additional 124,965, 126,214, 127,476, and 128,751 shares, respectively, were issued to shareholders. For purposes

of earnings per share calculations, the Company's weighted average shares outstanding and potentially dilutive shares used in the computation of earnings per share have been restated after giving retroactive effect to the 1% stock dividends to shareholders for all periods presented.

The Company has sought to maintain a strong, yet conservative balance sheet while continuing to reduce the level of nonperforming assets and improve liquidity during the year ended December 31, 2010. Total assets decreased approximately \$15.0 million during the year ended December 31, 2010, with a decrease of \$66.9 million in loans, a decrease of \$19.9 million in investment securities, and \$1.4 million in goodwill. Offsetting these decreases was an increase of \$69.2 million in cash and cash equivalents. During the second quarter of 2010, the Company completed the sale of two purchased real estate mortgage loan portfolios totaling \$17.1 million, recognizing a gain of \$509,000 on the transaction. The sale of the mortgage loan portfolios has provided additional liquidity and was part of the reason for the decrease in loans during the year ended December 31, 2010. Decreases of \$8.0 million in FHLB term borrowings between December 31, 2009 and December 31, 2010 were compounded by decreases of \$4.2 million in net deposits. Increases of \$22.2 million in NOW and money market accounts during the year ended December 31, 2010 were more than offset by decreases of \$29.5 million in time deposits as the Company continued its efforts to reduce the level of brokered time deposits during 2010. Average loans comprised approximately 80% of overall average earning assets during the year ended December 31, 2010, as compared to 87% and 89% of average earning assets for the years ended December 2009 and 2008, respectively.

Nonperforming assets, which are primarily related to the real estate loan and property portfolio, remained high during the year ended December 31, 2010 as real estate markets continue to suffer from the mortgage crisis which began during mid-2007. Nonaccrual loans totaling \$34.4 million at December 31, 2010, decreased \$363,000 from the balance reported at December 31, 2009, and decreased \$11.3 million from the balance reported at December 31, 2008. In determining the adequacy of the underlying collateral related to these loans, management monitors trends within specific geographical areas, loan-to-value ratios, appraisals, and other credit issues related to the specific loans. Valuations on these loans and the underlying collateral continued to deteriorate during much of 2009 and 2010, resulting in increased charge-offs and levels of impaired loans. Impaired loans decreased \$2.8 million during the year ended December 31, 2010 to a balance of \$51.0 million at December 31, 2010, but increased \$2.1 million from the balance of \$48.9 million reported at December 31, 2008. Other real estate owned through foreclosure decreased \$637,000 between December 31, 2009 and December 31, 2010, but increased \$5.4 million from the balance of \$30.2 million reported at December 31, 2008. During the year ended December 31, 2010, write-downs on, and sales of, other real estate owned through foreclosure more than offset the \$14.2 million in loans transferred to other real estate owned during the year. As a result of these events, nonperforming assets as a percentage of total assets decreased from 12.56% at December 31, 2009 to 12.17% at December 31, 2010.

The following table summarizes various nonperforming components of the loan portfolio, the related allowance for loan and lease losses and provision for credit losses for the periods shown.

(in thousands)	December 31, 2010	December 31, 2009	December 31, 2008
Provision for credit losses during period	\$12,475	\$13,375	\$9,526
Allowance as % of nonperforming loans	35.19%	29.57%	25.24%
Nonperforming loans as % total loans	10.63%	9.99%	8.39%
Restructured loans as % total loans	5.65%	5.13%	--

As the economy has declined along with asset valuations, increased emphasis has been placed on impairment analysis of both tangible and intangible assets on the balance sheet. As of March 31, 2010, the Company conducted annual impairment testing on the largest component of its outstanding balance of goodwill, that of the Campbell operating unit (resulting from the Legacy merger during February 2007.) In part, as a result of continued declines in interest rates and other economic factors within the industry, we could not conclude at March 31, 2010 that there was not a possibility of goodwill impairment under the current economic conditions. During the second quarter of 2010, the

Company utilized an independent valuation service to determine the aggregate fair value of the individual assets, liabilities, and identifiable intangible assets of the Campbell operating unit in question to determine if the goodwill related to that operating unit was impaired, and if so, how much the impairment was. Management, with the assistance of the independent third-party, concluded that there was impairment of the goodwill related to the Campbell operating unit, and as a result the Company recognized an impairment loss of \$1.4 million or \$0.11 per share (pre-tax and after-tax) for the quarter ended June 30, 2010 and the year ended December 31, 2010. The Company recognized an impairment loss of \$3.0 million or \$0.25 per share (pre-tax and after-tax) for the quarter ended June 30, 2009 and the year ended December 31, 2009.

Management continues to monitor economic conditions in the real estate market for signs of further deterioration or improvement which may impact the level of the allowance for loan losses required to cover identified losses in the loan portfolio. As the real estate market declined through 2008, and that accelerated throughout much of 2009, the level of problem assets increased, and the estimated real estate values on many of those assets decreased resulting in increased charge-offs or write-downs of those assets. Greater focus has been placed on monitoring and reducing the level of problem assets, while working with borrowers to find more options, including loan restructures, to work through these difficult economic times. As a result of these efforts, restructured loans increased from a single loan totaling \$378,000 at December 31, 2008 to approximately 52 loans totaling \$26.1 million at December 31, 2009 and then decreasing to 48 loans totaling \$24.9 million at December 31, 2010. Provisions made to the allowance for credit losses, totaled \$12.5 million during the year ended December 31, 2010 as compared to \$13.4 million for the year ended December 31, 2009, and \$9.5 million for the year ended December 31, 2008. The provisions made to the allowance for credit losses, totaling \$1.6 million during the first quarter of 2010, \$519,000 during the second quarter of 2010, \$1.2 million made during the third quarter of 2010, and \$9.1 million made during the fourth quarter of 2010, provided a level in the allowance for credit losses that is deemed adequate to cover inherent losses in the loan portfolio. Net loan and lease charge-offs during the year ended December 31, 2010 totaled \$11.1 million, as compared to \$9.9 million and \$5.7 million for the years ended December 31, 2009 and 2008, respectively. The Company charged-off approximately 74 loans during the year ended December 31, 2010, compared to 70 loans during the year ended December 31, 2009, and 50 loans during year ended December 31, 2008. Loan and lease charge-offs totaling \$11.1 million during the year ended December 31, 2010 included \$43,000 during the quarter ended March 31, 2010, \$4.7 million during the quarter ended June 30, 2010, \$307,000 during the quarter ended September 30, 2010, and an additional \$5.6 million during the fourth quarter of 2010. The percentage charge-offs to average loans were 2.2%, 1.9%, and 0.9% for the years ended December 31, 2010, 2009, and 2008, respectively.

Deposits decreased by \$4.2 million during the year ended December 31, 2010, with increases experienced in NOW, money market, and savings accounts, which were more than offset by decreases of \$29.5 million in time deposits during 2010. Decreases in time deposits experienced during the year ended December 31, 2010 were primarily the result of decreases in brokered wholesale deposits, as the Company continues to reduce its reliance on brokered deposits and other wholesale funding sources, while enhancing liquidity.

Brokered deposits have provided the Company a relatively inexpensive funding source over the past several years totaling \$81.5 million or 14.6% of total deposits at December 31, 2010, as compared to \$129.4 million or 23.0% of total deposits at December 31, 2009, and \$93.4 million or 18.4% of total deposits at December 31, 2008. Brokered deposits and other wholesale funding sources were used to some degree to fund loan growth in 2007 and 2008, but the current state of the economy and the financial condition of the Company have made it increasingly important to continue to develop core deposits and reduce the Company's dependence on brokered and other wholesale funding sources, including lines of credit with the Federal Reserve Bank and the FHLB. The Company increased its efforts early in 2009 to develop core deposit growth with employee training throughout the entire organization and a deposit-gathering program that incited employees to bring in new deposits from our local market area and establish more extensive relationships with our customers. The Company continues its deposit gathering program and committed additional resources to its efforts during 2010 including two full time employees dedicated to business development. As part of its liquidity position improvement plan resulting from the formal agreement with the Federal Reserve Bank issued in March 2010, the Company will reduce its reliance on brokered deposits over the next two years to levels more comparable with peers, which is currently about 5% of total deposits. The Company will seek to replace maturing brokered deposits with core deposits, but may also control loan growth to help achieve that objective.

While the Company still has a higher percentage of brokered deposits than peers at December 31, 2010, efforts to restructure the balance sheet through reducing the level of total assets, and specifically real estate loans, are proving successful. Total wholesale borrowings and brokered deposits decreased from \$248.4 million at December 31, 2008 to

\$169.4 million at December 31, 2009, representing a decrease of \$79.1 million during 2009, and the Company went from being a net purchaser of overnight funds at December 31, 2008, with \$66.5 million in federal funds purchased, to a net seller of overnight funds with \$11.6 million in federal funds sold at December 31, 2009. Total wholesale borrowings and brokered deposits decreased an additional \$55.8 million during the year ended December 31, 2010 to a balance of \$113.5 million at December 31, 2010.

Although balances have declined during 2010, the Company will continue to utilize overnight borrowings and other term credit lines as deemed prudent, with borrowings totaling \$32.0 million at December 31, 2010 as compared to \$40.0 million at December 31, 2009. The average rate of those term borrowings was 0.35% at December 31, 2010, as compared to 0.86% at December 31, 2009. Although the Company continues to realize significant interest expense reductions by utilizing overnight and term borrowings lines, the use of such lines are monitored closely to ensure sound balance sheet management in light of the current economic and credit environment.

The cost of the Company's subordinated debentures issued by USB Capital Trust II has remained low as market rates have actually declined during most of 2009. With pricing at 3-month-LIBOR plus 129 basis points, the effective cost of the subordinated debt was 1.59% and 1.54% at December 31, 2010 and December 31, 2009, respectively. Pursuant to fair value accounting guidance, the Company has recorded \$316,000 in pretax fair value gains on its junior subordinated debt during the year ended December 31, 2010, bringing the total cumulative gain recorded on the debt to \$5.2 million at December 31, 2010.

The Company continues to emphasize relationship banking and core deposit growth, and has focused greater attention on its market area of Fresno, Madera, and Kern Counties, as well as Campbell, in Santa Clara County. The San Joaquin Valley and other California markets continue to exhibit weak demand for construction lending and commercial lending from small and medium size businesses, as commercial and residential real estate markets declined during much of 2008, and 2009, and have continued to do so in 2010. Although we saw some improvement during 2010, the past year has presented significant challenges for the banking industry with tightening credit markets, weakening real estate markets, and increased loan losses adversely affecting the Banking industry and the Company.

The Company continually evaluates its strategic business plan as economic and market factors change in its market area. Balance sheet management, enhancing revenue sources, and maintaining market share will be of primary importance during 2010 and beyond. The banking industry is currently experiencing continued pressure on net margins as well as asset quality resulting from conditions in the real estate market, and weak credit markets. During March 2010, the Company and the Bank entered into a regulatory agreement with the Federal Reserve Bank which, among other things, requires improvements in the overall condition of the Company and the Bank. As a result, market rates of interest, asset quality, as well as regulatory oversight will continue to be an important factor in the Company's ongoing strategic planning process.

Application of Critical Accounting Policies and Estimates

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

The most significant accounting policies followed by the Company are presented in Note 1 to the Company's consolidated financial statements included herein. These policies, along with the disclosures presented in the other financial statement notes and in this financial review, provide information on how significant assets and liabilities are valued in the financial statements and how those values are determined. Based on the valuation techniques used and the sensitivity of financial statement amounts to the methods, assumptions, and estimates underlying those amounts, management has identified the determination of the allowance for credit losses, other real estate owned through foreclosure, impairment of collateralized mortgage obligations and other investment securities, and fair value estimates on junior subordinated debt, valuation for deferred income taxes, and goodwill, to be accounting areas that require the most subjective or complex judgments, and as such could be most subject to revision as new information becomes available.

Allowance for Credit Losses

The allowance for credit losses represents management's estimate of probable credit losses inherent in the loan portfolio. Determining the amount of the allowance for credit losses is considered a critical accounting estimate because it requires significant judgment and the use of estimates related to the amount and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, and consideration of current economic trends and conditions, all of which may be susceptible to significant change. The loan portfolio also represents the largest asset type on the consolidated balance sheet. Note 1 to the consolidated financial statements describes the methodology used to determine the allowance for credit losses and a discussion of the factors driving changes in the amount of the allowance for credit losses is included in the Asset Quality and Allowance for Credit Losses section of this financial review.

Other Real Estate Owned

Real estate properties acquired through, or in lieu of, loan foreclosure are to be sold and are initially recorded at fair value of the property, less estimated costs to sell. The excess, if any, of the loan amount over the fair value of the collateral is charged to the allowance for credit losses. The determination of fair value is generally based upon pre-approved, external appraisals. As real estate markets declined over the past three years and essentially became illiquid in many areas, Management was required to use additional judgment in determining the factors associated with fair value of the real estate, including the term over which the properties could be disposed in an orderly liquidation. This became necessary as many appraisals were based upon comparable sales which were deeply discounted forced liquidations or bulk sales caused by the severity of the housing crises. Subsequent declines in the fair value of other real estate owned, along with related revenue and expenses from operations, are charged to noninterest expense. The fair market valuation of such properties is based upon estimates, and as such, is subject to change as circumstances in the Company's market area, or general economic trends, change.

Impairment of Investment Securities

Investment securities classified as available for sale ("AFS") are carried at fair value and the impact of changes in fair value are recorded on the Company's consolidated balance sheet as an unrealized gain or loss in "Accumulated other comprehensive income (loss)," a separate component of shareholders' equity. Securities classified as AFS or held to maturity ("HTM") are subject to review to identify when a decline in value is other than temporary. In April 2009, the FASB updated the accounting standards for the recognition and presentation of other-than-temporary impairments. The standard amends existing guidance on other-than-temporary impairments for debt securities and requires that the credit portion of other-than-temporary impairments be recorded in earnings and the noncredit portion of losses be recorded in other comprehensive income (loss) when the entity does not intend to sell the security and it is more likely than not that the entity will not be required to sell the security prior to recovery of its cost basis. The Company adopted the standard during the first quarter of 2009. Factors considered in determining whether a decline in value is other than temporary include: whether the decline is substantial; the duration of the decline; the reasons for the decline in value; whether the decline is related to a credit event or to a change in interest rate; our ability and intent to hold the investment for a period of time that will allow for a recovery of value; and the financial condition and near-term prospects of the issuer.

At December 31, 2010, the Company considered three of its investment securities other than temporarily impaired. The three private-label collateralized mortgage obligations (residential mortgage obligations) have an amortized cost of \$12.0 million and carrying value of \$10.0 million. Impairment analysis on these three residential mortgage obligations was performed utilizing the services of a third-party investment broker specializing in private-label CMO's, and was based upon estimated cash flows. Estimated cash flows were based upon assumptions of future prepayments and default rates, and thus may be subject to revision as events change in the future. For the year ended December 31, 2010, the Company recognized pre-tax losses totaling \$1.3 million related to the credit portion of the other-than-temporary impairment in earnings. The remaining \$2.0 million impairment on the three residential mortgage obligations is recorded as a component of other comprehensive income at December 31, 2010.

Fair Value

Effective January 1, 2007, the Company adopted fair value option accounting standards choosing to apply the standards to its junior subordinated debt. The Company concurrently adopted the accounting standards related to fair value measurements. The accounting standards related to fair value measurements defines how applicable assets and liabilities are to be valued, and requires expanded disclosures about financial instruments carried at fair value. The fair value measurement accounting standard establishes a hierarchical disclosure framework associated with the level of pricing observability utilized in measuring financial instruments at fair value. The degree of judgment utilized in

measuring the fair value of financial instruments generally correlates to the level of pricing observability. Financial instruments with readily available active quoted prices or for which fair value can be measured from actively quoted prices generally will have a higher degree of pricing observability and a lesser degree of judgment utilized in measuring fair value. Conversely, financial instruments infrequently traded or not quoted in an active market will generally have little or no pricing observability and a higher degree of judgment utilized in measuring fair value. Pricing observability is impacted by a number of factors, including the type of financial instrument, whether the financial instrument is new to the market and not yet established and the characteristics specific to the transaction. Determining fair values under the accounting standards may include judgments related to measurement factors that may vary from actual transactions executed in the marketplace. For the years ended December 31, 2010 and December 31, 2009, the Company recorded fair value gains related to its junior subordinated debt totaling \$316,000 and \$1.1 million, respectively. (See Notes 8 and 13 of the Notes to Consolidated Financial Statements for additional information about financial instruments carried at fair value.)

Goodwill

Business combinations involving the Company's acquisition of the equity interests or net assets of another enterprise or the assumption of net liabilities in an acquisition of branches constituting a business may give rise to goodwill. The acquisition of Taft National Bank during April 2004 gave rise to goodwill totaling approximately \$1.6 million, and the acquisition of Legacy Bank during February 2007 resulted in goodwill of approximately \$8.8 million. Goodwill represents the excess of the cost of an acquired entity over the net of the amounts assigned to assets acquired and liabilities assumed in transactions accounted for under the purchase method of accounting. The value of goodwill is ultimately derived from the Company's ability to generate net earnings after the acquisition. A decline in net earnings could be indicative of a decline in the fair value of goodwill and result in impairment. For that reason, goodwill is assessed for impairment at a reporting unit level at least annually using an internal discounted cash flow model. During the years ended December 31, 2010 and 2009, the Company recognized goodwill impairment of \$1.4 million, and 3.0 million, respectively, on the goodwill associated with the 2007 Legacy acquisition. While the Company believes all assumptions utilized in its assessment of goodwill for impairment are reasonable and appropriate, changes in earnings, the effective tax rate, historical earnings multiples and the cost of capital could all cause different results for the calculation of the present value of future cash flows.

Income Taxes

Deferred income taxes are provided for the temporary differences between the financial reporting basis and the tax basis of the Company's assets and liabilities. Deferred taxes are measured using current tax rates applied to such taxable income in the years in which those temporary differences are expected to be recovered. If the Company's future income is not sufficient to apply the deferred tax assets within the tax years to which they may be applied, the deferred tax asset may not be realized and the Company's income will be reduced.

On January 1, 2007, the Company adopted the accounting standards related to uncertainty in income taxes. The standard prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Under the accounting standards, an entity should recognize the financial statement benefit of a tax position if it determines that it is more likely than not that the position will be sustained on examination. The term "more likely than not" means a likelihood of more than 50 percent." In assessing whether the more-likely-than-not criterion is met, the entity should assume that the tax position will be reviewed by the applicable taxing authority.

The Company reviewed its various tax positions, including its ongoing REIT case with the California Franchise Tax Board (FTB), as of January 1, 2007 (adoption date), and then again each subsequent quarter during 2007 in light of the adoption of the accounting standards related to uncertainty in income taxes. The Bank, with guidance from advisors believes the case related to consent dividends taken by the Bank's REIT during 2002 has merit with regard to points of law, and that the tax law at the time allowed for the deduction of the consent dividend. However, the Bank, with the concurrence of advisors, cannot conclude that it is "more than likely" (as defined) that the Bank will prevail in its case with the FTB. As a result of this determination, effective January 1, 2007, the Company recorded a reduction of \$1,298,470 to beginning retained earnings upon adoption of the accounting standards related to uncertainty in income taxes to recognize the potential tax liability under the guidelines of the interpretation. The adjustment includes amounts for assessed taxes, penalties, and interest. During the years ended December 31, 2010, 2009 and 2008, the Company increased the unrecognized tax liability by an additional \$87,092, \$87,092 and \$87,421, respectively, in interest for the period, bringing the total recorded tax liability to \$1,669,000, \$1,582,000 and \$1,473,000 at December 31, 2010, December 31, 2009 and December 31, 2008, respectively. It is the Company's policy to recognize interest and penalties under FIN48 as a component of income tax expense.

Pursuant to the accounting standards related to uncertainty in income taxes, the Company will continue to re-evaluate existing tax positions, as well as new positions as they arise. If the Company determines in the future that its tax positions are not “more likely than not” to be sustained (as defined) by taxing authorities, the Company may need to recognize additional tax liabilities.

Revenue recognition

The Company’s primary sources of revenue are interest income from loans and investment securities. Interest income is generally recorded on an accrual basis, unless the collection of such income is not reasonably assured or cannot be reasonably estimated. Pursuant to accounting standards related to revenue recognition, nonrefundable fees and costs associated with originating or acquiring loans are recognized as a yield adjustment to the related loans by amortizing them into income over the term of the loan using a method which approximates the interest method. Other credit-related fees, such as standby letter of credit fees, loan placement fees and annual credit card fees are recognized as noninterest income during the period the related service is performed.

For loans placed on nonaccrual status, the accrued and unpaid interest receivable may be reversed at management's discretion based upon management's assessment of collectibility, and interest is thereafter credited to principal to the extent necessary to eliminate doubt as to the collectibility of the net carrying amount of the loan.

Results of Operations

For the year ended December 31, 2010, the Company reported a net loss of \$4.4 million or \$0.34 per share (\$0.34 diluted) compared to a net loss of \$4.5 million or \$0.35 per share (\$0.35 diluted) for the year ended December 31, 2009, and net income of \$4.1 million or \$0.32 per share (\$0.32 diluted) for the year ended December 31, 2008. Net losses decreased \$98,000 between December 31, 2009 and December 31, 2010 as the result of decreases provisions for credit losses taken during the year, which were partially offset by increases in other OREO impairment losses and FDIC insurance expenses. Net income decreased \$8.6 million between December 31, 2008 and December 31, 2009 as the result of increased provisions for credit losses taken during the year, combined with declines in the volume of, and yields on earning assets, as well as increases in other impairment losses and OREO-related expenses.

The Company's return on average assets was (0.63%) for the year ended December 31, 2010 as compared to (0.62%) and 0.52 % for the same twelve-month periods of 2009 and 2008, respectively. The Company's return on average equity was (5.69%) for the year ended December 31, 2010 as compared to (5.77%) and 4.93 % for the same twelve-month periods of 2009 and 2008, respectively. As with variances in net income, changes in the return on average assets and average equity experienced by the Company during 2010 and 2009 were primarily the result of fluctuations in loan loss provisions taken during the past three years, as well as changes in impairment losses and OREO-related expenses.

Net Interest Income

Net interest income, the most significant component of earnings, is the difference between the interest and fees received on earning assets and the interest paid on interest-bearing liabilities. Earning assets consist primarily of loans, and to a lesser extent, investments in securities issued by federal, state and local authorities, and corporations, as well as interest-bearing deposits and overnight funds with other financial institutions. These earning assets are funded by a combination of interest-bearing and noninterest-bearing liabilities, primarily customer deposits and short-term and long-term borrowings.

Net interest income before provision for credit losses totaled \$27.9 million for the year ended December 31, 2010 as compared to \$28.3 million for the year ended December 31, 2009, and \$30.2 million for the year ended December 31, 2008. This represents a decrease of \$448,000 or 1.6 % between the years ended December 31, 2009 and 2010, as compared to a decrease of \$1.9 million or 6.2% between 2008 and 2009. The decrease in net interest income between 2009 and 2010, as well as between 2008 and 2009, is primarily the result of decreased volumes of, and yields earned, on interest-earning assets, which more than offset the decreased yields on interest-bearing liabilities. Significant declines in the Company's cost of funds helped to mitigate declines in net interest income and actually enhanced the net margin between the three annual periods.

Table 1. – Distribution of Average Assets, Liabilities and Shareholders' Equity:
Interest rates and interest differentials
Years Ended December 31, 2010, 2009, and 2008

(Dollars in thousands)	Average Balance	2010 Interest	Yield/ Rate	Average Balance	2009 Interest	Yield/ Rate	Average Balance	2008 Interest	Yield/ Rate
Assets:									
Interest-earning assets:									
Loans (1)	\$490,421	\$29,502	6.02%	\$534,830	\$31,197	5.83%	\$582,500	\$39,669	6.81%
Investment Securities – taxable	60,696	2,794	4.60%	82,865	4,298	5.19%	98,330	5,170	5.26%
	1,246	58	4.65%	1,252	58	4.63%	1,452	68	4.68%

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Investment Securities – nontaxable									
(2)									
Interest on deposits in other banks	2,457	41	1.67%	5,905	117	1.90%	9,680	222	2.29
Interest on deposits in FRB	25,519	59	0.23%	3,227	3	0.09%	0	0	0.00
Federal funds sold and reverse repos	29,506	36	0.12%	3,708	3	0.08%	549	18	3.28
Total interest-earning assets	609,845	\$32,490	5.33%	631,787	\$35,676	5.65%	692,511	\$45,147	6.52
Allowance for credit losses	(13,825)			(12,639)			(8,729)		
Noninterest-bearing assets:									
Cash and due from banks	16,815			15,301			20,785		
Premises and equipment, net	12,950			13,731			14,981		
Accrued interest receivable	2,105			2,405			2,779		
Other real estate owned	37,089			34,345			9,434		
Other assets	42,708			49,153			46,122		
Total average assets	\$707,687			\$734,083			\$777,883		
Liabilities and Shareholders' Equity:									
Interest-bearing liabilities:									
NOW accounts	\$62,779	\$128	0.20%	\$45,189	\$176	0.39%	\$42,988	\$223	0.52
Money market accounts	115,752	1,434	1.24%	116,522	2,214	1.90%	124,202	2,963	2.39
Savings accounts	35,336	139	0.39%	35,228	219	0.62%	40,699	482	1.18
Time deposits	231,876	2,516	1.09%	205,261	3,583	1.75%	230,746	8,420	3.65
Other borrowings	35,181	124	0.35%	99,877	804	0.80%	91,368	2,116	2.32
Trust Preferred securities	10,172	248	2.44%	11,692	331	2.83%	12,710	734	5.77
Total interest-bearing liabilities	491,096	\$4,589	0.93%	513,769	\$7,327	1.43%	542,713	\$14,938	2.75
Noninterest-bearing liabilities:									
Noninterest-bearing	133,458			134,925			144,772		
Accrued interest payable	318			623			1,131		
Other liabilities	4,556			6,147			6,782		
Total average liabilities	629,428			655,464			695,398		
Total average shareholders' equity	78,259			78,619			82,485		
Total average liabilities and Shareholders' equity	\$707,687			\$734,083			\$777,883		
Interest income as a percentage									
of average earning assets			5.33%			5.65%			6.52
Interest expense as a percentage									
of average earning assets			0.75%			1.17%			2.16
Net interest margin									
			4.58%			4.49%			4.36

(1) Loan amounts include nonaccrual loans, but the related interest income has been included only if collected for the period prior to the loan being placed on a nonaccrual basis. Loan interest income includes loan fees of approximately \$1,165,000, \$1,547,000, and \$3,074,000 for the years ended December 31, 2010, 2009, and 2008, respectively.

(2) Applicable nontaxable securities yields have not been calculated on a tax-equivalent basis because they are not material to the Company's results of operations.

The Bank's year-to-date net interest margin, as shown in Table 1, increased to 4.58% at December 31, 2010 from 4.49% at December 31, 2009, an increase of 9 basis points (100 basis points = 1%) between the two periods, and increased 22 basis points from the 4.36% net margin realized during the year ended December 31, 2008.

As a result of changes in market rates of interest, the prime rate averaged 3.25% for the years ended December 31, 2010 and 2009, as compared to 5.09% for the year ended December 31, 2008.

Both the Company's net interest income and net interest margin are affected by changes in the amount and mix of interest-earning assets and interest-bearing liabilities, referred to as "volume change." Both are also affected by changes in yields on interest-earning assets and rates paid on interest-bearing liabilities, referred to as "rate change." The following table sets forth the changes in interest income and interest expense for each major category of interest-earning asset and interest-bearing liability, and the amount of change attributable to volume and rate changes for the years indicated. Changes in interest income and expense, which are not attributable specifically to either rate or volume, are allocated proportionately between the two variances based on the absolute dollar amounts of the change in each.

Table 2. Rate and Volume Analysis

(In thousands)	2010 compared to 2009			2009 compared to 2008		
	Total	Rate	Volume	Total	Rate	Volume
Increase (decrease) in interest income:						
Loans	\$(1,695)	\$954	\$(2,649)	\$(8,472)	\$(5,395)	\$(3,077)
Investment securities	(1,504)	(445)	(1,059)	(882)	(70)	(812)
Interest-bearing deposits in other banks	(76)	(27)	(49)	(105)	(39)	(66)
Interest-bearing deposits in FRB	56	(21)	77	3	0	3
Federal funds sold and securities purchased under agreements to resell	33	2	31	(15)	(32)	17
Total interest income	(3,186)	463	(3,649)	(9,471)	(5,536)	(3,935)
Increase (decrease) in interest expense:						
Interest-bearing demand accounts	(828)	(1,056)	228	(796)	(695)	(101)
Savings accounts	(80)	(81)	1	(263)	(205)	(58)
Time deposits	(1,067)	(1,487)	420	(4,837)	(3,992)	(845)
Other borrowings	(680)	(316)	(364)	(1,312)	(1,493)	181
Trust Preferred securities	(83)	(43)	(40)	(403)	(348)	(55)
Total interest expense	(2,738)	(2,983)	245	(7,611)	(6,733)	(878)
Increase (decrease) in net interest income	\$(448)	\$3,446	\$(3,894)	\$(1,860)	\$1,197	\$(3,057)

Total interest income decreased approximately \$3.2 million, or 8.9% between the years ended December 31, 2009 and 2010, as the result of declines in the volume of averaging earning assets between the two periods. Earning asset volumes decreased in all earning-asset categories except federal funds sold and interest bearing deposits with the FRB between the two annual periods, with the largest decrease experienced in loans. On average, loans decreased by approximately \$44.4 million between 2009 and 2010 as the Company continued to focus on the work-out of problem assets. The Company continues to maintain a high percentage of loans in its earning asset mix with loans averaging 80.4% of total earning assets for the year ended December 31, 2010, as compared to 86.1% and 89.0% for the years ended December 31, 2009 and 2008, respectively.

Total interest expense decreased approximately \$2.7 million, or 37.8% between the years ended December 31, 2009 and 2010, and is attributable to significant declines in the average rates paid on interest-bearing liabilities. Between those two periods, average interest-bearing liabilities decreased by \$22.7 million, and the average rates paid on these liabilities decreased by 49 basis points. Average rates decreased in all interest-bearing liabilities except junior subordinated debentures, and lower-cost deposits including NOW accounts increased while higher-cost deposits including time deposits decreased on average between the two annual periods.

Total interest income decreased approximately \$9.5 million or 21.0% between the years ended December 31, 2008 and 2009, and was attributable to a decrease in yields on those earning assets, and to a lesser degree, earning asset volume. Earning asset decline was mostly in loans, with smaller declines in investments and interest-bearing deposits in other banks.

Total interest expense decreased approximately \$7.6 million between the years ended December 31, 2008 and 2009 as a result of significant decreases in rates paid on interest-bearing liabilities during 2009, combined with decreases in the volumes of those interest-bearing liabilities. Deposit rates continued to decline throughout much of 2009 as the Federal Reserve lengthened the anticipated duration of the low-interest rate cycle in its efforts to resolve the severe economic downturn. Between the years ended December 31, 2009 and December 31, 2008, rates paid on interest-bearing liabilities decreased in all categories, and on average decreased to almost half of what they had been during the year ended December 31, 2008. During 2009, the Company benefited as it utilized lower-cost funding sources including overnight and short-term borrowings, as well as brokered and other wholesale time deposits, which provided funding rates of less than 0.50% during a significant portion of the year.

Provision for Credit Losses

Provisions for credit losses and the amount added to the allowance for credit losses is determined on the basis of management's continuous credit review of the loan portfolio, consideration of past loan loss experience, current and future economic conditions, and other pertinent factors. Such factors consider the allowance for credit losses to be adequate when it covers estimated losses inherent in the loan portfolio. Based on the condition of the loan portfolio, management believes the allowance is sufficient to cover risk elements in the loan portfolio. For the year ended December 31, 2010 the provision to the allowance for credit losses amounted to \$12.5 million as compared to \$13.4 million and \$9.5 million for the years ended December 31, 2009 and 2008, respectively.

Provisions to the allowance for credit losses during 2010 included large provisions during the fourth quarters of the year as additional problem loans and further deterioration in existing problem loans were identified during the fourth quarter of 2010. The Company's review of adequacy of the allowance for loans losses during the fourth quarter included reassessments of the economic improvements seen during the first half of the year which appeared to slow or stall during the third and fourth quarters of 2010 due in part to the prolonged nature of the economic downturn. The Company has determined in working with its bank regulators that many of its loans required a more adverse classification and a greater provision for loan losses than had been taken in prior comparable periods.

During 2009, increases in the provision to the allowance for credit losses included large provisions during the second and fourth quarters of the year as prolonged weakness in the economy, and specifically the residential housing market, required the Company to become even more proactive in its assessment of problem loans. Provisions of \$4.8 million and \$6.8 million were made in the second and fourth quarters of 2009

Increases in the provision to the allowance for credit losses during 2008, including provisions of \$6.4 million and \$2.4 million in the third and fourth quarters of 2008, respectively, were the result of higher levels of nonperforming loans during the year, and general deterioration in the housing and credit markets which began during the later part of 2007, and continued throughout 2008.

The amount provided to the allowance for credit losses during 2010 brought the allowance to 3.75% of net outstanding loan balances at December 31, 2010, as compared to 2.96% of net outstanding loan balances at December 31, 2009, and 2.12% at December 31, 2008.

Noninterest Income

The following table summarizes significant components of noninterest income for the years indicated and the net changes between those years:

(In thousands)	Years Ended December 31,			Increase (decrease) during Year	
	2010	2009	2008	2010	2009
Customer service fees	\$3,812	\$3,882	\$4,656	\$(70)	\$(774)
Increase in cash surrender value of BOLI	554	544	639	10	(95)
Gain (loss) on disposition of securities	68	(37)	24	105	(61)
(Loss) gain on sale of OREO	(85)	(793)	67	708	(860)
Gain on sale of assets	0	863	0	(863)	863
Gain on sale of loans	509	0	0	509	0
Proceeds from life insurance	174	0	0	174	0
Gain (loss) on swap ineffectiveness	0	0	9	0	(9)
Gain on fair value option of financial liabilities	316	1,145	1,363	(829)	(218)
(Loss) gain on sale of fixed assets	(11)	22	(4)	(33)	26
Shared appreciation income	0	23	265	(23)	(242)
Other	602	656	1,324	(54)	(668)
Total	\$5,939	\$6,305	\$8,343	\$(366)	\$(2,038)

Noninterest income consists primarily of fees and commissions earned on services that are provided to the Company's banking customers and, to a lesser extent, gains on sales of Company assets and other miscellaneous income. Noninterest income for the year ended December 31, 2010 decreased \$366,000 or 5.8% when compared to the previous year, and decreased \$2.4 million or 28.8% when compared to the year ended December 31, 2008.

Customer service fees continue to provide a substantial part of noninterest income over the three years presented, representing 64.2%, 61.5%, and 55.8% of total noninterest income for the years ended December 31, 2010, 2009, and 2008, respectively. Customer service fees decreased \$70,000 between the years ended December 31, 2009 and December 31, 2010, and decreased \$774,000 between the years ended December 2008 and December 31, 2009. Much of the decrease in customer service fees between 2008 and 2009 is attributable to decreases in ATM fee income.

During the year ended December 31, 2010, the Company realized gains on the sale of loans totaling \$509,000 as the result of the sale of two \$17.1 million purchase real estate mortgage portfolios, as well as \$174,000 from insurance proceeds on an insurance policy held as collateral on a previously charged-off loan. Additionally, the Company also saw reductions of \$708,000 in losses on the disposition of OREO properties during the year ended December 31, 2010 as compared to the previous year.

Decreases in noninterest income were experienced primarily in two categories during 2010. Fair value gains on the Company's junior subordinated debt totaled \$316,000 for the year ended December 31, 2010, representing a decrease of \$829,000 from the gains recognized during 2009. In addition, during the year ended December 31, 2009, the Company recognized gains of \$863,000 on the sale of a large inventory of agricultural equipment that had been foreclosed upon during the years. The gains were not again realized during 2010.

Decreases in noninterest income were experienced in all but two categories during 2009, with decreases experienced in customer service fees, gains in OREO sales, and shared appreciation income. Increases were experienced in gains on sale of assets as the Company disposed of a large inventory of agricultural equipment that had been foreclosed upon during the year. The decrease of \$760,000 in other noninterest income experienced during 2009 includes a decrease of approximately \$312,000 on OREO rental income; an income decline which the Company does not expect to see change in the future. The loss of \$37,000 realized during 2009 on the disposition of investment securities was the result of the sale of a \$5.0 million mutual fund that was disposed of for liquidity purposes. The Company has experienced decreases in gains realized from the sale of other real estate owned through foreclosure and, actually realized net pre-tax losses of \$793,000 during 2009 as compared to net pre-tax gains of \$67,000 for the year ended December 31, 2008. During 2009, the Company accelerated the process of disposing of properties when economically possible rather than continue to hold them and incur ongoing carrying costs to maintain the properties. Additionally, decreases of approximately \$450,000 were experienced in revenue generated by the Company's financial services department between the years ended December 31, 2008 and December 31, 2009.

Shared appreciation income has decreased over the three years presented, with decreases of \$23,000 between 2009 and 2010, as compared to decreases of \$242,000 between 2008 and 2009. Shared appreciation income results from agreements between the Company and the borrower on certain construction loans where the Company agrees to receive interest on the loan at maturity rather than monthly and the borrower agrees to share in the profits of the project. The profit is determined by the appraised value of the completed project and subsequent refinancing or sale of the project. Due to the difficulty in calculating future values, shared appreciation income is recognized when received. The Company has not participated in a significant number of shared appreciation projects in the past, and as a result of the economic deterioration in the real estate markets over the past several years, we anticipate little or no shared appreciation income in the future.

Noninterest Expense

The following table sets forth the components of total noninterest expense in dollars and as a percentage of average earning assets for the years ended December 31, 2010, 2009 and 2008:

(Dollars in thousands)	2010			2009			2008		
	Amount	% of Average Earning Assets		Amount	% of Average Earning Assets		Amount	% of Average Earning Assets	
Salaries and employee benefits	\$8,949	1.47	%	\$8,551	1.35	%	\$10,610	1.53	%
Occupancy expense	3,789	0.62	%	3,692	0.58	%	3,954	0.57	%
Data processing	85	0.01	%	102	0.02	%	279	0.04	%
Professional fees	2,081	0.34	%	2,201	0.35	%	1,482	0.21	%
FDIC/DFI assessments	2,546	0.42	%	1,203	0.19	%	535	0.08	%
Directors fees	232	0.04	%	253	0.04	%	262	0.04	%
Amortization of intangibles	769	0.13	%	885	0.14	%	972	0.14	%
Correspondent bank service charges	315	0.05	%	362	0.06	%	427	0.06	%
Writedown on investment	355	0.06	%	0	0.00	%	23	0.00	%
Impairment loss on OREO	2,831	0.46	%	1,324	0.21	%	887	0.13	%
Impairment loss on intangible assets	57	0.01	%	81	0.01	%	648	0.09	%
Impairment loss on Goodwill	1,414	0.23	%	3,026	0.48	%	0	0.00	%

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Impairment loss on investment securities	1,253	0.21	%	843	0.13	%	0	0.00	%
Loss on lease assets held for sale	0	0.00	%	0	0.00	%	0	0.00	%
Loss on CA Tax Credit Partnership	424	0.07	%	428	0.07	%	432	0.06	%
OREO expense	1,532	0.25	%	1,612	0.26	%	418	0.06	%
Other	2,388	0.39	%	3,403	0.54	%	2,422	0.35	%
Total	\$29,020	4.76	%	\$27,966	4.43	%	\$23,351	3.37	%

Noninterest expense, excluding provision for credit losses and income tax expense, totaled \$29.0 million for the year ended December 31, 2010 as compared to \$28.0 million and \$23.4 million for the years ended December 31, 2009 and 2008, respectively. These figures represent an increase of \$1.1 million or 3.8% between the years ended December 31, 2009 and 2010 and an increase of \$4.6 million or 19.8% between the years ended December 31, 2008 and 2009. As a percentage of average earning assets, total noninterest expense has increased over the past three years primarily as the result of increases in impairment losses on OREO, goodwill and other assets held by the Company, increases in professional fees related to problem assets and foreclosed properties, as well as increases in FDIC insurance assessments. Noninterest expense amounted to 4.76% of average earning assets for the year ended December 31, 2010 as compared to 4.43% at December 31, 2009 and 3.37% for the year ended December 31, 2008.

Increases in noninterest expense between the years ended December 31, 2009 and December 31, 2010 include impairment losses of \$2.8 million on OREO, other-than-temporary impairment losses of \$1.3 million on investment securities, and impairment losses of \$1.4 million on goodwill. The amount expensed as other-than-temporary impairment losses on the investment securities represents the identified credit-related portion of the impairment. With the prolonged economic downturn, impairment loss continued as the values on many assets declined. Impairment losses on OREO properties are also a function of an increase in the volume of OREO acquired during the last several years, which is also reflected in OREO expense of \$1.5 million for the year ended December 31, 2010. During the year ended December 31, 2010, the Company recognized a write-down on an equity investment in bank stock totaling \$355,000 as a result of continued deterioration in the economic condition of the company, reflected in a stock price that continued to decline over later half of the year. FDIC insurance assessments increased \$1.4 million during 2010 reflecting both the financial condition of the Bank and a general increase in insurance assessment rates within the industry.

The net increase in noninterest expense between the years ended December 31, 2008 and 2009 is in large part the result of \$3.0 million in goodwill impairment losses taken during second quarter of 2009. Other changes in noninterest expense are comprised of reductions in salaries and bonus incentives of nearly \$2.1 million, and reductions in occupancy and data processing costs of \$262,000, which were more than offset by increases in OREO impairment and overhead costs, legal fees, FDIC insurance assessments, and other expenses associated with nonperforming and foreclosed loans, as well as changes in the components of other impairment losses taken on various assets of the Company. During the year ended December 31, 2009, the Company recognized \$843,000 in impairment losses (\$163,000 during the first quarter, \$240,000 during the second quarter, \$317,000 during the third quarter, and \$123,000 during the fourth quarter of 2009) on three of its residential collateralized mortgage obligations which were determined to be other-than-temporarily impaired. As the economy has declined between 2008 and 2009, the Company streamlined certain departments to more effectively control salary and employee benefit costs where the levels of business are lower than they have been historically. The increase of \$981,000 in other noninterest expense between the years ended December 31, 2009 and 2008 is primarily the result of a legal settlement totaling \$800,000 for a disputed ATM servicing contract with a third-party servicer.

During the years ended December 31, 2010, 2009, and 2008, the Company recognized stock-based compensation expense of \$41,000 (less than \$0.01 per share basic and diluted), \$53,000 (less than \$0.01 per share basic and diluted), and \$110,000 (\$0.01 per share basic and diluted), respectively. This expense is included in noninterest expense under salaries and employee benefits. Under the current pool of stock options, the Company expects stock-based compensation expense to be about \$4,600 per quarter for 2011, about \$2,500 per quarter for 2012, and decline after that through 2015. If new stock options are issued, or existing options fail to vest due, for example, to forfeiture, actual stock-based compensation expense in future periods will change.

Income Taxes

The Company's income tax expense is impacted to some degree by permanent taxable differences between income reported for book purposes and income reported for tax purposes, as well as certain tax credits which are not reflected in the Company's pretax income or loss shown in the statements of operations and comprehensive income. As pretax income or loss amounts become smaller, the impact of these differences become more significant and are reflected as variances in the Company's effective tax rate for the periods presented. In general, the permanent differences and tax credits affecting tax expense have a positive impact and tend to reduce the effective tax rates shown in the Company's statements of operations and comprehensive income.

The Company reviews its current tax positions at least quarterly based accounting standards related to uncertainty in income taxes which includes the criteria that an individual tax position would have to meet for some or all of the income tax benefit to be recognized in a taxable entity's financial statements. Under the income tax guidelines, an

entity should recognize the financial statement benefit of a tax position if it determines that it is more likely than not that the position will be sustained on examination. The term “more likely than not” means a likelihood of more than 50 percent.” In assessing whether the more-likely-than-not criterion is met, the entity should assume that the tax position will be reviewed by the applicable taxing authority.

On December 31, 2003 the California Franchise Tax Board (FTB) announced certain tax transactions related to real estate investment trusts (REITs) and regulated investment companies (RICs) will be disallowed pursuant to Senate Bill 614 and Assembly Bill 1601, which were signed into law in the 4th quarter of 2003. As a result, the Company reversed related net state tax benefits recorded in the first three quarters of 2003 and has taken no related tax benefits since that time. The Company continues to review the information available from the FTB and its financial advisors and believes that the Company's position has merit. The Company will pursue its tax claims and defend its use of these entities and transactions. At this time, the Company cannot predict the ultimate outcome.

Pursuant to the guidance, the Company reviewed its REIT tax position as of January 1, 2007 (adoption date of the new guidance), and then has again reviewed its position each subsequent quarter since adoption. The Bank, with guidance from advisors, believes that the case has merit with regard to points of law, and that the tax law at the time allowed for the deduction of the consent dividend. However, the Bank, with the concurrence of advisors, cannot conclude that it is "more than likely" that the Bank will prevail in its case with the FTB. As a result of this determination, effective January 1, 2007 the Company recorded an adjustment of \$1.3 million to beginning retained earnings upon adoption of the new guidance related to uncertainty in income taxes to recognize the potential tax liability under the guidelines of the interpretation. The adjustment includes amounts for assessed taxes, penalties, and interest. During the years ended December 31, 2009, 2008, and 2007, the Company increased the unrecognized tax liability by an additional \$87,000 in interest for each of the three years, bringing the total recorded tax liability to \$1.6 million at December 31, 2009. The Company has determined that there has been no material change to its position on the REIT from that at December 31, 2009, and as a result recorded additional interest liability of \$87,000 during the year ended December 31, 2010. It is the Company's policy to recognize interest and penalties as a component of income tax expense. The Company has reviewed all of its tax positions as of December 31, 2010, and has determined that, other than the REIT, there are no other material amounts that should be recorded under the current income tax accounting guidelines.

Financial Condition

Total assets decreased by \$15.0 million or 2.2% during the year to \$678.2 million at December 31, 2010, and decreased \$82.9 million or 10.9% from the balance of \$761.1 million at December 31, 2008. During the year ended December 31, 2010, decreases of \$68.2 million were experienced in net loans as construction and real estate lending continued to slow and approximately \$14.2 million in problem loans were transferred to OREO, while another \$11.9 million was charged off against the allowance for loan losses. Overnight interest-bearing deposits in the Federal Reserve Bank, and federal funds sold, increased a net \$70.9 million, while investment securities decreased by \$19.9 million during the year ended December 31, 2010. Total deposits of \$557.5 million at December 31, 2010 decreased \$4.2 million or 0.8% from the balance reported at December 31, 2009, but increased \$49.0 million or 9.6% from the balance of \$508.5 million reported at December 31, 2008. Declines of \$47.8 million in brokered time deposits were partially offset by growth in NOW, money market, and other interest-bearing deposit accounts. Decreases in brokered time deposits during 2010 are the result of the Company's plan to reduce its dependence on brokered deposits and other wholesale funding sources.

During the year ended December 31, 2009, decreases of \$35.6 million were experienced in net loans as construction and real estate lending slowed and approximately \$20.0 million in problem loans were transferred to OREO, while another \$10.1 million was charged off against the allowance for loan losses. Interest-bearing deposits in other banks and investment securities decreased by \$17.1 million and \$21.3 million, respectively, during the year ended December 31, 2009. Total deposits of \$561.7 million at December 31, 2009 increased \$53.2 million or 10.5% from the balance reported at December 31, 2008, and decreased \$73.0 million or 11.5% from the balance of \$634.6 million reported at December 31, 2007. Deposit growth during 2009 occurred in interest-bearing checking accounts and time deposits of \$100,000 or more, while other deposit categories experienced declines between December 31, 2008 and December 31, 2009. Increases in time deposits during 2009 are in large part the result of additional brokered deposits which were obtained as the Company sought to reduce its dependence on overnight and term borrowings from the Federal Reserve and FHLB.

Earning assets averaged approximately \$609.8 million during the year ended December 31, 2010, as compared to \$631.8 million and \$692.5 million for the years ended December 31, 2009 and 2008, respectively. Average interest-bearing liabilities decreased to \$491.1 million for the year ended December 31, 2010, as compared to \$513.8 million for the year ended December 31, 2009, and decreased from the balance of \$542.7 million for the year ended December 31, 2008.

Loans

The Company's primary business is that of acquiring deposits and making loans, with the loan portfolio representing the largest and most important component of its earning assets. Loans totaled \$441.7 million at December 31, 2010, representing a decrease of \$66.9 million or 13.2% when compared to the balance of \$508.6 million at December 31, 2009, and a decrease of \$102.9 million or 18.9% when compared to the balance of \$544.6 million reported at December 31, 2008. Total loans decreased approximately \$30.5 million during the fourth quarter of 2010, \$4.4 million of which was the result of transfers of nonperforming loans to OREO, and another \$5.6 million was the result of charge-offs against the reserve for loan and lease losses. Average loans totaled \$534.8 million, \$582.5 million, and \$575.4 million for the years ended December 31, 2009, 2008 and 2007, respectively. During 2010 average loans decreased 8.3% when compared to the year ended December 31, 2009 and decreased 15.8% compared to the year ended December 31, 2008.

The following table sets forth the amounts of loans outstanding by category and the category percentages as of the year-end dates indicated:

(In thousands)	2010		2009		2008		2007		2006	
	Dollar Amount	% of Loans	Dollar Amount	% of Loans	Dollar Amount	% of Loans	Dollar Amount	% of Loans	Dollar Amount	% of Loans
Commercial and industrial	\$ 159,224	36.00 %	\$ 167,930	33.00 %	\$ 188,207	34.60 %	\$ 188,826	31.90 %	\$ 146,964	29.70 %
Real estate – mortgage	157,781	35.7	165,629	32.6	130,856	24	135,252	22.8	113,613	22.9
RE construction & development	65,182	14.8	105,220	20.7	151,091	27.7	200,836	33.8	176,825	35.7
Agricultural	46,308	10.5	50,897	10	52,020	9.6	46,387	7.8	35,502	7.2
Installment/other	12,891	2.9	18,191	3.6	20,782	3.8	18,171	3.1	16,712	3.4
Lease financing	305	0.1	706	0.1	1,595	0.3	3,323	0.6	5,507	1.1
Total Loans	\$441,691	100.00%	\$508,573	100.00%	\$544,551	100.00%	\$592,795	100.00%	\$495,123	100.00%

Loan volume continues to be greatest in what has historically been the Bank's primary lending emphasis: commercial, real estate mortgage, and construction lending. With the continued deterioration of real estate markets that began in 2008, the Company experienced decreases in all loan categories during 2010, with a decrease of \$40.0 million or 38.1 % in construction loans, a decrease of \$8.7 million or 5.8% in commercial and industrial loans, and a decrease of 7.8 million or 4.7 % in real estate mortgage loans. Modest decreases were also experienced in agricultural loans and installment loans. Lease financing decreased \$401,000 during 2010, as the Company is no longer originating commercial leases. Approximately \$14.2 million of the total \$66.9 million decrease in loans experienced during the year ended December 31, 2010, was the result of nonperforming loans transferred to other real estate owned when all other means of settlement were exhausted.

During 2009, the Company experienced a decrease of \$45.9 million or 30.4 % in construction loans, and a decrease of \$20.3 million or 10.81% in commercial and industrial loans, with minor decreases in installment as well as in agricultural loans. Lease financing decreased \$889,000 during 2009. Partially offsetting these decreases were increases of \$34.8 million in real estate mortgage loans, a portion of which were the result of construction loans which were completed or matured during the year and the borrower obtained longer-term financing from the Company. Approximately \$20.0 million of the total \$36.0 million decrease in loans experienced during the year ended December 31, 2009, was the result of nonperforming loans transferred to other real estate owned.

During 2008, the Company experienced a decrease of \$49.7 million or 24.8 % in construction loans, and decreases of \$4.4 million and \$619,000 in real estate mortgage loans, and commercial and industrial loans, respectively. Lease financing decreased \$1.7 million during 2008, as the Company is no longer originating commercial leases. Partially offsetting these decreases were increases of \$6.0 million in agricultural loans, and \$2.6 million in consumer installment loans. Part of the decrease in construction and real estate loans experienced during 2008 is the result of transfers of approximately \$28.5 million (\$26.0 million net of charge-offs) in nonperforming loans to OREO.

At December 31, 2010, approximately 72% of commercial and industrial loans have floating rates and, although some may be secured by real estate, many are secured by accounts receivable, inventory, and other business assets. Residential housing markets remained depressed through 2009 and 2010, and as a result, residential construction loans decreased during 2009 and again during 2010. Real estate construction loans decreased \$40.0 million or 38.1% during 2010, as compared to a decrease of \$45.9 million or 30.4 % during 2009. Construction loans are generally short-term, floating-rate obligations, which consist of both residential and commercial projects. Agricultural loans consisting of mostly short-term, floating rate loans for crop financing, decreased \$4.6 million or 9.0% between December 31, 2009

and December 31, 2010, while installment loans decreased \$5.3 million or 29.1% during that same period.

The real estate mortgage loan portfolio totaling \$159.2 million at December 31, 2010 consists of commercial real estate, residential mortgages, and home equity loans. Commercial real estate is the core of this segment of the portfolio, with balances of \$131.6 million, \$117.0 million, and \$86.0 million at December 31, 2010, 2009, and 2008, respectively. Commercial real estate loans are generally a mix of short to medium-term, fixed and floating rate instruments and, are mainly tied to commercial income and multi-family residential properties. The Company does not currently offer traditional residential mortgage loans, but may purchase mortgage portfolios. The residential real estate mortgage portfolio had balances of \$23.8 million, \$45.8 million, and \$41.6 million at December 31, 2010, 2009 and 2008, respectively. During 2010, the Company sold two purchased residential real estate mortgage portfolios totaling approximately \$17.1 million, resulting in the decrease in the residential mortgage portfolio during 2010. The Company also offers short to medium-term, fixed-rate, home equity loans, which totaled \$2.4 million at December 31, 2010, \$2.8 million at December 31, 2009, and \$3.2 million at December 31, 2008.

The following table sets forth the maturities of the Bank's loan portfolio at December 31, 2010. Amounts presented are shown by maturity dates rather than repricing periods:

(In thousands)	Due in one year or less	Due after one Year through Five years	Due after Five years	Total
Commercial and agricultural	\$ 108,301	\$ 80,992	\$ 16,239	\$ 205,532
Real estate construction & development	31,460	33,722	0	65,182
	139,761	114,714	16,239	270,714
Real estate – mortgage	31,368	80,709	45,704	157,781
All other loans	4,790	5,154	3,252	13,196
Total Loans	\$			