

The logo consists of two overlapping triangles. The larger triangle is olive green and points towards the top-left. The smaller triangle is maroon and points towards the bottom-left, partially overlapping the green one.

California Bank of Commerce

...defined by the company we keep.

2009 Annual Report



In memory of Brad Kisner
Founder, Director, and Friend



Fellow Shareholders:

Your Bank performed exceptionally well throughout 2009, our second full year in business. We added many new relationships with privately held businesses and expanded our loan and deposit portfolios. We grew revenues and managed overhead, thus driving big improvements to the bottom line.

Full Year 2009 Highlights versus 2008:

- Total Loans of \$142 million, up 47%
- Total Deposits of \$153 million, up 38%
- Interest Income of \$6.7 million, up 51%
- Interest Expense of \$1.3 million, down 9%
- Net Interest Margin of 3.52%, up 40 basis points

Aided both by increased loan volumes and by margin improvements, 2009 net revenues (net interest income, before the provision for loan losses) improved to \$5.4 million, up by 80% over 2008. Overhead (non-interest expense exclusive of 2008 impairment charges) grew only 9%. These accomplishments resulted in positive operating income of \$450,000 in 2009 versus an operating loss of (\$1,336,000) in 2008*.

We finished 2009 with zero non-performing loans and a healthy \$2.56 million reserve for loan losses (1.8% of total loans). At December 31, 2009, the Bank remained well capitalized, with a Tier 1 Leverage Capital Ratio of 12.8%, well in excess of the FDIC's 8% standard for a "well capitalized" bank. In addition, the Bank continued to maintain strong liquidity, with over \$30 million in cash and cash equivalents at December 31, 2009.

In short, in 2009 we made excellent headway in building a bank that will live up to the high expectations of its shareholders.

Looking Ahead

We expect the Fed to keep rates low, so we believe margins will continue to be a challenge. We expect Washington and Sacramento will be more a hindrance than a help. We expect unemployment to stay high and for real estate to remain depressed.

These conditions are not much changed from those of the past two years. So, we remain committed to our plan, which calls for steady but moderate growth, achieved by focusing on our core business. Our strength is our relationships with well managed closely held businesses. Over time, there will be fewer independent banks that have the expertise to serve such clients. We see opportunity. We have the right people in the right place at the right time to thrive.



John Rossell
President and Chief Executive Officer



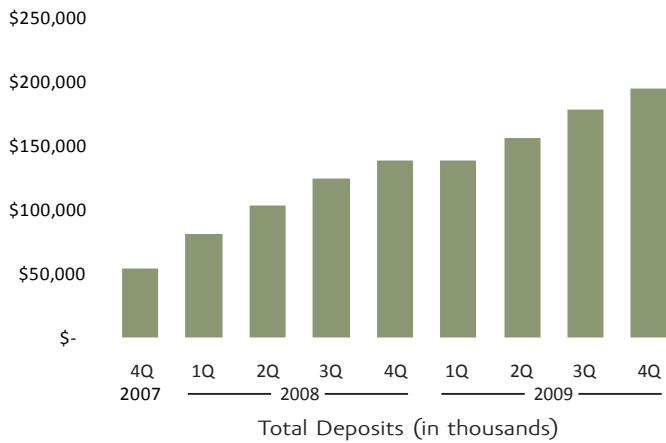
Edward B. Collins
Chairman of the Board

* Operating Income is Net Income adjusted for the Provision for Loan Losses, stock option expense, and the extraordinary item in 2008.

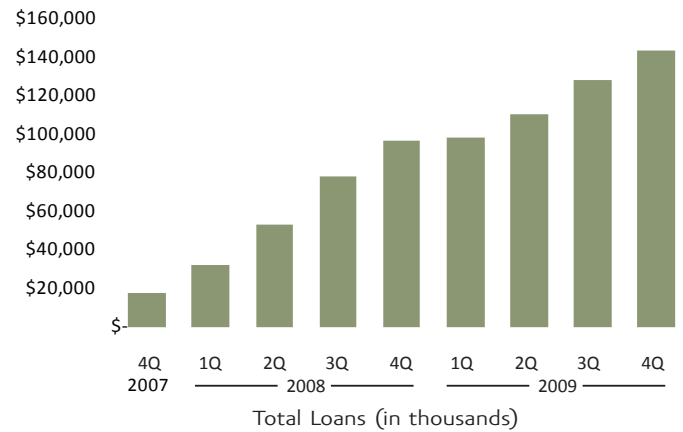


2009 Financial Highlights

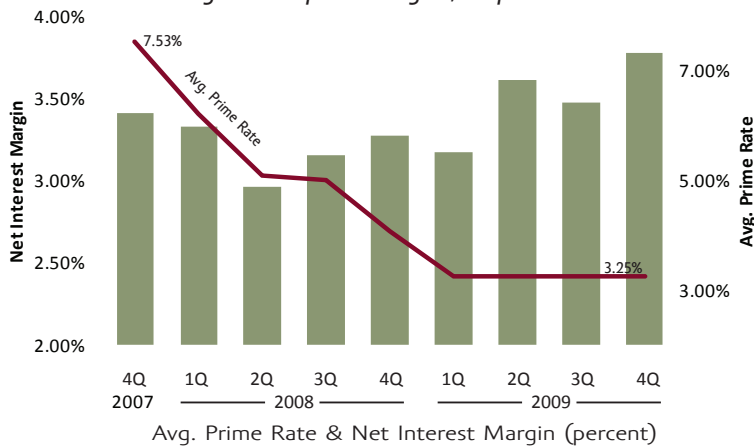
We continued to attract and retain deposits...



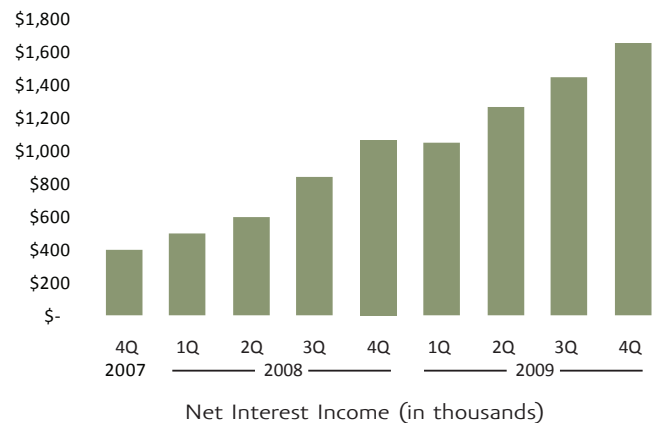
...funding steady loan growth...



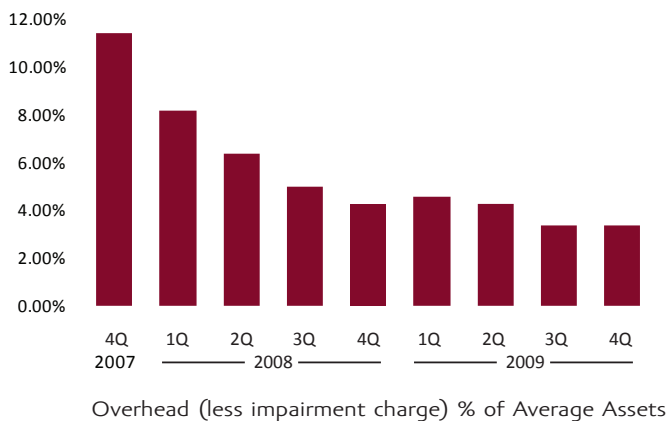
...allowing us to improve margins, despite low Fed rates...



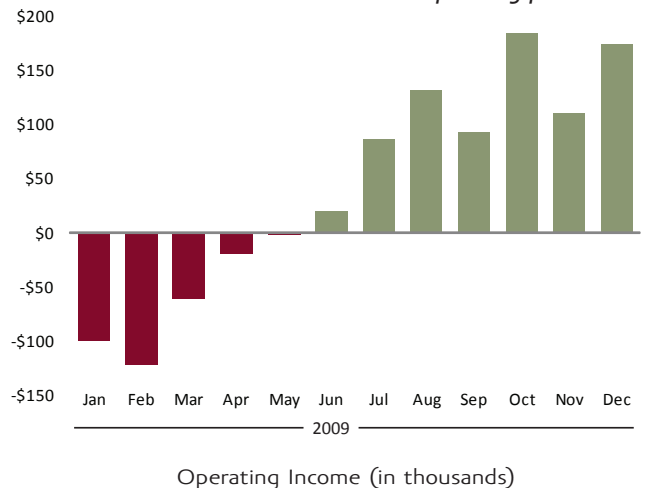
...so net interest income grew.



We managed overhead costs...



...and thus turned the corner to operating profits.



...defined by the



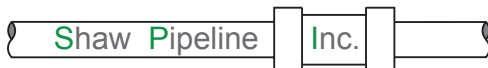
Bay Cities
Paving &
Grading



B C McCosker Construction Company, Inc.
GENERAL ENGINEERING CONTRACTOR



ELECTRICAL SERVICES
COMPANY



TAHOE ASPHALT



company we keep.



FLEENOR PAPER COMPAN



CALIFORNIA TRENCHLESS, INC.



Organizers

Our Organizers share a vision of California Bank of Commerce. They put their time, their money, and their reputations on the line to make it happen. We thank all of them for their contribution and commitment to building this Bank.

Andy and Denise Armanino	Danville, CA	Stu and Sally Kahn	Orinda, CA
Charles and Judith Bellig	Danville, CA	Brad and Jeanne Kisner	Lafayette, CA
John and Susan Bellig	Danville, CA	Ken Kisner	Lafayette, CA
Mike and Patrice Botto	Moraga, CA	Paul and Vicki Klapper	Hillsborough, CA
Peter and Mona Branagh	San Francisco, CA	Roxy and Steve Klein	Lafayette, CA
Joe and Jodie Brescia	Alamo, CA	Bob and Judy Locker	Lafayette, CA
Ray and Terry Brown	Newport Beach, CA	David and Marsha Maiero	Belmont, CA
Jeff and Patty Calder	Orinda, CA	John and Nancy Montgomery	Orinda, CA
Sandy and Jean Colen	Orinda, CA	Tom and Carol Morehouse	Orinda, CA
Ted and Margaret Collins	San Francisco, CA	Terry and Linda Murray	Lafayette, CA
Jerry Condon	Orinda, CA	Guy and Maria Muzio	San Francisco, CA
Michael and Darcy Cookson	Walnut Creek, CA	J.P. and Jane Oosterbaan	Mill Valley, CA
Steve and Ann Cortese	Orinda, CA	Tom and Sue Park	Orinda, CA
Jack and Jackie Cullen	Orinda, CA	Paul Remack	Walnut Creek, CA
Kevin and Amy Cullen	Lafayette, CA	Dave and Lori Sanson	Walnut Creek, CA
Steve and Elaine Dathe	Orinda, CA	Hans Schroeder	San Francisco, CA
Richard and Nancy Doyle	Lafayette, CA	Dan and Denise Siri	Orinda, CA
Joe and Jackie Duffel	Orinda, CA	Randy and Kathryn Soso	Orinda, CA
Doug and Lori Fowler	Lafayette, CA	Bill and Sherry Stevenson	Orinda, CA
John and Leslie French	Orinda, CA	Mark and Kristi Swimmer	Orinda, CA
Rob and Laurie Fuller	Orinda, CA	Steve and Trish Thomas	Walnut Creek, CA
Claude and Jackie Gaubert	Lafayette, CA	Ed and Mary Traille	Moraga, CA
Barry and Mary Gilbert	Alameda, CA	Bruce and Patti Westphal	Oakland, CA
Mollie and Greg Gilbert	Oakland, CA	Dick and Lorraine Whitehurst	Alamo, CA
		Steve and Linda Wight	Lafayette, CA



Board of Directors

Edward B. Collins
*Chairman of the Board,
California Bank of Commerce
Chairman and Director, Branded Spirits, Ltd.*

Stephen A. Cortese
*Vice Chairman of the Board,
California Bank of Commerce
Managing Partner, Cortese Investments*

John E. Rossell III
President and CEO, California Bank of Commerce

Peter W. Branagh
President, Branagh Development, Inc.

Kevin J. Cullen
Chief Financial Officer, Guarantee Glass, Inc.

Stephen R. Dathe
*Vice President and General Manager
A & B Die Casting Company*

Stuart J. Kahn
President, United Growth Companies

Rochelle G. Klein
Advisory Director, Ocean Gate Capital Management

John E. Lindstedt
Chief Credit Officer, California Bank of Commerce

Thomas R. Morehouse
Retired President and Founder, Filesafe Inc.

John H. Sears
*Retired, Special Counsel
Sheppard, Mullin, Richter & Hampton*

Edmond E. Traille
CEO, GALLINA LLP

Executive Officers

John E. Rossell III
President and Chief Executive Officer

Virginia M. Robbins
Chief Administrative Officer

Randall D. Greenfield
Chief Financial Officer

John E. Lindstedt
Chief Credit Officer

Mark A. DeVincenzi
*Chief Marketing Officer
and EVP Investor Relations*

Thomas M. Park
Executive Vice President

Steven E. Shelton
Executive Vice President

Stephen P. Tessler
Executive Vice President



INDEPENDENT AUDITOR'S REPORT



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415.576.1100

To the Board of Directors
California Bank of Commerce
Lafayette, California

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

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

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

March 22, 2010

Perry-Smith LLP



BALANCE SHEET

December 31, 2009 and 2008

	<u>2009</u>	<u>2008</u>
ASSETS		
Cash and due from banks	\$ 30,568,105	\$ 2,668,421
Federal funds sold	<u>-</u>	<u>4,825,000</u>
Total cash and cash equivalents	30,568,105	7,493,421
Investment securities (Note 3)		
Available-for-sale, at estimated fair value	17,315,449	31,869,637
Loans held for sale (Note 1)	909,000	490,000
Loans, less allowance for loan losses of \$2,565,000 in 2009 and \$1,400,000 in 2008 (Notes 4, 7, 8 and 9)	140,689,024	95,730,266
Premises and equipment, net (Note 5)	385,703	520,571
Accrued interest receivable and other assets	<u>3,896,817</u>	<u>1,313,210</u>
Total assets	<u>\$ 193,764,098</u>	<u>\$ 137,417,105</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Non-interest bearing	\$ 35,417,907	\$ 17,787,276
Interest bearing (Note 6)	<u>117,256,129</u>	<u>92,722,908</u>
Total deposits	152,674,036	110,510,184
Long-term borrowings (Note 8)	12,000,000	6,000,000
Short-term borrowings (Note 8)	5,000,000	-
Accrued interest payable and other liabilities (Note 13)	<u>759,929</u>	<u>573,584</u>
Total liabilities	<u>170,433,965</u>	<u>117,083,768</u>
Commitments and contingencies (Notes 8 and 9)	-	-
Shareholders' equity (Notes 10 and 11):		
Preferred stock – no par value; 10,000,000 shares authorized		
Series A, noncumulative, \$1,000 per share liquidation value, 4,000 shares issued and outstanding at December 31, 2009 (Note 16)	3,787,039	-
Series B, noncumulative, \$1,000 per share liquidation value, 200 shares issued and outstanding at December 31, 2009 (Note 16)	192,065	-
Common stock - no par value; 40,000,000 shares authorized; 2,750,000 issued and outstanding in 2009 and 2008	29,269,174	28,540,035
Accumulated deficit	(10,142,295)	(8,361,480)
Accumulated other comprehensive income, net of taxes (Notes 3 and 14)	<u>224,150</u>	<u>154,782</u>
Total shareholders' equity	<u>23,330,133</u>	<u>20,333,337</u>
Total liabilities and shareholders' equity	<u>\$ 193,764,098</u>	<u>\$ 137,417,105</u>

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



STATEMENT OF OPERATIONS

For the Year Ended December 31, 2009 and 2008

	<u>2009</u>	<u>2008</u>
Interest income:		
Interest and fees on loans	\$ 5,927,097	\$ 2,956,465
Interest on investment securities	751,771	1,096,087
Interest on Federal funds sold	1,208	230,998
Interest on deposits in banks	<u>59,385</u>	<u>189,814</u>
Total interest income	6,739,461	4,473,364
Interest expense:		
Interest on deposits (Note 6)	1,195,283	1,475,944
Interest on long-term borrowings (Note 8)	151,514	4,317
Interest on short-term borrowings (Note 8)	<u>307</u>	<u>678</u>
Total interest expense	<u>1,347,104</u>	<u>1,480,939</u>
Net interest income before provision for loan losses	5,392,357	2,992,425
Provision for loan losses (Note 4)	<u>1,256,357</u>	<u>1,152,000</u>
Net interest income after provision for loan losses	<u>4,136,000</u>	<u>1,840,425</u>
Non-interest income:		
Service charges and fees	124,958	29,838
Dividends on preferred stock	-	93,187
Net gains on sales of loans	-	151,249
Net gains on sales of investment securities (Note 3)	106,971	130,778
Other	<u>117,855</u>	<u>62,871</u>
Total non-interest income	<u>349,784</u>	<u>467,923</u>
Non-interest expenses:		
Salaries and employee benefits (Notes 4 and 13)	3,764,291	3,541,863
Occupancy and equipment (Note 5)	649,679	645,849
Impairment charge on available-for-sale securities (Note 3)	-	2,045,875
Other (Note 15)	<u>1,607,762</u>	<u>1,327,569</u>
Total non-interest expense	<u>6,021,732</u>	<u>7,561,156</u>
Loss before provision for income taxes	(1,535,948)	(5,252,808)
Provision for income taxes (Note 7)	<u>800</u>	<u>800</u>
Net Loss	(1,536,748)	(5,253,608)
Preferred stock dividend	<u>(210,733)</u>	<u>-</u>
Loss to common shareholders	<u>\$ (1,747,481)</u>	<u>\$ (5,253,608)</u>
Basic loss per common share	<u>\$ (0.64)</u>	<u>\$ (1.91)</u>
Weighted average number of shares outstanding	<u>2,750,000</u>	<u>2,750,000</u>

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



STATEMENT OF CHANGES IN SHAREHOLDER'S EQUITY AND COMPREHENSIVE LOSS

For the Year Ended December 31, 2009 and 2008

	<u>Preferred Stock – Series A</u>		<u>Preferred Stock – Series B</u>		<u>Common Stock</u>		<u>Accum- ulated Deficit</u>	<u>Accum- ulated Other Compre-- hensive Income</u>	<u>Total Share- holders' Equity</u>	<u>Compre- hensive Loss</u>
	<u>Shares</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>				
Balance, January 1, 2008					2,750,000	\$ 27,821,247	\$ (3,107,872)	\$ 76,590	\$ 24,789,965	
Share-based compensation expense (Note 10)						718,788			718,788	
Comprehensive loss (Note 14):										
Net Loss							(5,253,608)		(5,253,608)	\$ (5,253,608)
Other Comprehensive income:										
Net change in unrealized gains on available for-sale investment securities, net of taxes								78.192	78.192	78.192
Total comprehensive loss										<u>\$ (5,175,416)</u>
Balance, December 31, 2008					2,750,000	\$ 28,540,035	\$ (8,361,480)	\$ 154,782	\$ 20,333,337	
Issuance of Series A Preferred stock, net of discount	4,000	\$ 3,755,293							3,755,293	
Issuance of Series B Preferred stock			200	\$ 190,477					190,477	
Amortization of discount on Series A and discount accretion on Series B preferred stock		31,746		1,588			(33,334)			
Share-based compensation expense (Note 10)						729,139			729,139	
Preferred dividends							(210,733)		(210,733)	
Comprehensive loss (Note 14):										
Net loss							(1,536,748)		(1,536,748)	\$ (1,536,748)
Other Comprehensive income:										
Net change in unrealized gains on available-for-sale investment securities, net of taxes								69.368	69.368	69.368
										<u>\$ (6,642,796)</u>
Balance, December 31, 2009	<u>4,000</u>	<u>\$ 3,787,039</u>	<u>200</u>	<u>\$ 192,065</u>	<u>2,750,000</u>	<u>\$ 29,269,174</u>	<u>\$ (10,142,295)</u>	<u>\$ 224,150</u>	<u>\$ 23,330,133</u>	

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



STATEMENT OF CASH FLOWS

For the Year Ended December 31, 2009 and 2008

	<u>2009</u>	<u>2008</u>
Cash flows from operating activities:		
Net loss	\$ (1,536,748)	\$ (5,253,608)
Adjustments to reconcile net loss to net cash used in operating activities:		
Provision for loan losses	1,256,357	1,152,000
Impairment charge on securities available-for-sale		2,045,875
Depreciation	159,882	143,903
Deferred loan origination costs, net	38,221	(247,682)
Change in amortization (accretion) of investment security premiums (discounts), net	56,024	(11,158)
Share-based compensation expense	729,139	718,788
Increase in cash surrender value of life insurance	(18,052)	-
Change in amortization of discount on retained portion of sold loans	31,446	-
Gain on sale of investment securities, net	(106,971)	(130,778)
Increase in loans held for sale	(419,000)	(490,000)
Increase in accrued interest receivable and other assets	(920,255)	(346,558)
Gain on sale of equipment	-	110
Increase in accrued interest payable and other liabilities	<u>83,640</u>	<u>275,555</u>
Net cash used in operating activities	<u>(646,317)</u>	<u>(2,143,553)</u>
Cash flows from investing activities:		
Purchase of available-for-sale investment securities	(10,138,180)	(48,545,519)
Proceeds from sales and maturities of available-for-sale investment securities	18,542,967	29,301,080
Proceeds from principal payments on available-for-sale investment securities	6,317,921	1,597,353
Proceeds from principal payments on held-to-maturity investment securities	-	1,002,036
Net increase in loans	(46,284,782)	(78,972,070)
Purchases of premises and equipment	(25,014)	(250,427)
Purchase of bank-owned life insurance policies	(1,300,000)	-
Purchase of Bank equity securities	<u>(345,300)</u>	<u>(472,000)</u>
Net cash used in investing activities	<u>(33,232,388)</u>	<u>(96,339,547)</u>

(Continued)

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



STATEMENT OF CASH FLOWS (continued)

For the Year Ended December 31, 2009 and 2008

	<u>2009</u>	<u>2008</u>
Cash flows from financing activities:		
Increase in demand, interest bearing and savings deposits	\$ 49,942,942	\$ 45,797,738
Net (decrease) increase in time deposits	(7,779,090)	36,383,623
Net proceeds from sale of preferred stock	3,945,770	-
Payment of dividends on preferred stock	(156,233)	-
Proceeds from short-term borrowings	5,000,000	-
Proceeds from long-term borrowings	<u>6,000,000</u>	<u>6,000,000</u>
Net cash provided by financing activities	<u>56,953,389</u>	<u>88,181,361</u>
Decrease in cash and cash equivalents	23,074,684	(10,301,739)
Cash and cash equivalents at beginning of period	<u>7,493,421</u>	<u>17,795,160</u>
Cash and cash equivalents at end of period	<u>\$ 30,568,105</u>	<u>\$ 7,493,421</u>
Supplemental disclosure of cash flow information:		
Cash paid during the year for:		
Interest	\$ 1,380,145	\$ 1,416,930
Income taxes	\$ 800	\$ 800
Non-cash investing activities:		
Net change in unrealized gains on available-for-sale investment securities	\$ 117,573	\$ 132,530

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



NOTES TO FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General

California Bank of Commerce (the "Bank") was approved as a state-chartered non-member bank on March 23, 2007, and commenced operations on July 17, 2007. The Bank is subject to regulation by the California Department of Financial Institutions (the "DFI") and the Federal Deposit Insurance Corporation (the "FDIC"). The Bank is headquartered in Lafayette, California and provides products and services to customers who are predominately small to middle-market businesses, professionals and not-for-profit organizations located in Contra Costa, Alameda, and surrounding counties.

The Bank's deposits are insured by the FDIC up to applicable legal limits. Additionally, the Bank is participating in the FDIC's Transaction Account Guarantee Program. Under this program, through June 30, 2010, all noninterest-bearing transaction accounts are fully guaranteed by the FDIC for the entire amount in the account and the Bank is assessed an annual fee of 10 basis points for all deposit amounts exceeding the existing deposit insurance limit of \$250,000. Coverage under the Transaction Account Guarantee Program is in addition to and separate from the coverage available under the FDIC's general deposit insurance rules.

The accounting and reporting policies of the Bank conform with accounting principles generally accepted in the United States of America and prevailing practices within the banking industry.

Use of Estimates

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

Reclassifications

Certain reclassifications have been made to prior year balances to conform to classifications used in 2009.

Cash and Cash Equivalents

For the purpose of the statement of cash flows, cash and cash equivalents consist of cash and due from banks and Federal funds sold. Generally, Federal funds are sold for one day period.

Investment Securities

Investment securities are classified into the following categories:

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



NOTES TO FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Investment Securities (Continued)

Management determines the appropriate classification of its investments at the time of purchase. Subsequent transfers between categories are accounted for at fair value. During 2008, as financial and credit markets deteriorated, an analysis of the Bank's held-to-maturity ("HTM") investment portfolio denominated with long maturity mortgage-backed securities issued by FNMA and FHLMC, identified a potential rising level of credit exposure. As a result of this increased credit exposure, the Bank transferred all of its securities classified as HTM, with a fair value of \$6,162,683, to the available-for-sale classification. The transfer and subsequent sale of these investment securities, which occurred during the fourth quarter of 2008, complied with specific exemptions under SFAS 115.

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

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

Investment in Federal Home Loan Bank Stock

As a member of the Federal Home Loan Bank of San Francisco, the Bank is required to maintain an investment in the capital stock of the Federal Home Loan Bank (FHLB). The investment is carried at cost. The Bank became a member during 2008 and at December 31, 2009 and 2008, FHLB stock totaled \$627,300 and \$282,000, respectively, and is included on the balance sheet in accrued interest receivable and other assets.

Investment in Other Bank Stocks

Independent Bankers Financial Corporation

The Independent Bankers Financial Corporation ("IBFC"), the holding company for The Independent Banker's Bank, provides services exclusively to banks. At December 31, 2009 and 2008, IBFC stock totaled \$50,419 and \$50,419, respectively, and is included on the balance sheet in accrued interest receivable and other assets.



NOTES TO FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Investment in Other Bank Stocks (Continued)

Pacific Coast Bankers' Bancshares

The Pacific Coast Bankers' Bancshares ("PCBB"), the holding company for The Pacific Coast Banker's Bank, provides services exclusively to banks. At December 31, 2009 and 2008, PCBB stock totaled \$190,000 and \$190,000, respectively, and is included on the balance sheet in accrued interest receivable and other assets.

Loans

Loans are stated at principal balances outstanding, except for loans transferred from loans held for sale which are carried at the lower of principal balance or market value at the date of transfer, adjusted for accretion of discounts. Interest is accrued daily based upon outstanding loan balances. However, when, in the opinion of management, loans are considered to be impaired and the future collectability of interest and principal is in serious doubt, loans are placed on nonaccrual status and the accrual of interest income is suspended. Any interest accrued but unpaid is charged against income. Payments received are applied to reduce principal to the extent necessary to ensure collection. Subsequent payments on these loans, or payments received on nonaccrual loans for which the ultimate collectability of principal is not in doubt, are applied first to earned but unpaid interest and then to principal. Interest income on impaired loans, if appropriate, is recognized on a cash basis. Generally, loans are restored to accrual status when the obligation is brought current and has performed in accordance with the contractual terms for a reasonable period of time and the ultimate collectability of the total contractual principal and interest is no longer in doubt.

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

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

The Bank services loans that have been participated with other financial institutions totaling approximately \$7,126,000 and \$8,165,435, respectively, as of December 31, 2009 and 2008. The participated balances of these loans were sold without recourse and are not included on the Bank's balance sheet.

Allowance for Loan Losses

The allowance for loan losses (the "allowance") is established through a provision for loan losses which is charged to expense. Additions to the allowance are expected to maintain the adequacy of the total allowance after credit losses (net of recoveries) and loan growth. The allowance for loan losses at December 31, 2009 reflects management's estimate of probable losses in the portfolio.



NOTES TO FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Loan Losses (Continued)

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

Loans determined to be impaired or classified are individually evaluated by management for specific risk of loss. In addition, reserve factors are assigned to currently performing loans based on management's assessment of the following for each identified loan type: (1) inherent credit risk, (2) historical losses and (3) where the Bank has not experienced losses, the loss experience of peer banks, and (4) other qualitative factors.

The Bank maintains a separate allowance for losses related to undisbursed loan commitments. Management estimates the amount of probable losses by applying a loss factor to the available portion of undisbursed lines of credit. This allowance of \$35,000 and \$60,000, at December 31, 2009 and 2008, respectively, is included in accrued interest payable and other liabilities on the balance sheet.

These estimates are particularly susceptible to changes in the economic environment and market conditions.

The Bank's Directors' Loan Committee reviewed the adequacy of the allowance for loan losses at December 31, 2009 and 2008.

In addition, the FDIC and California Department of Financial Institutions, as an integral part of their examination process, review the adequacy of the allowance. These agencies may require additions to the allowance based on their judgment about information available at the time of their examinations.

Transfer of Financial Assets

Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed surrendered when (1) the assets have been isolated from the Bank, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Sales and Servicing of Government Guaranteed Loans

During 2009 and 2008 the Bank originated loans which, in general are 70 to 85 percent guaranteed by either the U.S. Department of Agriculture (USDA) or the Small Business Administration (SBA). None of these loans were sold in 2009. The Bank's investment in the loans is allocated between the retained portion of the loan, the servicing asset, the interest only strip and the sold portion of the loan. The carrying value of the retained portion is discounted based on the estimated yield of a comparable non-guaranteed loan. The value of servicing assets and interest only strips related to these loans was not significant at December 31, 2009 and 2008.



NOTES TO FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Bank Premises and Equipment

Bank premises and equipment are carried at cost. Depreciation is determined using the straight-line method over the estimated useful lives of the related assets. The useful lives of furniture, fixtures and equipment are estimated to be 3 to 5 years. Leasehold improvements are amortized over the lesser of the respective lease term (including renewal periods that are reasonably assured) or their useful lives, which are generally 7 to 14 years.

Certain operating leases contain scheduled and specified rent increases or incentives in the form of tenant improvement allowances or credits. The scheduled rent increases are recognized on a straight-line basis over the lease term as an increase in the amount of rental expense recognized each period. Lease incentives are capitalized at the inception of the lease and amortized on a straight-line basis over the lease term as a reduction of rental expense. Amounts accrued in excess of amounts paid related to the scheduled rent increases and the unamortized deferred credits are included in accrued interest payable and other liabilities on the balance sheet.

When assets are sold or otherwise disposed of, the cost and related accumulated depreciation or amortization are removed from the accounts, and any resulting gain or loss is recognized in income for the period. The cost of maintenance and repairs is charged to expense as incurred. The Bank evaluates premises and equipment for financial impairment as events or changes in circumstances indicate that the carrying amount of such assets may not be fully recoverable.

Income Taxes

Deferred tax assets and liabilities are recognized for the tax consequences of temporary differences between the reported amount of assets and liabilities and their tax basis. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. A valuation allowance is recognized if, based on the weight of available evidence, management believes it is more likely than not that some portion or all of the deferred tax assets will not be realized. At December 31, 2009 and 2008, the bank established a valuation allowance for substantially all of its net deferred tax position.

Accounting for Uncertainty in Income Taxes

The Bank considers all tax positions recognized in its financial statements for the likelihood of realization. When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of the tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination. Interest expense and penalties associated with unrecognized tax benefits, if any, are classified as income tax expense in the statement of operations.



NOTES TO FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Earnings (Loss) Per Share

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

Share-Based Payments

The Bank has one share-based compensation plan, the California Bank of Commerce 2007 Equity Incentive Plan (the "Plan"), which has been approved by its shareholders and permits the grant of stock options and restricted stock for up to 825,000 shares of the Bank's common stock. The Plan is designed to attract and retain employees and directors. The amount, frequency, and terms of share-based awards may vary based on competitive practices, the Bank's operating results and government regulations. New shares are issued upon option exercise or restricted share grants.

The Plan does not provide for the settlement of awards in cash. The Plan requires that the option price may not be less than the fair market value of the stock at the date the option is granted, and that the stock must be paid in full at the time the option is exercised.

Restricted stock awards are grants of shares of common stock that are subject to forfeiture until specific conditions or goals are met. Conditions may be based on continuing employment or achieving specified performance goals. During the period of restriction, participants holding restricted stock may have full voting and dividend rights. The restrictions lapse in accordance with a schedule or with other conditions determined by the Board of Directors. No awards of restricted stock were made during the years ended December 31, 2009 and 2008.

The Bank recognizes share-based compensation expense be recorded for all stock options that are ultimately expected to vest as the requisite service is rendered, which is generally the vesting period.

Management estimates the fair value of each option award as of the date of grant using a Black-Scholes-Merton option pricing formula. Expected volatility is based on historical volatility of similar entities over a preceding period commensurate with the expected term of the option because the Bank's common stock has been publicly traded for a shorter period than the expected term for the options.

The risk-free rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of grant. Expected dividend yield was not considered in the option pricing formula since we have not paid dividends and have no current plans to do so in the future. In addition to these assumptions, management makes estimates regarding pre-vesting forfeitures that will impact total compensation expense recognized under the Plan.



NOTES TO FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Comprehensive Income (Loss)

Comprehensive income (loss) is a more inclusive financial reporting methodology that includes disclosure of other comprehensive income or loss that historically has not been recognized in the calculation of net income or loss. Sources of other comprehensive income or loss include unrealized gains and losses on available-for-sale investment securities. Total comprehensive income (loss) and components of accumulated other comprehensive income (loss) are presented in the statement of changes in shareholders' equity and comprehensive loss.

Adoption of New Financial Accounting Standards

FASB Accounting Standards Codification™ (ASC or Codification)

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

Noncontrolling Interests in Consolidated Financial Statements

In December 2007, the FASB issued ASC 810-10-65-1, (previously SFAS No. 160), *Noncontrolling Interests in Consolidated Financial Statements*. This standard requires that a noncontrolling interest in a subsidiary be reported separately within equity and the amount of consolidated net income specifically attributable to the noncontrolling interest be identified in the consolidated financial statements. It also calls for consistency in the manner of reporting changes in the parent's ownership interest and requires fair value measurement of any noncontrolling equity investment retained in a deconsolidation. This standard was effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. The Bank adopted the provisions of this standard on January 1, 2009 without a material impact on our financial condition or results of operations.

FASB Clarifies Other-Than-Temporary Impairment

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



NOTES TO FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Adoption of New Financial Accounting Standards (Continued)

FASB Clarifies Application of Fair Value Accounting

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

Measuring Liabilities at Fair Value

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

Business Combinations

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

Subsequent Events

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



NOTES TO FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Impact of New Accounting Standards

Accounting for Transfers of Financial Assets

In June 2009, the FASB issued ASC Topic 860 (previously SFAS No. 166), *Accounting for Transfers of Financial Assets, an amendment of SFAS No. 140*. This standard amends the derecognition accounting and disclosure guidance included in previously issued standards. This standard eliminates the exemption from consolidation for qualifying special-purpose entities (SPEs) and also requires a transferor to evaluate all existing qualifying SPEs to determine whether they must be consolidated in accordance with ASC Topic 810. This standard also provides more stringent requirements for derecognition of a portion of a financial asset and establishes new conditions for reporting the transfer of a portion of a financial asset as a sale. This standard is effective January 1, 2010. Management is assessing the impact of this standard on the Bank's financial condition, results of operations and disclosures.

Transfers and Servicing

In December 2009, the FASB issued Accounting Standards Update (ASU) No. 2009-16, *Transfers and Servicing (ASC Topic 860): Accounting for Transfers of Financial Assets*, which updates the derecognition guidance in ASC Topic 860 for previously issued SFAS No. 166. This update reflects the Board's response to issues entities have encountered when applying ASC 860, including: (1) requires that all arrangements made in connection with a transfer of financial assets be considered in the derecognition analysis, (2) clarifies when a transferred asset is considered legally isolated from the transferor, (3) modifies the requirements related to a transferee's ability to freely pledge or exchange transferred financial assets, and (4) provides guidance on when a portion of a financial asset can be derecognized. This update is effective for financial asset transfers occurring after January 1, 2010. Management is assessing the impact of this standard on the Bank's financial condition, results of operations and disclosures.

Improvements to Financial Reporting of Interests in Variable Interest Entities

In June 2009, the FASB issued ASC Topic 810 (previously SFAS No. 167), *Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities*. This standard amends the consolidation guidance applicable to variable interest entities. The amendments to the consolidation guidance affect all entities currently within the scope of ASC Topic 810, as well as qualifying special-purpose entities that are currently excluded from the scope of ASC Topic 810. This standard is effective as of January 1, 2010. The Bank does not expect the adoption of this standard will have a material impact on its financial position or results of operations.



NOTES TO FINANCIAL STATEMENTS

2. FAIR VALUE MEASUREMENTS

Fair Value of Financial Instruments

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

	December 31, 2009		December 31, 2008	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:				
Cash and cash equivalents	\$ 30,568,105	\$ 30,568,105	\$ 7,493,421	\$ 7,493,421
Investment securities	16,935,533	17,315,449	31,869,637	31,869,637
Loans held for sale	909,000	912,237	490,000	493,184
Loans, net	140,689,024	153,465,713	95,730,266	101,820,834
Federal Home Loan Bank (FHLB) stock	627,300	627,300	282,000	282,000
The Independent Banker's Bank stock	50,419	50,419	50,419	50,419
Pacific Coast Banker's Bank stock	190,000	190,000	190,000	190,000
Accrued interest receivable	596,946	596,946	454,959	454,959
Bank-owned life insurance	1,318,052	1,318,052	-	-
Financial liabilities:				
Deposits	152,674,036	152,518,482	110,510,184	110,471,280
Borrowings	17,000,000	17,031,472	6,000,000	5,994,703
Accrued interest payable	30,968	30,968	64,009	64,009

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

The following methods and assumptions were used to estimate the fair value of financial instruments. For cash and cash equivalents, accrued interest receivable and payable, FHLB, IBFC and PCBB stock, demand deposits, short-term borrowings and fixed-rate long-term borrowings, the carrying amount is estimated to be fair value. For investment securities, fair values are based on quoted market prices, quoted market prices for similar securities and indications of value provided by brokers. The fair values for loans and leases, including loans held-for-sale, are estimated using discounted cash flow analyses, using interest rates currently being offered at each reporting date for loans with similar terms to borrowers of comparable creditworthiness. The fair value of the Bank's investment in BOLI is its cash surrender value. Fair values for fixed-rate certificates of deposit are estimated using discounted cash flow analyses using interest rates offered at each reporting date by the Bank for certificates with similar remaining maturities.

The fair values of commitments are estimated using the fees currently charged to enter into similar agreements and are not significant and, therefore, not included in the above table.



NOTES TO FINANCIAL STATEMENTS

2. FAIR VALUE MEASUREMENTS (Continued)

Fair Value Hierarchy

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

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

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

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

Assets Recorded at Fair Value

The following tables present information about the Bank's assets and liabilities measured at fair value on a recurring basis as of December 31, 2009 and 2008:

Recurring Basis

The Bank is required or permitted to record the following assets at fair value on a recurring basis under other accounting pronouncements.

Description	2009			
	Fair Value	Level 1	Level 2	Level 3
Available-for-sale investment securities	\$ 17,315,449	\$	\$ 17,315,449	\$

Description	2008			
	Fair Value	Level 1	Level 2	Level 3
Available-for-sale investment securities	\$ 31,869,637	\$	\$ 31,869,637	\$

Fair values for available-for-sale investment securities, which include debt securities of U.S. Governmental Agencies and U.S. Agency guaranteed mortgage-backed securities are based on quoted market prices for similar securities. There were no changes in the valuation techniques used during 2009 or 2008.

The Bank did not have any assets or liabilities measured at fair value on a non-recurring basis at December 31, 2009 or 2008.



NOTES TO FINANCIAL STATEMENTS

3. INVESTMENT SECURITIES

Available-for-Sale

The amortized cost and estimated fair value of available-for-sale investment securities at December 31, 2009 and 2008 consisted of the following:

	2009			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Agency guaranteed mortgage-backed securities	\$ 16,935,533	\$ 379,916	\$ -	\$ 17,315,449

Net unrealized gains on available-for-sale investment securities totaling \$379,916 were recorded, net of \$155,766 in tax liabilities, as accumulated other comprehensive income within shareholders' equity at December 31, 2009. Proceeds and gross realized gains from the sale of available-for-sale investment securities for the year ended December 31, 2009 totaled \$18,380,098 and \$106,971 respectively.

	2008			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Government agencies	\$ 1,000,000	\$ 30,938	\$ -	\$ 1,030,938
U.S. Agency guaranteed mortgage-backed securities	15,307,294	168,113	(3,108)	15,472,299
Other Securities:				
Money Market mutual funds	15,300,000	-	-	15,300,000
Preferred stock	-	66,400	-	66,400
	<u>\$ 31,607,294</u>	<u>\$ 265,451</u>	<u>\$ (3,108)</u>	<u>\$ 31,869,637</u>

At December 31, 2008, the Bank's investment securities included 80,000 shares of FNMA Series S preferred stock. Due to the current status of FNMA, which is in a conservatorship relationship with the U.S. Treasury, and the significant decline in the stock price, the Bank recorded an other-than-temporary impairment write-down of \$2,045,875, as of September 30, 2008. These securities were sold during 2009 for a gain of \$101,099.

Net unrealized gains on available-for-sale investment securities totaling \$262,343 were recorded, net of \$107,561 in tax liabilities, as accumulated other comprehensive income within shareholders' equity at December 31, 2008. Proceeds and gross realized gains from the sale of available-for-sale investment securities for the year ended December 31, 2008 totaled \$29,301,080 and \$130,778, respectively.

At December 31, 2009, investment securities consisted of U.S. Agency guaranteed mortgage-backed securities with no single maturity dates. Expected maturities will differ from contractual maturities because the issuers of the securities may have the right to call or prepay obligations with or without call or prepayment penalties.

At December 31, 2009, all investment securities were pledged to secure State Treasury funds on deposit and borrowing arrangements in place at the Federal Reserve Bank of San Francisco. (See Note 8)



NOTES TO FINANCIAL STATEMENTS

4. LOANS

Outstanding loans are summarized below:

	December 31,	
	2009	2008
Commercial	\$ 58,230,033	\$ 44,133,804
Real estate - commercial	55,348,877	40,234,431
Real estate - construction	15,241,727	7,622,415
Real estate - residential	12,973,285	2,827,333
Personal and installment	1,143,841	1,957,801
	142,937,763	96,775,784
Deferred loan origination costs, net	316,261	354,482
Allowance for loan losses	(2,565,000)	(1,400,000)
	<u>\$ 140,689,024</u>	<u>\$ 95,730,266</u>

As of and for the years ended December 31, 2009 and 2008, the Bank had no impaired loans or loans placed on nonaccrual status.

Changes in the allowance for loan and lease losses were as follows:

	Years Ended December 31,	
	2009	2008
Balance at beginning of year	\$ 1,400,000	\$ 248,000
Provision for loan losses	1,256,357	1,152,000
Loans charged-off	(91,357)	-
Recoveries of loans previously charged-off	-	-
	<u>\$ 2,565,000</u>	<u>\$ 1,400,000</u>

Salaries and employee benefits totaling \$752,391 and \$893,448 were deferred as loan origination costs for the years ended December 31, 2009 and 2008, respectively.

Loans with book values of approximately \$98,753,000 were pledged to secure borrowing arrangements at December 31, 2009 (see Note 8).



NOTES TO FINANCIAL STATEMENTS

5. PREMISES AND EQUIPMENT

Premises and equipment consisted of the following:

	December 31,	
	2009	2008
Furniture, fixtures and equipment	\$ 584,532	\$ 559,518
Leasehold improvements	<u>133,382</u>	<u>133,382</u>
	717,914	692,900
Less accumulated depreciation and amortization	<u>(332,211)</u>	<u>(172,329)</u>
	<u>\$ 385,703</u>	<u>\$ 520,571</u>

Depreciation and amortization included in occupancy and equipment expense totaled \$159,882 and \$143,903, respectively, for 2009 and 2008.

6. INTEREST-BEARING DEPOSITS

Interest-bearing deposits consisted of the following:

	December 31,	
	2009	2008
Savings	\$ 7,061,028	\$ 4,243,227
Money market	72,325,767	45,609,801
Interest-bearing demand accounts	4,847,819	2,069,275
Time, \$100,000 or more	32,326,515	40,279,843
Other time	<u>695,000</u>	<u>520,762</u>
	<u>\$ 117,256,129</u>	<u>\$ 92,722,908</u>

Aggregate annual maturities of time deposits are as follows:

Year Ending December 31,	
2010	\$ 32,776,510
2011	<u>245,005</u>
	<u>\$ 33,021,515</u>



NOTES TO FINANCIAL STATEMENTS

6. INTEREST-BEARING DEPOSITS (Continued)

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

	<u>Year Ended December 31,</u>	
	<u>2009</u>	<u>2008</u>
Savings	\$ 63,358	\$ 28,662
Money market	781,151	745,409
Interest-bearing demand accounts	26,207	32,877
Time, \$100,000 or more	315,963	659,423
Other time	<u>8,604</u>	<u>9,573</u>
	<u>\$ 1,195,283</u>	<u>\$ 1,475,944</u>

At December 31, 2009, approximately \$34,549,000, or 22.6% of total deposits were from three customers whose individual deposit relationships each exceeded 5% of total deposits. The loss of these relationships could have a material impact on the Bank's operations and liquidity. Management attempts to mitigate this risk by working directly with these depositors and by maintaining sufficient liquidity to manage fluctuations in current balances within these larger relationships.

7. INCOME TAXES

The provision for income taxes for the years ended December 31, 2009 and 2008 consisted of the following:

	<u>2009</u>	<u>2008</u>
Current	\$ 800	\$ 800
Deferred	(395,591)	(1,869,295)
Increase in valuation allowance	<u>395,591</u>	<u>1,869,295</u>
Income tax expense	<u>\$ 800</u>	<u>\$ 800</u>



NOTES TO FINANCIAL STATEMENTS

7. INCOME TAXES (Continued)

Deferred tax assets (liabilities) consisted of the following:

	December 31,	
	2009	2008
Deferred tax assets:		
Net operating losses	\$ 1,967,682	\$ 1,350,392
Share-based compensation	142,307	84,635
Organization costs	383,507	414,086
Allowance for loan losses	835,135	468,171
Impairment on FNMA preferred stock	-	695,598
State deferred tax asset	<u>622,567</u>	<u>554,012</u>
Deferred tax assets before valuation allowance	3,951,198	3,566,894
Valuation allowance	<u>(3,581,697)</u>	<u>(3,186,106)</u>
Total deferred tax assets	<u>369,501</u>	<u>380,788</u>
Deferred tax liabilities:		
Accrual to cash conversion	(102,666)	(99,058)
Deferred loan origination costs	(265,668)	(237,162)
Premises and equipment	(181)	(39,079)
Unrealized gain on available-for-sale investment securities	(155,766)	(107,561)
Other	<u>(986)</u>	<u>(5,489)</u>
Total deferred tax liabilities	<u>(525,267)</u>	<u>(488,349)</u>
Net deferred tax liability	<u>\$ (155,766)</u>	<u>\$ (107,561)</u>

The determination of the amount of deferred income tax assets which are more likely than not to be realized is primarily dependent on projections of future earnings, which are subject to uncertainty and estimates that may change given economic conditions and other factors. The realization of deferred income tax assets is assessed and a valuation allowance is recorded if it is "more likely than not" that all or a portion of the deferred tax asset will not be realized. "More likely than not" is defined as greater than a 50% chance. All available evidence, both positive and negative is considered to determine whether, based on the weight of that evidence, a valuation allowance is needed.

Included in the valuation allowance against the deferred tax assets is the loss on sale of FNMA Preferred Stock. The loss on the preferred shares is accorded ordinary treatment for federal income tax purposes, but treated as a capital loss for California tax purposes. For California, capital losses are deductible only to the extent they offset capital gains within five years of the date that the loss is realized for tax. Management believes that a valuation allowance is appropriate against the California capital loss exposure in the amount of \$141,979. This valuation allowance is included as a component in the full valuation allowance against the Bank's deferred tax assets.

Based upon our analysis of available evidence, we have determined that it is "more likely than not" that all of our deferred income tax assets as of December 31, 2009 and 2008 will not be fully realized and therefore a valuation allowance was recorded.



NOTES TO FINANCIAL STATEMENTS

7. INCOME TAXES (Continued)

At December 31, 2009, the Bank had Federal and State net operating loss carry-forwards (NOLs) of \$5,782,105 and \$3,782,070, respectively. The Federal and State NOLs begin to expire in 2027 and 2019, respectively.

The Bank files income tax returns in the U.S federal and California jurisdictions. There are currently no pending U.S. federal or state income tax or non-U.S. income tax examinations by tax authorities. The Bank is subject to tax examinations by U.S. Federal and state taxing authorities for all tax returns filed since its inception.

As of December 31, 2009 and 2008, there were no unrecognized tax benefits or interest and penalties accrued by the Bank

8. BORROWING ARRANGEMENTS

The Bank has \$15,000,000 in unsecured borrowing arrangements with four of its correspondent banks to meet short-term liquidity needs. In a separate agreement, the Bank can borrow up to the lesser of \$8,000,000 or the total market value of securities pledged to a correspondent bank under a repurchase agreement. At December 31, 2009 and 2008, there were no investment securities pledged to the correspondent bank under this agreement. There were \$5,000,000 in borrowings outstanding under these arrangements at December 31, 2009 and none in 2008.

The Bank entered into a borrowing arrangement with the Federal Reserve Bank of San Francisco (FRB) during 2008 under which advances are secured by portions of the Bank's loan and investment securities portfolios. The Bank's credit limit varies according to the amount and composition of the assets pledged as collateral. At December 31, 2009, amounts pledged and available under such limits were approximately \$34,614,000.

The Bank entered into a borrowing arrangement with the Federal Home Loan Bank (FHLB) during 2008 under which advances are secured by portions of the Bank's loan portfolio. The Bank's credit limit varies according to its total assets and the amount and composition of the loan portfolio pledged as collateral. At December 31, 2009, amounts pledged and available under such limits were approximately \$17,439,000 and \$5,439,000, respectively. There were \$12,000,000 in borrowings outstanding under this arrangement at fixed interest rates ranging from 1.68% to 2.79% at December 31, 2009, with an average maturity of approximately 3.4 years.

9. COMMITMENTS AND CONTINGENCIES

Operating Leases

The Bank leases its headquarters facility in Lafayette, California from an affiliated party under a non-cancelable operating lease. The lease expires on May 30, 2015 and has one 7 1/2 year renewal option. The lease includes annual rent adjustments during the initial lease term and increases to the then current fair-market rent commencing the first year of the option. It is management's intention to exercise the renewal option.



NOTES TO FINANCIAL STATEMENTS

9. COMMITMENTS AND CONTINGENCIES (Continued)

Operating Leases (Continued)

Future minimum lease payments are as follows:

<u>Year Ending December 31,</u>	
2010	\$ 396,090
2011	405,765
2012	414,990
2013	424,755
2014	434,970
Thereafter	<u>184,950</u>
	<u>\$ 2,261,520</u>

Rental expense included in occupancy and equipment expense totaled \$408,276 and \$409,906 for the years ended December 31, 2009 and 2008, respectively.

Financial Instruments with Off-Balance-Sheet Risk

The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business in order to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates.

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

	<u>December 31,</u>	
	<u>2009</u>	<u>2008</u>
Commitments to extend credit	\$ 62,081,896	\$ 61,609,606
Standby letters of credit	\$ 1,352,018	\$ 996,654

The Bank's exposure to credit loss in the event of nonperformance by the other party for commitments to extend credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments as it does for loans included on the balance sheet.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee.

Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis.

The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies, but may include accounts receivable, inventory, and deeds of trust on residential real estate and income-producing commercial properties.



NOTES TO FINANCIAL STATEMENTS

9. COMMITMENTS AND CONTINGENCIES (Continued)

Financial Instruments with Off-Balance-Sheet Risk (Continued)

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

Commercial loan commitments represent approximately 71% of total commitments and are generally unsecured or secured by collateral other than real estate and have variable interest rates. Real estate loan commitments represent approximately 24% of total commitments and are generally secured by property with a loan-to-value ratio not to exceed 75%. The majority of real estate commitments also have variable interest rates. Home equity and personal lines of credit represent the remaining 5% of total commitments and are generally secured by residential real estate and have both variable and fixed interest rates.

Significant Concentrations of Credit Risk

The Bank grants real estate mortgage, real estate construction, commercial and installment loans to customers in the Bank's geographic service area. In management's judgment, a concentration exists in real estate related loans which represented approximately 58% and 53% of the Bank's loan portfolio at December 31, 2009 and 2008, respectively. Although management believes such concentrations to have no more than the normal risk of collectability, a substantial decline in the economy in general, or a decline in real estate values in the Bank's primary market area in particular, could have an adverse impact on collectability of these loans. Personal and business income represents the primary source of repayment for a majority of these loans.

Contingencies

The Bank may be subject to legal proceedings and claims which arise in the ordinary course of business. In the opinion of management, the amount of ultimate liability with respect to such actions will not materially affect the financial position or results of operations of the Bank.

Correspondent Banking Agreements

The Bank maintains funds on deposit with other federally insured financial institutions under correspondent banking agreements. Those insured financial institutions have elected to participate in the FDIC sponsored Transaction Account Guarantee Program. Under that program, through December 31, 2009, all noninterest-bearing transaction accounts were fully guaranteed by the FDIC for the entire amount in the account and, as a result of the program, there were no uninsured deposits with correspondent banks at December 31, 2009 or December 31, 2008. Coverage under the Transaction Account Guarantee Program is in addition to and separate from the coverage available under the FDIC's general deposit insurance rules.



NOTES TO FINANCIAL STATEMENTS

10. SHARE-BASED PAYMENT

Stock Option Awards

The California Bank of Commerce 2007 Equity Incentive Plan (the "Plan") permits the grant of stock options to directors, organizers and employees of the Bank. Grants of options to the organizers during the start up phase of the Bank and to the Directors are considered Non-Qualified Stock Option Awards. All other option grants are considered Incentive Stock Option Awards. All of the options granted under the Plan have a 10 year term and have been issued with exercise prices at the fair market value of the underlying shares at the date of grant. The Non-Qualified stock option awards to the organizers vested 100% immediately, whereas the Stock Option Awards to directors and employees vest over a three year period from the date the options were granted. The share-based compensation expense related to awards granted to organizers is included in pre-opening expenses.

For the years ended December 31, 2009 and 2008, the compensation cost recognized for stock option compensation was \$729,139 and \$718,788, respectively.

A summary of option activity under the Plan for the years ended December 31, 2009 and 2008 is presented below:

<u>Options</u>	<u>Shares</u>	<u>Weighted Average Exercise Price</u>	<u>Weighted Average Remaining Contractual Term (Years)</u>
Granted and outstanding at December 31, 2007	592,250	\$ 10.00	
Granted	21,500	\$ 10.16	
Forfeited	(4,250)	\$ 10.00	
Outstanding at December 31, 2008	<u>609,500</u>	<u>\$ 10.01</u>	<u>8.61</u>
Vested or expected to vest at December 31, 2008	<u>594,975</u>	<u>\$ 10.01</u>	<u>8.61</u>
Exercisable at December 31, 2008	<u>302,674</u>	<u>\$ 10.00</u>	<u>8.58</u>
Granted and outstanding at December 31, 2008	609,500	\$ 10.01	8.61
Granted	58,647	\$ 7.61	
Forfeited	(7,444)	\$ 10.48	
Outstanding at December 31, 2009	<u>660,703</u>	<u>\$ 9.79</u>	<u>7.81</u>
Vested or expected to vest at December 31, 2009	<u>644,671</u>	<u>\$ 9.79</u>	<u>7.81</u>
Exercisable at December 31, 2009	<u>487,381</u>	<u>\$ 10.01</u>	<u>7.59</u>

As of December 31, 2009, the unrecognized compensation cost related to non-vested stock option awards totaled \$671,531. That cost is expected to be amortized on a straight-line basis over a weighted average period of 0.83 years and will be adjusted for subsequent changes in estimated forfeitures.



NOTES TO FINANCIAL STATEMENTS

10. SHARE-BASED PAYMENT (Continued)

Stock Option Awards (Continued)

At December 31, 2009, there was no intrinsic value associated with outstanding stock option awards.

The following information relates to stock option grants granted during the years ended December 31, 2009 and 2008:

	2009	2008
Weighted average grant date fair value per share of options granted	\$ 5.03	\$ 3.86
Significant fair value assumptions:		
Expected term in years	6 years	6 years
Expected annual volatility	74.23%	33.22%
Expected annual dividend yield	0%	0%
Risk-free interest rate	2.25%	3.09%

11. SHAREHOLDERS' EQUITY

Dividends

Upon declaration by the Board of Directors, all shareholders of record will be entitled to receive dividends. The California Financial Code restricts the total dividend payment of any state banking association in any calendar year to the lesser of (1) the bank's retained earnings or (2) the bank's net income for its last three fiscal years, less distributions made to shareholders during the same three-year period. At December 31, 2009, no amounts were free of such restrictions.

Regulatory Capital

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

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

The Bank is also subject to additional capital guidelines under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the table on the following page. The most recent notification from the FDIC categorized the Bank as well capitalized under these guidelines. There are no conditions or events since that notification that management believes have changed the Bank's category.

Management believes that the Bank met all capital adequacy requirements as of December 31, 2009 and 2008.



NOTES TO FINANCIAL STATEMENTS

11. SHAREHOLDERS' EQUITY (Continued)

Regulatory Capital (Continued)

During its first three years, the Bank is required to maintain a minimum leverage ratio of 8%. In addition, to be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth below.

	<u>2009</u>		<u>2008</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
<u>Leverage Ratio</u>				
California Bank of Commerce	\$23,106,000	12.8%	\$20,179,000	15.2%
Minimum requirement for "Well-Capitalized" institution under prompt corrective action provisions	\$ 9,040,000	5.0%	\$ 6,643,000	5.0%
Minimum regulatory requirement	\$ 7,233,000	4.0%	\$ 5,315,000	4.0%
Minimum leverage ratio for de novo institution	\$14,465,000	8.0%	\$10,629,000	8.0%
<u>Tier 1 Risk-Based Capital Ratio</u>				
California Bank of Commerce	\$23,106,000	13.4%	\$20,179,000	14.4%
Minimum requirement for "Well-Capitalized" institution under prompt corrective action provisions	\$10,337,000	6.0%	\$ 8,412,000	6.0%
Minimum regulatory requirement	\$ 6,891,000	4.0%	\$ 5,608,000	4.0%
<u>Total Risk-Based Capital Ratio</u>				
California Bank of Commerce	\$25,265,000	14.7%	\$21,669,000	15.5%
Minimum requirement for "Well-Capitalized" institution under prompt corrective action provisions	\$17,228,000	10.0%	\$14,020,000	10.0%
Minimum regulatory requirement	\$13,782,000	8.0%	\$11,216,000	8.0%



NOTES TO FINANCIAL STATEMENTS

12. RELATED PARTY TRANSACTIONS

During the normal course of business, the Bank enters into transactions with related parties, including Directors, executive officers and affiliates. These transactions include borrowings from the Bank with substantially the same terms, including rates and collateral, as loans to unrelated parties.

The following is a summary of the aggregate activity involving related party borrowers during the year ended December 31, 2009:

Balance, December 31, 2008	\$ <u>6,370,560</u>
Disbursements	3,511,927
Amounts participated with other banks	18,274
Amounts repaid	<u>(1,909,340)</u>
Balance, December 31, 2009	\$ <u>7,991,421</u>
Undisbursed commitments to related parties, December 31, 2009	\$ <u>2,116,510</u>

At December 31, 2009, the Bank's deposits from related parties totaled \$3,292,000.

The Bank also leases its office from a company owned by a member of the Board of Directors. Rental payments under this agreement totaled \$423,756 for the year ended December 31, 2009 and \$425,386 for the year ended December 31, 2008.

13. EMPLOYEE BENEFIT PLANS

Profit Sharing Plan

In 2007, the Bank adopted the California Bank of Commerce Profit Sharing 401(k) Plan. All full-time employees 21 years of age or older with 3 months of service are eligible to participate in the plan. Eligible employees may elect to make tax deferred contributions up to the maximum amount allowed by law. The Bank may make additional contributions to the plan at the discretion of the Board of Directors. Bank contributions vest at a rate of 20% annually for all employees. The Bank did not make a contribution to the Plan during the years ended December 31, 2009 or 2008.

Salary Continuation and Retirement Plan

The Board of Directors approved a salary continuation plan for the Chief Executive Officer (CEO) during 2007. Under the Plan, once the CEO reaches age 65, the Bank is obligated to provide the CEO with annual benefits for twenty years after retirement. The estimated present value of these future benefits is accrued from the effective date of the plan until the CEO's expected retirement date based on a discount rate of 6.5%. The expense recognized under this plan for the years ended December 31, 2009 and 2008 totaled \$50,782 and \$38,711, respectively. Accrued compensation payable under the salary continuation plan totaled \$135,774 and \$84,992 at December 31, 2009 and 2008, respectively, and is included in accrued interest payable and other liabilities on the Bank's balance sheet.



NOTES TO FINANCIAL STATEMENTS

14. COMPREHENSIVE INCOME (LOSS)

Comprehensive income (loss) is reported in addition to net income for all periods presented. Comprehensive income (loss) is a more inclusive financial reporting methodology that includes disclosure of other comprehensive income (loss) that historically has not been recognized in the calculation of net income. Unrealized gains and losses on the Bank's available-for-sale investment securities are included in other comprehensive income (loss). Total comprehensive income and the components of accumulated other comprehensive income (loss) are presented in the statement of changes in shareholder's equity.

The Bank held securities classified as available-for-sale which had unrealized gains as follows:

	Before Tax	Tax Liability	After Tax
For the Year Ended December 31, 2009			
Other comprehensive income:			
Unrealized holding gains on available-for-sale investment securities	486,887	(199,624)	287,263
Less: reclassification adjustment for realized gains included in net income	<u>106,971</u>	<u>(43,858)</u>	<u>63,113</u>
Other comprehensive income from available-for-sale investment securities	<u>\$ 379,916</u>	<u>\$ (155,766)</u>	<u>\$ 224,150</u>
For the Year Ended December 31, 2008			
Other comprehensive income:			
Unrealized holding gains on available-for-sale investment securities	393,121	(161,180)	231,941
Less: reclassification adjustment for realized gains included in net income	<u>130,778</u>	<u>(53,619)</u>	<u>77,159</u>
Other comprehensive income from available-for-sale investment securities	<u>\$ 262,343</u>	<u>\$ (107,561)</u>	<u>\$ 154,782</u>



NOTES TO FINANCIAL STATEMENTS

15. OTHER EXPENSES

Other expenses for the years ended December 31, 2009 and 2008 consisted of the following:

	2009	2008
Outsourced data processing and electronic banking	\$ 224,109	\$ 156,461
Computer network and internet support	177,222	169,101
Director's stock-based compensation	169,625	166,034
Professional fees	201,618	202,354
Advertising, promotion and business development	165,412	177,890
Regulatory fees	337,590	76,323
Provision for unfunded loan commitments	(25,000)	48,000
Stationery and supplies	25,327	44,689
Correspondent Bank service charges	74,779	45,474
Other operating expenses	257,080	241,243
	<u>\$ 1,607,762</u>	<u>\$ 1,327,569</u>

16. PREFERRED STOCK

On February 27, 2009, the Bank entered into a Letter Agreement (the "Purchase Agreement") with the United States Department of the Treasury (the "Treasury"), pursuant to which the Bank issued and sold 4,000 shares of the Bank's Fixed Rate Non-cumulative Perpetual Preferred Stock, Series A (the "Series A Preferred") for a purchase price of \$4,000,000. Additionally, the Bank created and authorized 200.002 shares of the Bank's Fixed Rate Non-cumulative Perpetual Preferred Stock, Series B stock, (the "Series B Preferred"), which were issued to the United States Department of the Treasury in exchange for warrants to purchase 200.002 shares of Preferred Stock with a liquidation value of \$1,000 per share. Costs incurred by the Bank for the issuance of the Series A and Series B Preferred Stock totaled \$54,230.

The Series A Preferred will qualify as Tier 1 capital and will pay non-cumulative dividends quarterly at a rate of 5% per annum for the first five years, and 9% per annum thereafter. The Series B Preferred will qualify as Tier 1 capital and will pay non-cumulative dividends quarterly at a rate of 9% per annum until redemption. Subject to the approval of the Appropriate Federal Banking Agency, either series may be redeemed, in whole or in part, by the Bank after three years; however, the Series B Preferred may not be redeemed until after all the Series A Preferred has been redeemed. Prior to the end of three years, terms of the Series A Preferred and the Series B Preferred provide that such securities may be redeemed by the Bank only with proceeds from the sale of qualifying equity securities of the Bank (a "Qualified Equity Offering"). However, under Section 7001 of the American Recovery and Reinvestment Act of 2009 effective February 17, 2009, as acknowledged in a side letter with the Treasury dated February 27, 2009 and subject to consultation with the Federal Deposit Insurance Corporation, the Bank shall be permitted to redeem such securities without regard to the source of funds or waiting periods.



NOTES TO FINANCIAL STATEMENTS

16. PREFERRED STOCK (Continued)

The Series A Preferred Stock and the Series B Preferred Stock were issued in a private placement exempt from registration pursuant to Section 4(2) of the Securities Act of 1933, as amended. Neither the Series A nor the Series B Preferred Stock will be subject to any contractual restrictions on transfer, except that the Treasury and its transferees shall not effect any transfer of the Series A or Series B Preferred Stock which would require us to become subject to the periodic reporting requirements of Section 13 or 15(d) of the Exchange Act.

The Series A Preferred and Series B Preferred are non-voting, other than class voting rights on (i) any authorization or issuance of shares ranking senior to the Series A Preferred and Series B Preferred, (ii) any amendment to the rights of the Series A Preferred and Series B Preferred, or (iii) any merger, exchange or similar transaction which would adversely affect the rights of the Series A Preferred and Series B Preferred.

If dividends on the Series A Preferred and Series B Preferred are not paid in full for six dividend periods, whether or not consecutive, the holders of the Series A Preferred and Series B Preferred will have the right to elect 2 directors. The right to elect directors will end when full dividends have been paid for four consecutive dividend periods.

In the Purchase Agreement, the Bank agreed that, until such time as the Treasury ceases to own any debt or equity securities of the Bank acquired pursuant to the Purchase Agreement, the Bank will take all necessary action to ensure that its benefit plans with respect to its senior executive officers comply with Section 111(b) of the Emergency Economic Stabilization Act of 2008 (the "EESA") as implemented by any guidance or regulation under the EESA that has been issued and is in effect as of the date of issuance of the Series A Preferred and the Series B Preferred, and has agreed to not adopt any benefit plans with respect to, or which cover, its senior executive officers that do not comply with the EESA, and the applicable executives have consented to the foregoing. Furthermore, the Purchase Agreement allows the Treasury to unilaterally amend the terms of the agreement.

With respect to dividends on our common stock, the Treasury's consent shall be required for any increase in common dividends per share until the third anniversary of the date of its investment, unless prior to such third anniversary the Series A Preferred Stock and the Warrant Preferred are redeemed in whole or the Treasury has transferred all of the Series A Preferred Stock and Warrant Preferred to third parties. After the third anniversary and prior to the tenth anniversary, the Treasury's consent shall be required for any increase in aggregate common dividends per share greater than 3% per annum; provided that no increase in common dividends may be made as a result of any dividend paid in common shares, any stock split or similar transaction. After the tenth anniversary, we are prohibited from paying common dividends or repurchasing any equity securities or trust preferred securities until all equity securities held by the Treasury are redeemed in whole or the Treasury has transferred all of such equity securities to third parties.

Furthermore, for as long as any Series A Preferred or Series B Preferred is outstanding, no dividends may be declared or paid on junior preferred shares, preferred shares ranking pari passu with the Series A Preferred or Series B Preferred (other than in the case of pari passu preferred shares, dividends on a pro rata basis with the Series A Preferred or Series B Preferred), nor may the Bank repurchase or redeem any common shares, junior preferred shares, preferred shares ranking pari passu with the Series A Preferred or Series B Preferred, unless all accrued and unpaid dividends for all past dividend periods on the Series A Preferred and Series B Preferred are fully paid.



NOTES TO FINANCIAL STATEMENTS

16. PREFERRED STOCK (Continued)

The Bank recorded a discount on the Series A Preferred Stock at approximately the liquidation preference of the Series B Preferred Stock. The discount recorded on the Series A Preferred Stock will be amortized on the level-yield method over 5 years.

17. SUBSEQUENT EVENTS

We have reviewed all events occurring from December 31, 2009 through March 22, 2010, the date the financial statements were available to be issued, and no subsequent events occurred requiring accrual or disclosure.





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