PACIFIC CAPITAL BANCORP /CA/
Form 10-K
March 15, 2002

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, 2001
COMMISSION FILE NUMBER	0-11113

PACIFIC CAPITAL BANCORP
(Exact Name of Registrant as Specified in its Charter)

CALIFORNIA (State or other jurisdiction of incorporation or organization)	95-3673456 (I.R.S. Employer Identification No.)
1021 ANACAPA ST. SANTA BARBARA, CALIFORNIA (Address of principal executive offices)	93101 (Zip Code)

(805) 564-6298
(Registrant's telephone number, including area code)

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

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

Title of Class
COMMON STOCK, NO PAR VALUE

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes X 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 registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

The aggregate market value of the voting stock held by non-affiliates of the registrant as of February 21, 2002, based on the sales prices reported to the registrant on that date of $29.45 per share:

Common Stock - $731,719,972*
*Based on reported beneficial ownership by all directors and executive officers and the registrant's Employee Stock Ownership Plan; however, this determination does not constitute an admission of affiliate status for any of these stockholders.

As of February 21, 2002, there were 26,182,630 shares of the issuer's common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE: Portions of registrant's Proxy Statement for the Annual Meeting of Shareholders on April 23, 2002 are incorporated by reference into Part III.

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PART I

ITEM 1. BUSINESS

(a) General Development of the Business

Operations commenced as Santa Barbara National Bank with one office and 18 employees in 1960. In 1979, the Bank switched to a state charter and changed its name to Santa Barbara Bank & Trust ("SBB&T"). Santa Barbara Bancorp ("SBBancorp") was formed in 1982. In 1998, SBBancorp merged with Pacific Capital Bancorp ("PCB"), a bank holding company that was the parent of First National Bank of Central California ("FNB") and South Valley National Bank ("SVNB"). SBBancorp was the surviving company, but took the name Pacific Capital Bancorp. Unless otherwise stated, "Company" refers to this consolidated entity and to its subsidiary banks when the context indicates. "Bancorp" refers to the parent company only.

SBB&T has grown to 29 banking offices with loan, trust and escrow offices. Through 1988, banking activities were primarily centered in the southern coastal region of Santa Barbara County. Two banking offices were added in the merger with Community Bank of Santa Ynez Valley on March 31, 1989. Five offices in northern Santa Barbara County were added with the acquisition of First Valley Bank on March 31, 1997, and three offices in the Santa Clara River Valley region of Ventura County were added with the acquisition of Citizens State Bank on September 30, 1997. From 1995 through 1998, six banking offices were opened in western Ventura County and one in northern Santa Barbara County. The Company acquired Los Robles Bank ("LRB") at the end of June, 2000, when the Company purchased all of the outstanding shares of Los Robles Bancorp, parent of LRB. LRB was merged with SBB&T in the second quarter of 2001. LRB had three offices. Two of these became offices of SBB&T and the third was closed because of its close proximity to one of the existing offices of SBB&T.

FNB has 12 banking offices in Monterey, Santa Cruz, Santa Clara, and San Benito counties. The offices in Santa Clara County use the name South Valley National Bank, which was a separate subsidiary of PCB until it merged with FNB shortly before PCB merged with SBBancorp. The offices in San Benito County use the name San Benito Bank ("SBB"). SBB was a separate bank prior to its merger with FNB at the end of July, 2000. FNB also provides trust and investment services to its customers.

A third subsidiary, Pacific Capital Commercial Mortgage Company ("PCCM"), was formed in 1988. This subsidiary, which was primarily involved in mortgage brokering services and the servicing of brokered loans ceased business and became inactive in 2001.

There is a fourth subsidiary, Pacific Capital Services Corporation, which is also inactive.

During the fourth quarter of 2001, the Company applied for and received approval for a single national banking charter. We anticipate that SBB&T and FNB will be merged into this single charter at the end of the first quarter of 2002. The Company will continue to use the brand names of Santa Barbara Bank & Trust, First National Bank of Central California, South Valley National Bank, and San

Benito Bank in their respective market areas.

(b) FINANCIAL INFORMATION ABOUT INDUSTRY SEGMENTS

Information about industry segments is provided in Note 20 to the consolidated financial statements.

(c) NARRATIVE DESCRIPTION OF BUSINESS

Bancorp is a bank holding company. As of December 31, 2001, as described above, it had two bank subsidiaries and two inactive non-bank subsidiaries. Bancorp provides support services to its subsidiary banks. These services include executive management, personnel and benefits, risk management, data processing, strategic planning, legal, accounting and treasury.

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The banks offer a full range of commercial banking services to households, professionals, and smallto medium-sized businesses. These include various commercial, real estate and consumer loan, leasing and deposit products. The banks offer other services such as electronic fund transfers and safe deposit boxes to both individuals and businesses. In addition, services such as lockbox payment servicing, foreign currency exchange, letters of credit, and cash management are offered to business customers. The banks also offer trust and investment services to individuals and businesses. These include acting as trustee or agent for living and testamentary trusts, charitable remainder trusts, employee benefit trusts, and profit sharing plans, as well as executor or probate agent for estates. Investment management and advisory services are also provided.

COMPETITION: For most of its banking products, the Company faces competition in its market area from branches of most of the major California money center banks, some of the statewide savings and loan associations, and other local community banks and savings and loans. For some of its products, the Company faces competition from other non-bank financial service companies, especially securities firms.

EMPLOYEES: The Company currently employs the equivalent of approximately 1,200 full time employees. Additional employees would be added if new opportunities for geographic expansion or other business activities should occur.

(d) FINANCIAL INFORMATION ABOUT FOREIGN AND DOMESTIC OPERATIONS AND EXPORT SALES

The Company does not have any foreign business operations or export sales of its own. However, it does provide financial services including wire transfers, foreign currency exchange, letters of credit, and loans to other businesses involved in foreign trade.

ITEM 2. PROPERTIES

The Company maintains its executive offices in leased premises at 1021 Anacapa St., Santa Barbara, California. The Trust & Investment Services Division is also located in this building. The Company leases other premises in the Santa Barbara area for Information Technology, Operations Support and other administrative functions.

Of the 41 branch banking offices, all or a portion of 27 are leased. The Company owns the building used by the Residential Real Estate, Business Services, and International Banking Units.

ITEM 3. LEGAL PROCEEDINGS

The Company was one of a number of financial institutions named as party defendants in a patent infringement lawsuit filed in February 2000 by an unaffiliated financial institution. Generally, the lawsuit relates to the Company's tax refund program. The plaintiff contends that the program infringes on certain patents which it holds. The Company retained outside patent litigation counsel to vigorously defend it in this case. In November 2001, the plaintiff and the Company tentatively agreed to a settlement of the case. A final settlement agreement has been prepared and the Company expects that it will be fully executed in early 2002. The Company believes that the settlement is a reasonable compromise between the parties. The settlement provides for the Company to pay a license fee to the plaintiff beginning in 2002 for transactions processed in 2002 and continuing until the expiration of the patents at approximately the end of 2007.

The Company is involved in various other litigation of a routine nature which is being handled and defended in the ordinary course of the Company's business. In the opinion of Management, based in part on consultation with legal counsel, the resolution of these litigation matters will not have a material impact on the Company's financial position.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

There were no matters submitted to a vote of security holders during the fourth quarter of the fiscal year covered by this report.

PART II

ITEM 5. MARKET FOR THE REGISTRANT'S COMMON STOCK AND RELATED STOCKHOLDER MATTERS

(a) MARKET INFORMATION

The Company's common stock trades on The Nasdaq Stock Market under the symbol SABB. The following table presents the high and low closing sales prices of the Company's common stock for each quarterly period for the last two years as reported by The Nasdaq Stock Market:

	2001 QUARTERS				2000 QUARTERS			
	4TH	3RD	2ND	1ST	4TH	3RD	2ND	1S
Range of stock prices:								
High	$29.25	$30.15	$30.45	$30.38	$28.63	$28.50	$29.29	$30
Low	$26.15	$27.57	$25.44	$26.13	$24.13	$25.06	$23.44	$23

(b) HOLDERS

There were approximately 10,000 shareholders as of December 31, 2001. This number includes an estimate of the number of shareholders whose shares are held in the name of brokerage firms or other financial institutions. The Company is not provided with the number or identities of these shareholders, but has estimated the number of such shareholders from the number of shareholder documents requested by these firms for distribution to their customers.

Approximately 21% of the Company's shares are owned by institutional investors based on filings with the SEC by these investors.

(c) DIVIDENDS

The Company declares dividends four times a year. The following table presents cash dividends declared per share for the last two years:

	2001 QUARTERS				2000 QUARTERS			
	4TH	3RD	2ND	1ST	4TH	3RD	2ND	1S
Cash dividends declared	$0.22	$0.22	$0.22	$ -	$0.22	$0.22	$0.20	$0.
Cash dividends paid	$0.22	$0.22	$0.22	$0.22	$0.22	$0.20	$0.20	$0.

The Company declares cash dividends to its shareholders each quarter. Its policy is to declare and pay dividends of between 35% and 40% of its net income to shareholders. In 2001, the Company paid dividends of $0.22 per quarter. However, it changed the timing of the declaration of the dividend from the month prior to the quarter end to the first month of each quarter. In December 2000, the Company declared a dividend of $0.22 per share payable in February 2001. In April 2001 the Company declared a dividend of $0.22 per share payable in May 2001. In prior years, the dividend payable in May would have been declared in March. The number of dividends paid and the amount for the dividends paid to shareholders remains the same, but since only three quarterly dividends were declared in 2001, there is a smaller amount of dividends reported as declared in the Consolidated Statements of Shareholders' Equity for 2001 than for the preceding years.

The Company funds the dividends paid to shareholders primarily from dividends received from the subsidiary banks.

ITEM 6. SELECTED FINANCIAL DATA

The following table compares selected financial data for 2001 with the same data for the four prior years. The Company's Consolidated Financial Statements and the accompanying notes presented in Item 8 explain reasons for the year-to-year differences.

(AMOUNTS IN THOUSANDS EXCEPT PER SHARE AMOUNTS)	2001	INCREASE (DECREASE)	2000	1999	19
RESULTS OF OPERATIONS:					
Interest income	$291,108	$ 1,144	$289,964	$225,127	$205
Interest expense	97,226	(13,300)	110,526	72,475	72
Net interest income	193,882	14,444	179,438	152,652	133
Provision for credit losses	26,671	12,231	14,440	7,043	9
Noninterest revenue	65,726	15,386	50,340	43,919	39

Operating expense:					
Staff expense	69,788	2,584	67,204	55,357	52
Other operating expense	73,362	8,609	64,753	62,068	59
Income before income taxes	89,787	6,406	83,381	72,103	51
Provision for income taxes	33,676	1,751	31,925	25,570	19
NET INCOME	$56,111	$4,655	$51,456	$46,533	$31
DILUTED PER SHARE DATA: (1)					
Average shares outstanding	26,639	31	26,609	26,552	26
NET INCOME	$2.11	$0.18	$1.93	$1.75	$
Cash dividends declared	$0.66	($0.18)	$0.84	$0.72	$
Cash dividends paid	$0.88	$0.04	$0.84	$0.72	$
FINANCIAL CONDITION:					
Total assets	$3,960,929	$283,304	$3,677,625	$3,080,309	$2,825
Total deposits	$3,365,575	$262,756	$3,102,819	$2,621,457	$2,488
Long-term debt	$175,000	$72,000	$103,000	$85,017	$42
Total shareholders' equity	$325,876	$29,615	$296,261	$253,041	$230
OPERATING AND CAPITAL RATIOS:					
Average total shareholders' equity to average total assets	8.33%	0.56%	7.77%	8.25%	
Rate of return on average:					
Total assets	1.45%	0.05%	1.40%	1.57%	
Total shareholders' equity	17.46%	-0.60%	18.06%	19.00%	1

The above results of operations and balances for prior years have been restated to reflect the Company's pooling transactions with the former Pacific Capital Bancorp and with San Benito Bank.

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

Management's discussion and analysis of the financial condition and results of operation begins on the following page.

The following provides Management's comments on the financial condition and results of operations of Pacific Capital Bancorp and its subsidiaries. Unless otherwise stated, "we" or "the Company" refers to this consolidated entity. You should read this discussion in conjunction with the Company's consolidated financial statements and the notes to the consolidated financial statements. These statements and notes are presented on pages 54 through 98 of this Annual Report on Form 10-K. "Bancorp" will be used to refer to the parent company only. Terms with which the reader may not be familiar are printed in bold and defined the first time they occur or are defined in a note on pages 47 through 49.

The subsidiary banks are Santa Barbara Bank & Trust ("SBB&T") and First National

Bank of Central California ("FNB"). South Valley National Bank ("SVNB") and San Benito Bank ("SBB") were independent banks that merged with FNB and now operate under the same national bank charter as FNB. The Company acquired Los Robles Bank ("LRB") when it purchased all of the outstanding stock of Los Robles Bancorp at the end of June 2000. LRB was merged into SBB&T in the second quarter of 2001. Pacific Capital Commercial Mortgage Corporation ("PCCM") is a non-bank subsidiary of Bancorp which was primarily involved in mortgage brokering and the servicing of brokered loans. It ceased business and became inactive in 2001. The Company has a second inactive subsidiary, Pacific Capital Services Corporation.

This discussion and analysis provides insight into Management's assessment of the operating trends over the last several years and its expectations for 2002. Such expressions of expectations are not historical in nature and are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are subject to risks and uncertainties that may cause actual future results to differ materially from those expressed in any forward-looking statement. Such risks and uncertainties with respect to the Company include:

o increased competitive pressure among financial services companies;
o changes in the interest rate environment reducing interest margins or increasing interest rate risk;
o deterioration in general economic conditions, internationally, nationally or in the State of California;
o the occurrence of future events such as the terrorist acts of September 11, 2001;
o the availability of sources of liquidity at a reasonable cost;
o substantial increases in energy costs in California;
o reduced demand for or earnings derived from the Company's income tax refund loan and refund transfer programs;
o legislative or regulatory changes adversely affecting the business in which the Company engages; and
o difficulties integrating acquired operations.

This discussion also provides information on the strategies adopted by the Company to address these risks, and the results of these strategies.

The acquisitions of SBB and LRB are described in Note 19 to the consolidated financial statements. We accounted for the merger of SBB with the Company using the "pooling-of-interests" method of accounting. As a result, all amounts in this discussion and in the consolidated financial statements have been restated to reflect the results of operations as if this merger had occurred prior to the earliest period presented. In contrast, the acquisition LRB was accounted for as a purchase transaction, and its results of operations are included with those of the Company only from the date of acquisition.

OVERVIEW OF EARNINGS PERFORMANCE

In 2001, the net income for the Company was $56.1 million, or $2.11 per diluted share. This represents a 9.0% increase over the $51.5 million net income or $1.93 per diluted share reported for 2000. Reported net income for 2000 had been significantly impacted by expenses related to the acquisitions of SBB and LRB. Exclusive of these merger expenses (Note A), the Company's core or pro forma net operating income for 2000 was $56.8 million and diluted earnings per share for the year 2000 would have been $2.13. Earnings for 2001 were thus down slightly from the 2000 pro forma earnings.

The primary reasons for the slight decline in net income for 2001 compared to the pro forma figure for 2000 were the significant declines in interest rates during 2001 and the additional provision expense necessary to address the credit quality issues that result from a slowdown in the economy.

2000 pro forma earnings exceeded 1999 earnings by 22.0%, and 2000 pro forma earnings per share exceeded the 1999 figure by 21.7%. The primary reason for this increase was the large increase in interest income because of growth in loans and other earning assets only partially offset by increased interest expense.

From a longer range perspective, for the five years from 1997 through 2001, the Company's net income increased at a compound average annual rate of 20.4%. Among the reasons for this favorable trend of increase in net income have been:

- the integration of ten new branch offices through acquisitions (Note B);
- growth in the tax refund anticipation loan ("RAL") and refund transfer ("RT") programs;
- strong loan demand during the last three years;
- continued growth in service charges and fee income; and
- cost savings related to its mergers.

EXTERNAL FACTORS IMPACTING THE COMPANY

The major external factors impacting the Company include economic conditions, regulatory considerations, and trends in the banking and financial services industries.

ECONOMIC CONDITIONS

From a national perspective, the most significant economic factors impacting the Company in the last three years have been the steady growth in the economy and the actions of the Federal Reserve Board ("the Fed") to manage the pace of that growth. During late 1999, the Fed began to raise interest rates to slow economic growth and continued with periodic increases until mid-2000. Early in 2001, the Fed began to lower rates, as the economy showed evidence of significant slowing. It continued throughout 2001 until it had lowered its target short-term rate by 4.75% to its lowest rate in 40 years. These changes, especially given the extreme rate of decline in 2001, impact the Company as market rates for loans, investments and deposits respond to the Fed's actions.

The local economies in which the Company operates experienced steady growth during 1999 and 2000, but started showing signs of slowing in the first and second quarters of 2001. The more pronounced slowing and recessionary environment seen in much of the country in the third and fourth quarters of 2001 were more moderately present in our market areas. The hospitality and tourism sectors were affected by the tragedy of September 11, but showed some indications of normalization at the close of the year. Agriculture continued to face price pressures during the year, and the high tech segment showed uncertain and varying results. Housing markets have shown some slowdown in sales, but generally prices were stable with the high-end residential properties showing some volatility. The commercial real estate markets showed some signs of slowdown, but the increase in vacancy rates, and softening in lease rates reflected a more normalized environment compared to

the unusually strong position in 2000. Other than those mentioned, other small business and middle market segments showed some growth albeit at a lesser rate than in 2000.

REGULATORY CONSIDERATIONS

Changes in the regulatory environment and differences in practices between the various banking regulators impact the Company. As a state-chartered commercial bank, SBB&T is regulated by the California Department of Financial Institutions (the "CDFI"). SBB&T is also a member of the Federal Reserve Bank (the "FRB") and therefore its primary Federal regulator is the FRB. The Office of the Comptroller of the Currency (the "OCC") is the primary regulator for FNB because it is a nationally chartered bank. However, it must also comply with FRB regulations. The FRB is also the regulator for the Bancorp because it is a bank holding company.

Changes in regulation may impact the Company in different ways. The FRB requires that all banks maintain cash reserves equal to a percentage of their transaction deposits. The FRB may increase or decrease the percentage of deposits that must be held at the FRB to impact the amount of funds available to commercial banks to lend to their customers. This may be done as a means of stimulating or slowing economic activity. This method has not been used in the last decade as Federal Open Market Committee purchases or sales of securities to manage short term rates have instead been the preferred method of managing the economy.

The FRB also impacts the Company and its subsidiary banks through minimum capital requirements. These rules are discussed below in the section entitled "Capital Adequacy." The actions which the various banking agencies can take with respect to financial institutions which fail to maintain adequate capital and comply with other requirements are discussed below in the section titled "Regulation."

The Company has received approval from the OCC to merge its two bank charters into one national charter. This merger is expected to occur at the end of the first quarter of 2002. This merger will help to simplify the regulatory environment for the Company as it moves to only one primary regulator.

COMPETITION

The Company faces competition from other financial institutions and from businesses in other industries that have developed financial products. Banks once had an almost exclusive franchise for deposit products and provided the majority of business financing. With deregulation in the 1980's, other kinds of financial institutions began to offer competing products. Also, increased competition in consumer financial products has come from companies not typically associated with the banking and financial services industry, such as AT&T, General Motors and various software developers. Similar competition is faced for commercial financial products from insurance companies and investment bankers. Community banks, including the Company, attempt to offset this trend by developing new products that capitalize on the service quality that a local institution can offer. Among these are new loan, deposit, and investment products. The Company's primary competitors are different for each specific product and market area. While this offers special challenges for the marketing of our products, it offers protection from one competitor dominating the Company in its market areas.

RISK MANAGEMENT

The Company sees the process of addressing the potential impacts of the external factors listed above as part of its management of risk. In addition to common business risks such as disasters, theft, and loss of market share, the Company is subject to special types of risk due to the nature of its business. New and sophisticated financial products are continually appearing with different types of risk which need to be defined and managed if the Company chooses to offer them to its customers. Also, the risks associated with existing products must be reassessed periodically. The Company cannot operate risk-free and make a profit. Instead, the process of risk definition and assessment allows the Company to select the appropriate level of risk for the anticipated level of reward and then decide on the steps necessary to manage this risk. The Company's Chief Risk Officer and the other members of its Senior Leadership Council under the direction and oversight of the Board of Directors lead the risk management process.

Some of the risks faced by the Company are those faced by most enterprises-reputational risk, operational risk, and legal risk. The special risks related to financial products are CREDIT RISK and INTEREST RATE RISK. Credit risk relates to the possibility that a debtor will not repay according to the terms of the debt contract. Credit risk is discussed in the sections related to loans. Interest rate risk relates to the adverse impacts of changes in interest rates. The types of interest rate risk will be explained in the next section. The effective management of these and the other risks mentioned above is the backbone of the Company's business strategy.

THE IMPACT OF CHANGES IN ASSETS AND LIABILITIES TO NET INTEREST INCOME AND NET INTEREST MARGIN

The Company earns income from two sources. The primary source is from the management of its financial assets and liabilities and the second is from charging fees for services provided. The first source involves functioning as a FINANCIAL INTERMEDIARY; that is, the Company accepts funds from depositors or obtains funds from other creditors and then either lends the funds to borrowers or invests those funds in securities or other financial instruments. Income is earned as a spread between the interest earned from the loans or investments and the interest paid on the deposits and other borrowings. The second source, fee income, is discussed in other sections of this analysis, specifically in "Noninterest Revenue" and "Tax Refund Anticipation Loans and Refund Transfers."

The Company monitors asset and deposit levels, developments and trends in interest rates, liquidity, capital adequacy and marketplace opportunities. It responds to all of these to protect and increase income while managing risks within acceptable levels as set by the Company's policies. In addition, alternative business plans and contemplated transactions are analyzed for their impact. This process, known as ASSET/LIABILITY MANAGEMENT, is carried out by changing the maturities and relative proportions of the various types of loans, investments, deposits and other borrowings in the ways described above. The Management staff responsible for asset/liability management provides regular reports to the Asset/Liability Committee for each bank's Board of Directors and obtains approvals for major actions or occasional exceptions to policy.

CHANGES IN NET INTEREST INCOME AND NET INTEREST MARGIN

NET INTEREST INCOME is the difference or spread between the interest and fees earned on loans and investments (the Company's EARNING ASSETS) and the interest expense paid on deposits and other liabilities. The amount by which interest income will exceed interest expense depends on two factors: (1) the volume or balance of earning assets compared to the volume or balance of interest-bearing deposits and liabilities, and (2) the interest rate earned on those interest earning assets compared with the interest rate paid on those interest-bearing deposits and liabilities.

NET INTEREST MARGIN is net interest income (tax equivalent) expressed as a percentage of average earning assets. It is used to measure the difference between the average rate of interest earned on assets and the average rate of interest that must be paid on liabilities used to fund those assets. To maintain its net interest margin, the Company must manage the relationship between interest earned and paid.

Table 1 compares the changes in TAX EQUIVALENT (Note D) net interest income and tax-equivalent net interest margin from 1999 to 2000 and from 2000 to 2001.

TABLE 1-CHANGES IN NET INTEREST INCOME AND NET INTEREST MARGIN
(dollars in thousands)

	TAX-EQUIVALENT NET INTEREST INCOME	AVERAGE EARNING ASSETS	AVERAGE INTEREST-BEARING LIABILITIES	TAX-EQUIVALENT NET INTEREST MARGIN
1999	$158,739	$2,756,174	$2,127,380	5.76%
Change	$26,872	$635,847	$516,973	(0.29%)
% Change	16.9%	23.1%	24.3%	5.00%
2000	$185,611	$3,392,021	$2,644,353	5.47%
Change	$13,995	$148,867	$109,019	0.17%
% Change	7.5%	4.4%	4.1%	3.10%
2001	$199,696	$3,540,888	$2,753,372	5.64%

Tax equivalent net interest income increased each year, but at a lower rate from 2000 to 2001 (7.5%) than it had from 1999 to 2000 (16.9%). The Company's net interest margin decreased from 1999 to 2000, 5.76% compared to 5.47%, and increased to 5.64% for 2001. The reasons for these changes will be explained through the remainder of this section of the discussion. Management uses the information in Tables 2 and 3 to analyze the changes in net interest income and net interest margin.

Table 2, "Distribution of Average Assets, Liabilities, and Shareholders' Equity and Related Interest Income, Expense and Rates," sets forth the AVERAGE DAILY BALANCES (Note E) for the major asset and liability categories, the related income or expense where applicable, and the resultant yield or cost attributable to the average earning assets and interest-bearing liabilities. Changes in the average balances and the rates received or paid depend on market opportunities, how well the Company has managed interest rate risks, product pricing policy, product mix, and external trends and developments.

Table 3, "Volume and Rate Variance Analysis of Net Interest Income," analyzes the changes in net interest income from 1999 to 2000 and from 2000 to 2001. The analysis shows the impact of volume and rate changes on the major categories of assets and liabilities from one year to the next. The table explains how much of the difference or variance in interest income or expense from one year to the next for each major category of assets or liabilities is due to changes in the balances (volume) or to changes in rates. For example, Table 2 shows that for 2000, savings and interest-bearing transaction accounts averaged $1,290 million, interest expense was $34.0 million and the average rate paid was 2.63%. For 2001, the average balance was $1,325 million, interest expense was $24.6 million, and the average rate paid was 1.86%. Table 3 shows that the $9.3 million net decrease in interest expense was due to a decrease of $10.2 million from a decrease in the average rate paid offset by a $900 thousand increase in expense from an increase in balances.

A shift in the relative size of the major balance sheet categories has an impact on net interest income and net interest margin. To the extent that funds invested in securities can be repositioned into loans, earnings increase because of the higher rates paid on loans. However, additional credit risk is incurred with loans compared to the very low risk of loss on securities, and the Company must carefully monitor the underwriting process to ensure that the benefit of the additional interest earned is not offset by additional credit losses. In general, depositors are willing to accept a lower rate on their funds than are other providers of funds because of the Federal Deposit Insurance Corporation ("FDIC") insurance coverage. To the extent that the Company can fund asset growth by deposits, especially the lower cost transaction accounts, rather than borrowing funds from other financial institutions, the average rates paid on funds will be less, and net interest income more.

THE IMPACT OF OVERALL TRENDS IN THE BALANCES AND RATES OF ASSETS AND LIABILITIES-1999 TO 2000

The Fed raised interest rates (Note F) in late 1999 and early 2000. Changes in deposit rates generally lag rate changes in assets. While loan rates rose in response, rates on deposits rose by a larger proportion as they caught up in 2000 with the loan rate increases from 1999.

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Interest income increased by $64.8 million as average earning assets increased by 23.1% from $2.76 billion to $3.39 billion and the average rate earned on these assets increased from 8.39% to 8.73%. The higher average balance of earning assets in 2000 than in 1999 resulted in $7.9 million in additional interest income. The higher rates prevalent in 2000 added $57.0 million in interest income over the amount earned in 1999. The acquisition of LRB in 2000 added $158 million in earning assets, but the Company was also able to generate strong growth in customer loans in the robust economy of 2000.

Average loans increased from $1.91 billion in 1999 to $2.39 billion in 2000, increasing slightly as a proportion of the total and benefiting the most from rising rates. Average deposits (interest-bearing and noninterest-bearing) increased by $569 million or 22.1%. With falling stock markets and significant losses for holders of many internet stocks, depositors seemed less inclined in 2000 than in 1998 and 1999 to withdraw funds from banks to place in equity investments.

The $431 million increase in interest-bearing deposits resulted in an increase of $18.4 million in interest expense, while the higher rates added $14.0 million additional expense. Part of the increases in both balances and rates of interest-bearing deposits relates to the Company's tax refund loan program. This program expanded significantly in 2000 over 1999 for reasons explained below in the section of this discussion titled "Tax Refund Anticipation Loan and Refund Transfer Programs." This expansion required a large amount of short term funding which was raised by using brokered Certificates of Deposit ("CDs"). Brokered CDs are obtained from third parties. There is a higher cost for these deposits and to get sufficient funds within a short period of time, the Company had to issue CDs with a longer term than was necessary to fund the refund loans. After the refund loans were repaid, the funds were invested in other assets, but at rates either equal to or only slightly higher than the rates paid on the deposits.

While the increase in deposits was significant, it was not enough to fund the increase in earning and non-earning assets (see "Nonearning Assets" below). Total average assets increased $699 million. The Company needed to increase its use of non-deposit sources to fund this growth. These overnight and longer term borrowings are generally more expensive than deposit funding sources.

The net impact of the above changes from 1999 to 2000 resulted in a $26.9 million or 16.9% increase in tax equivalent net interest income. However, as shown in Table 1, the net interest margin decreased from 5.76% to 5.47%. The reason for this seeming contradiction is that interest rates do not move for all asset and liability categories in a parallel manner (explained more fully in the section below titled "Interest Rate Risk"). From 1999 to 2000, interest income increased more than interest expense which increased net interest income. However, while average interest rates on both assets and liabilities rose, the rates on liabilities rose more. This caused the net interest margin to decline.

Average interest rates on earning assets increased by 0.34% or 34 basis points. Average interest rates paid on nondeposit sources of funds also increased 44 basis points, but average interest rates on deposits increased 75 basis points. This occurred because of the brokered deposits mentioned above and because average deposit rates continued to increase later in 2000 as time deposits were renewed at higher rates while loans generally remained at set at the rates of the last Fed increase in June 2000. The $14.0 million increase in interest expense on deposits due to rate increases was 43.2% of the total increase in interest expense on deposits, while the increase in interest income on all assets from rates was 12.1%. In summary, there was an increase in interest expense from rate increases on deposits that was more than offset by the increase in interest income from the increase in the balance of earning assets, resulting in an increase in net interest income. The increase in the average rate earned was not sufficient to cover the increase in the average cost of funds, and the net interest margin declined.

THE IMPACT OF OVERALL TRENDS IN THE BALANCES AND RATES OF ASSETS AND LIABILITIES-2000 TO 2001

The slower rate of growth in net interest income from 2000 to 2001 than was experienced from 1999 to 2000 occurred because of the slower rate of growth in the Company's earning assets and interest-bearing liabilities from 2000 to 2001 compared to the rate of growth from 1999 to 2000.

Average earning assets increased by 4.4% compared to 23.1% from 1999 to 2000 and interestbearing liabilities increased 4.1% compared to 24.3% for the prior year.

The slowdown in the economy in 2001 was the major factor in the reduced rates of growth in assets and liabilities. A second factor was that there were no acquisitions in 2001 like LRB in 2000.

As noted above, average rates on loans are usually higher than other assets and average rates on non-deposit sources of funds are generally higher than on deposits. Loans continued to grow as a proportion of earning assets, increasing from 70.4% in 2000 to 75.6% in 2001, helping to offset the effect of lower rates. Non-deposit sources of funds as a proportion of interest-bearing liabilities increased as well, but by only one tenth of a percent. These product mix changes helped to keep total interest income at virtually the same amount as in 2000, while interest expense declined by $13.3 million.

Each of the major categories of assets and liabilities is discussed in various sections below. In these sections, there is a description of the reason for any significant changes in the balances, how the changes impacted the net interest income and margin, and how the categories fit into the overall asset/liability strategy for managing risk.

TABLE 2-DISTRIBUTION OF AVERAGE ASSETS, LIABILITIES, AND SHAREHOLDERS' EQUITY AND RELATED INTEREST INCOME, EXPENSE, AND RATES (Notes D and G)

	2001		
(DOLLARS IN THOUSANDS)	BALANCE	INCOME	RATE
Assets			
Money market instruments			
Commercial paper	$ 48,613	$ 2,088	4.30%
Federal funds sold	132,941	5,852	4.40%
Total money market instruments	181,554	7,940	4.37%
Securities:			
Taxable	517,256	31,209	6.03%
Non-taxable	163,853	15,401	9.40%
Total securities	681,109	46,610	6.84%
Loans (Note D)			
Commercial	675,660	64,076	9.48%
Real estate	1,664,748	125,789	7.56%
Consumer	337,817	52,507	15.54%
Total loans	2,678,225	242,372	9.05%
Total earning assets	3,540,888	296,922	8.39%
Non-earning assets	317,421		
Total assets	$3,858,309		
Liabilities and shareholder's equity			
Interest bearing deposits:			
Savings and interest bearing transaction accounts	$1,324,595	24,619	1.86%
Time certificates of deposit	1,185,700	58,442	4.93%
Total interest bearing deposits	2,510,295	83,061	3.31%
Borrowed funds:			
Repos and fed funds purchased	85,631	3,289	3.84%
Other borrowings	157,446	10,876	6.91%
Total borrowed funds	243,077	14,165	5.83%

Total interest bearing liabilities	2,753,372	97,226	3.53%
Noninterest-bearing demand deposits	725,267		
Other liabilities	58,340		
Shareholders' equity	321,330		
Total Liabilities and shareholder's equity	$3,858,309		
Interest income/earning assets			8.39%
Interest expense/earning assets			2.75%
Net interest income/margin		199,696	5.64%
Provision for credit losses charged to operations/earning assets		26,671	0.75%
Net interest margin after provision for credit losses on tax equivalent basis		173,025	4.89%
Less: tax equivalent income included in interest income from non-taxable securities and loans		5,814	
Net interest income		$167,211	

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2000			1999		
BALANCE	INCOME	RATE	BALANCE	INCOME	RATE
$ 24,386	$ 1,602	6.57%	$ 5,800	$ 307	5.29%
172,227	9,870	5.73%	83,246	4,033	4.84%
196,613	11,472	5.83%	89,046	4,340	4.92%
640,458	38,925	6.08%	613,812	36,677	5.97%
166,210	16,340	9.83%	145,089	14,810	10.21%
806,668	55,265	6.86%	758,901	51,487	6.79%
616,467	64,713	10.50%	523,563	54,939	10.49%
1,439,019	119,077	8.27%	1,155,811	91,880	7.95%
333,254	45,610	13.69%	228,853	28,568	12.48%
2,388,740	229,400	9.60%	1,908,227	175,387	9.19%

3,392,021	296,137	8.73%	2,756,174	231,214	8.39%
274,394			211,274		
$3,666,415			$2,967,448		
$1,289,779	33,956	2.63%	$1,138,854	24,465	2.15%
1,148,023	64,337	5.60%	868,415	41,429	4.77%
2,437,802	98,293	4.03%	2,007,269	65,894	3.28%
76,197	4,247	5.57%	37,397	1,766	4.72%
130,354	7,986	6.13%	82,714	4,815	5.82%
206,551	12,233	5.92%	120,111	6,581	5.48%
2,644,353	110,526	4.18%	2,127,380	72,475	3.41%
703,531			565,525		
33,657			29,515		
284,874			245,028		
$3,666,415			$2,967,448		
		8.73%			8.39%
		3.26%			2.63%
	185,611	5.47%		158,739	5.76%
	14,440	0.43%		7,043	0.26%
	171,171	5.05%		151,696	5.50%
	6,173			6,087	
	$164,998			$145,609	

TABLE 3-VOLUME AND RATE VARIANCE ANALYSIS OF NET INTEREST INCOME
(Taxable equivalent basis - Notes D and H)

(IN THOUSANDS)	2001 OVER 2000			2000 OVE	
Increase (decrease) in:	RATE	VOLUME	TOTAL	RATE	VOLU
Interest income:					

Money market instruments					
Commercial paper	$ (697)	$ 1,183	$ 486	$ 51	$ 1,2
Federal funds sold	(2,027)	(1,991)	(4,018)	857	4,9
Money market funds	(20)	(90)	(110)	(8)	(
Total money market investment	(2,744)	(898)	(3,642)	900	6,1
Securities:					
Taxable	(316)	(7,400)	(7,716)	677	1,6
Non-taxable	(709)	(230)	(939)	(566)	2,0
Total securities	(1,025)	(7,630)	(8,655)	111	3,7
Loans					
Commercial loans	(6,572)	5,935	(637)	52	9,7
Real estate loans	(10,832)	17,544	6,712	3,838	23,3
Consumer loans	6,262	635	6,897	2,987	14,0
Total loans	(11,142)	24,114	12,972	6,877	47,1
Total earning assets	(14,911)	15,696	785	7,888	57,0
Liabilities:					
Interest bearing deposits:					
Savings and interest bearing transaction accounts	(10,226)	889	(9,337)	5,955	3,5
Time certificates of deposit	(7,938)	2,043	(5,895)	8,037	14,8
Total interest bearing deposits	(18,164)	2,932	(15,232)	13,992	18,4
Borrowed funds:					
Repos and fed funds purchased	(1,436)	478	(958)	4	2,4
Other borrowings	1,098	1,792	2,890	268	2,9
Total borrowed funds	(338)	2,270	1,932	272	5,3
Total interest bearing liabilities	(18,502)	5,202	(13,300)	14,264	23,7
Net Interest Income	$ 3,591	$10,494	$ 14,085	$(6,376)	$33,2

INTEREST RATE RISK

The net interest margin is subject to the following types of risks that are related to changes in interest rates: MARKET RISK, MISMATCH RISK, and BASIS RISK.

MARKET RISK RELATING TO FIXED-RATE INSTRUMENTS

MARKET RISK results from the fact that the market values of assets or liabilities on which the interest rate is fixed will increase or decrease with changes in market interest rates. If the Company invests funds in a fixed-rate long-term security and then interest rates rise, the security is worth less than a comparable security just issued because the older security pays less interest than the newly issued security. If the older security was sold before maturity, the Company would have to recognize a loss. Conversely, if interest rates decline after a fixed-rate security is purchased, its value increases, because it is paying a higher coupon rate than newly issued securities.

The fixed-rate liabilities of the Company, like certificates of deposit and borrowings from the Federal Home Loan Bank ("FHLB"), also change in value with changes in interest rates. As rates drop, they become more valuable to the depositor and hence more costly to the Company. As rates rise, they become more valuable to the Company. Therefore, while the value changes regardless of which direction interest rates move, the adverse impacts of market risk to the Company's fixed-rate assets are due to rising interest rates and for the Company's fixed-rate liabilities they are due to falling rates.

In general, for a given change in interest rates, the amount of the change in value up or down is larger for instruments with longer remaining maturities. Therefore, the exposure to market risk from assets is lessened by managing the amount of fixed-rate assets and by keeping maturities relatively

short. However, these steps must be balanced against the need for adequate interest income because variable rate and shorter term fixed-rate securities generally earn less interest than fixed-rate and longer term securities.

Note 14 to the consolidated financial statements discloses the carrying amounts and fair values of the Company's financial assets and liabilities, its NET FINANCIAL ASSETS, as of the end of 2001 and 2000. There is a relatively small difference between the carrying amount of the assets and their fair value due to credit quality issues. However, the primary difference between the carrying amount and the fair value of the Company's financial assets is essentially a measure of how much changes in interest rates have made the assets more or less valuable to the Company at December 31, 2001 and 2000 than when acquired. The excess of the fair value of the financial assets over their carrying amounts at the end of 2001 was $65.8 million compared with an excess of carrying amount over fair value of $32.7 million at the end of 2000. Most of this change is due to decreases in market rates during 2001.

Because the amount of the Company's fixed-rate liabilities is significantly less than its fixed-rate assets, and because the average maturity of the fixed-rate liabilities is substantially less than for the fixed-rate assets, the market risk relating to liabilities is not as great as for assets. The difference between the carrying amount and the fair value in the table in Note 14 shows the impact of changing rates on the Company's liabilities that have fixed-rates. They are worth $21.9 million more to customers or lenders to the Company at December 31, 2001, than they were when issued, because on a weighted average basis, they are paying rates that are higher than current market rates.

MISMATCH RISK

The second interest-related risk, MISMATCH RISK, arises from the fact that when interest rates change, the changes do not occur equally in the rates of interest earned on assets and paid on liabilities. This occurs because of differences in the contractual maturity terms of the assets and liabilities held. A difference in the maturities, a mismatch, can cause adverse impacts on net interest income.

The Company has a large portion of its loan portfolio tied to the national prime rate. If these rates are lowered because of general market conditions, e.g., the prime rate decreases in response to a rate decrease by the Fed as happened in 2001, these loans will be re-priced. If the Company were at the same time to have a large proportion of its deposits in longer-term fixed-rate certificates, interest earned on loans would decline while interest expense would remain at higher levels for a period of time until the certificates matured. Therefore, net interest income would decrease immediately. A decrease in net interest income could also occur with rising interest rates if the Company had a large portfolio of fixed-rate loans and securities that was funded by deposit accounts on which the rate is steadily rising.

If the assets of a holder of financial instruments mature or reprice sooner than its liabilities, then the assets will respond more quickly than liabilities to changes in interest rates. In this case, the holder is said to be ASSET SENSITIVE. If liabilities are more responsive to changes in rates than assets, it is said to be LIABILITY SENSITIVE. If the amounts of assets and liabilities maturing or repricing in the short-term are approximately the same, it is said to be NEUTRAL.

This exposure to mismatch risk is managed by attempting to match the maturities and repricing opportunities of assets and liabilities. This may be done by varying the terms and conditions of the products that are offered to depositors and borrowers. For example, if many depositors want shorterterm certificates while most borrowers are requesting longer-term fixed rate loans, the Company will adjust the interest rates on the certificates and loans to try to match up demand for similar maturities. The Company can then partially fill in mismatches by purchasing securities or borrowing funds from the FHLB with the appropriate maturity or repricing characteristics.

BASIS RISK

The third interest-related risk, BASIS RISK, arises from the fact that interest rates rarely change in a parallel or equal manner. The interest rates associated with the various assets and liabilities differ in how often they change, the extent to which they change, and whether they change sooner or later than other interest rates. For example, while the repricing of a specific asset and a specific liability may occur at roughly the same time, the interest rate on the liability may rise one percent in response to rising market rates while the asset increases only one-half percent. While the Company would appear to be evenly matched with respect to the maturities of the specific asset and liability, it would suffer a decrease in net interest income.

The nonparallel response occurs because various contractual limits and non-contractual factors come into play. An example of a contractual limit is the "interest rate cap" on some residential real estate loans, which may limit the amount that rates may increase. An example of a non-contractual factor is the assumption on how low rates could be lowered on ADMINISTERED rate accounts. Administered rate deposit accounts like negotiable order of withdrawal ("NOW") accounts, money market deposit accounts ("MMDA"), and savings, are the accounts that do not have a contractually set rate for their term as do certificates of deposit. The Company can reprice these products at its option based on competitive pressure and the need for funds.

This exposure to basis risk is the type of interest risk least able to be managed, but is also the least dramatic. Avoiding concentration in only a few types of assets or liabilities is the best means of increasing the chance that the average interest received and paid will move in tandem. The wider diversification means that many different rates, each with their own volatility characteristics, will come into play.

THE IMPACT OF INTEREST RATE RISK IN 2001

Each of these risks came into play in 2001 as the interest rate environment changed dramatically. As noted above, there was a substantial change in the fair value of fixed-rate assets compared to their carrying amount caused by the steep decline in market rates. This caused a switch from the carrying value being more than the fair value (depreciation) at the end of 2000 to the carrying value being less than the fair value (appreciation) at the end of 2001. To a lesser extent, liabilities were also impacted by this, moving from a position where the Company was paying less than market rates on some of its liabilities at the end of 2000, to where the Company was paying more than market rates on some of its liabilities at the end of 2001.

Over the last several years, with respect to mismatch risk, the Company has generally been neutral or asset sensitive. As mentioned above, this was a benefit from mid-1999 to mid-2000 as interest rates were rising. The Company's assets repriced faster than its liabilities and net interest income increased. It was a detriment in 2001 as a large proportion of the Company's assets kept repricing lower with each Fed action lowering rates while a large proportion of its liabilities lagged in their repricing.

Basis risk also had a substantial impact causing the Company to become increasingly asset sensitive as the market rates continued to drop. This occurred because while assets set to prime rate as an index changed with each decrease in prime and to exactly the same extent as prime, the rates even on administered rate deposits could not be decreased as frequently or to the same extent. The rate paid on NOW accounts at year-end 2000 was 50 basis points. It is clear that the rate on these accounts could not be decreased to the same extent as the 475 basis points that prime decreased in 2001.

NET INTEREST INCOME AND NET ECONOMIC VALUE SIMULATIONS

To quantify the extent of all of these risks both in its current position and in transactions it might take in the future, the Company uses computer modeling to simulate the impact of different interest rate scenarios on net interest income and on NET ECONOMIC VALUE. Net economic value, or the

MARKET VALUE OF PORTFOLIO EQUITY, is defined as the difference between the market value of financial assets and liabilities. These hypothetical scenarios include both sudden and gradual interest rate changes, and interest rate changes in both directions. This modeling is the primary means the Company uses for interest rate risk management decisions.

Each quarter, the Company models how sudden, hypothetical changes in interest rate, called SHOCKS, if applied to its asset and liability balances, would impact net interest income and net economic value. The results of this modeling indicate how much of the Company's net interest income and net economic value are "at risk" (deviation from the base level) from various sudden rate changes. Although interest rates normally would not change in this sudden manner, the very steep decline in interest rates during 2001 make the 2% shock a more realistic scenario than most observers would have believed a year ago. This exercise is valuable in identifying risk exposures and in comparing the Company's interest rate risk profile with those of other financial institutions. The results for the Company's December 31, 2001, balances indicate that the Company's net interest income at risk over a one-year period and net economic value at risk from 2% shocks are within normal expectations for such sudden changes.

	Shocked by -2%	Shocked by +2%
As of December 31, 2000:		
Net interest income	(3.72%)	3.65%
Net economic value	12.71%	(11.71%)
As of December 31, 2001:		

Net interest income	(5.87%)	+2.33%
Net economic value	+24.33%	(25.94%)

For these measurements, the Company makes certain assumptions that significantly impact the results. The most significant assumption is the use of a "static" balance sheet-the Company does not project changes in the size or mix of the various assets and liabilities. Additional assumptions include the duration of the Company's non-maturity deposits because they have no contractual maturity, and the extent to which the Company would adjust the rates paid on its administered rate deposits as external yields change.

As noted above, financial instruments do not respond in parallel fashion to rising or falling interest rates. This causes an asymmetry in the magnitude of changes in net interest income and net economic value resulting from the hypothetical increases and decreases in rates. In other words, the same percentage of increase and decrease in the hypothetical interest rate will not cause the same percentage change in net interest income or net economic value.

In addition, the degree of asymmetry changes as the base rate changes from period to period and as there are changes in the Company's product mix. For example, if savings accounts are paying 4% when one measures the impact of a 2% decrease in market rates, the measured responsiveness of the rate paid on these accounts to that decrease will be greater than the responsiveness if the current rate is 3% when the measurement is done. This is because the Company cannot assume that it will be able to lower the rates paid on these deposits as much from a 3% base as from a 4% base. Another example of non-contractual factors coming into play would be that to the extent consumer variable rate loans are a larger proportion of the portfolio than in a previous period, the caps on loan rates, which generally are present only in consumer loans, would have more of an adverse impact on the overall result if rates were to rise.

The change in the results of the analysis shown above between the two period-ends is due primarily to the substantial decrease in prevailing interest rates during 2001, which left certain low cost liability products at less than 2% of cost. As such, these products begin to behave as fixed rate products in 2% shock analysis. In other words, even if rates were to decrease 2%, the rates on these accounts would drop minimally. The Company has become increasingly asset sensitive as rates have fallen 4.75% from December 31, 2000 through December 31, 2001.

As interest rates change, the assumptions regarding responsiveness to further change must be reviewed, and any changes will affect the computed results. These assumptions are reviewed each quarter and are changed as deemed appropriate to reflect the best information available to Management. Assumptions used for the measurement at December 31, 2000 are not necessarily the same as those used for the measurement at December 31, 2001.

The same changes to the balance sheet and assumptions mentioned above in connection with net interest income also account for the changes in net economic value. However, the computation of net economic value discounts all cash flows over the life of the instrument, not only the next twelve months. For example, in estimating the impact on net interest income of a two-percent rise in rates on a security maturing in three years, only the negative impact during the first year is captured in net interest income. In estimating the impact on net economic value, the negative impact for all three years is captured. Therefore, the results tend to be more pronounced.

In addition to applying scenarios with sudden interest rate shocks, net interest income simulations are prepared at least twice a year using various interest rate projections. Reflecting that most market interest rates are at their lowest points in 40 years, but expected continued weakness in the economy for one or two quarters, the Company's projection for the most likely scenario includes generally stable interest rates with a slight increase later in 2002. In addition, the Company expects relatively normal yield curves (Note I). As the year progresses, the models are revised to make use of the latest available projections.

The interest rate simulation reports are dependent upon assumptions relating to the shape of the interest rate curves, the volatility of the interest rate scenarios selected, and the rates that would be paid on the Company's administered rate deposits as external yields change.

Under these more realistic scenarios, as in the case of the sudden rate shock model, the Company's net interest income at risk in 2002 is still well within normal expectations. The change in the average expected Fed funds rate is also shown to give perspective as to the extent of the interest rate changes assumed by the two scenarios.

	RATES LOWER THAN MOST LIKELY	RATES HIGHER THAN MOST LIKELY
Change in net interest income compared to most likely scenario	1.44%	0.70%
Change in average Fed funds rate	(0.27%)	0.50%

MANAGING INTEREST RATE RISK WITH HEDGING INSTRUMENTS

The steps that the Company takes to mitigate interest rate risk were mentioned above as each type of interest rate risk was explained. They primarily involve pricing products to achieve diversification or offsetting risk characteristics. The Company has also occasionally used hedge instruments, specifically interest rate swaps, to protect large loans or pools of loans. However, there are limitations and costs associated with these hedges.

In general, absent the ability to correctly predict the future direction and extent of changes in interest rates, there is a trade-off between assuming additional cost and assuming additional risk. For example, the Company can enter into an interest rate swap whereby it pays a variable rate on a notional amount to another financial institution in exchange for receiving a fixed rate. This will protect the Company interest income if rates drop, because it will pay less as the variable rate adjusts with each decrease in rates while it continues to pay the same fixed amount over the term of the contract. However, the Company would lose interest income if rates rise instead of decline as its variable payment increases. Alternatively, the Company could purchase an option contract under which it would receive cash from the other party if rates rose or fell by a specified amount, depending on which direction the Company anticipated rates to move. This contract avoids incurring risk should

rates move against its expectations, but the option fee, a not insignificant amount, is forfeited if rates do not move as anticipated.

Despite the trade-offs inherent in using hedge instruments, Management anticipates making more use of them in the future. As its RAL program continues to grow, the Company must increasingly structure its balance sheet to provide the large amount of liquidity needed in the first quarter of each year. This limits the Company's ability to take some of the natural or on-balance sheet hedge positions it could otherwise make use of. Hedge instruments may provide the additional flexibility needed both to maintain the liquidity and protect net interest income.

SECURITIES

The major components of the Company's earning asset base are the securities portfolio, the loan portfolio and its holdings of money market instruments. The Investment Committee has overall responsibility for the management of the securities portfolios and the money market instruments. The structure and detail within these portfolios are very significant to an analysis of the financial condition of the Company. The loan and money market instrument portfolios will be covered in later sections of this discussion.

SECURITIES PORTFOLIOS

The Company classifies its securities into three portfolios: the "Liquidity Portfolio," the "Discretionary Portfolio," and the "Earnings Portfolio." The Liquidity and Discretionary Portfolios are comprised of securities classified in the financial statements as available-for-sale. The Earnings Portfolio is comprised of securities that are classified as held-to-maturity.

The Liquidity Portfolio's primary purpose is to provide liquidity to meet cash flow needs. The portfolio consists of U.S. Treasury and agency securities. These securities are purchased with maturities of up to three years with an average maturity of between one and two years.

The Discretionary Portfolio's primary purposes are to provide income from available funds and to hold earning assets that can be purchased or sold as part of overall asset/liability management. The Discretionary Portfolio consists of U.S. Treasury and agency securities, COLLATERALIZED MORTGAGE OBLIGATIONS ("CMOs"), ASSET-BACKED SECURITIES, MORTGAGE BACKED SECURITIES (Note J), and municipal securities.

The Earnings Portfolio's primary purpose is to provide income from securities purchased with funds not expected to be needed for making loans or repaying depositors until maturity. The Earnings Portfolio consists of long-term tax-exempt obligations, and U.S. Treasury and agency securities.

Maintaining adequate liquidity is one of the highest priorities for the Company. Therefore, available funds are first used to purchase securities for the Liquidity Portfolio. So long as there are sufficient securities in that portfolio to meet its purposes, available funds are then used to purchase securities for the Discretionary Portfolio. It is the Company's current intention to allow existing securities in the Earnings Portfolio to mature, and then reposition the matured proceeds into either of the two "available-for-sale" portfolios. Accordingly, the balance of the Earnings Portfolio is expected to decline.

ADDITIONAL PURPOSES SERVED BY THE SECURITIES PORTFOLIOS

The securities portfolios of the Company serve additional purposes: (1) to act as collateral for the deposits of public agencies and trust customers that must be secured by certain securities owned by the Company; (2) to be used as collateral for borrowings that the Company occasionally utilizes for liquidity purposes; and (3) to support the development needs of the communities within its marketplace.

COLLATERAL FOR DEPOSITS: The legal requirements for securing specific deposits may only be satisfied by pledging certain types of the Company's securities. A large proportion of these deposits may be secured by state and municipal securities, but some can only be secured by U.S. Treasury securities, so holding a minimum amount of these securities will always be necessary.

COLLATERAL FOR BORROWING: As covered in other sections of this discussion, the Company occasionally borrows funds from other financial institutions to manage its liquidity position. Certain amounts may be borrowed unsecured, i.e. without collateral, but by pledging some of its securities as collateral, the Company may borrow more and/or at lower rates.

COMMUNITY DEVELOPMENT: The Company searches actively for investments that support the development needs of communities within its marketplace. Such investments would include mortgageback securities consisting of real estate loans to lower income borrowers in its market areas. The Company also holds several bonds of school districts within its market areas.

AMOUNTS AND MATURITIES OF SECURITIES

As discussed above, in addition to providing a ready source of liquidity, the size of the securities portfolios tends to vary with the relative increase in loan and deposit balances. The average balance of securities increased from 1999 to 2000 as deposits increased more than loans. The average balance declined from 2000 to 2001 as loans grew more than deposits. Table 4 sets forth the amounts and maturity ranges of the securities at December 31, 2001. Because many of the securities included in the Earnings Portfolio are state or municipal bonds, much of the income from this portfolio has the additional advantage of being tax-exempt. Therefore, the tax equivalent weighted average yields of the securities are shown in Table 4. The average yields on the taxable securities are significantly lower than the average rates earned from loans as shown in Table 2. Because of this, while taxable securities provide liquidity and act as collateral for deposits and borrowings, they are purchased for earnings only when loan demand is weak.

OTHER SECURITIES DISCLOSURES

TURNOVER AND MATURITY PROFILE: The accompanying Consolidated Statements of Cash Flows on page 58 shows there is a relatively large turnover in the Securities Portfolios-proceeds from the maturity, sale, or call of securities 2001 represented 47.0% of the average balance of securities for the year. This is not due to trading activity. The Company does not have a trading portfolio. That is, it does not purchase securities on the speculation that interest rates will decrease and thereby allow subsequent sale at a gain. Instead, if the purposes mentioned above are to be met, purchases must be made throughout interest rate cycles. Rather than anticipate the direction of changes in interest rates, the Company's investment practice with respect to securities in the Liquidity and Discretionary Portfolios is to purchase securities so that the maturities are approximately equally spaced by quarter within the portfolios. The periodic spacing of maturities provides the Company with a steady source of cash for liquidity purposes. If the cash is not needed, this steady source minimizes REINVESTMENT RISK, which is having too much cash available all at once that must be invested perhaps when rates are low.

The Company generally purchases municipal securities with maturities of 18-25 years because, in its judgment, they have the best ratio of rate earned to the market risk incurred in purchasing these fixed rate securities. However, to mitigate this higher interest rate risk, the Company purchases taxable securities with relatively short maturities. This in turn causes frequent maturities and what looks like a relatively high turnover rate.

TABLE 4-MATURITY DISTRIBUTION AND YIELD ANALYSIS OF THE SECURITIES PORTFOLIOS

AS OF DECEMBER 31, 2001 (DOLLARS IN THOUSANDS)	ONE YEAR OR LESS	AFTER ONE YEAR TO FIVE YEARS	AFTER FIVE YEARS TO TEN YEARS	TE
MATURITY DISTRIBUTION:				
Available-for-sale:				
U.S. Treasury obligations	$ 82,815	$ 72,660	$ -	$
U.S. agency obligations	73,313	245,481	5,116	
Collateralized mortgage obligations	11,103	91,556	3,021	
Asset-backed securities	-	11,660	-	
State and municipal securities	3,618	6,142	6,851	
Subtotal	170,849	427,499	14,988	
Held-to-maturity:				
U.S. Treasury obligations	-	-	-	
U.S. agency obligations	-	-	-	
Collateralized mortgage obligations	5	-	-	
State and municipal securities	9,589	14,717	12,235	
Subtotal	9,594	14,717	12,235	
Total	$180,443	$442,216	$27,223	$1
WEIGHTED AVERAGE YIELD (Tax equivalent-Note D):				
Available-for-sale:				
U.S. Treasury obligations	6.16%	4.13%	-	
U.S. agency obligations	6.31%	4.61%	4.78%	
Collateralized mortgage obligations	5.32%	6.13%	7.83%	
Asset-backed securities	-	2.46%	-	
State and municipal securities	4.44%	4.42%	5.38%	
Weighted average	6.14%	4.79%	5.67%	
Held-to-maturity:				
U.S. Treasury obligations	-	-	-	
U.S. agency obligations	-	-	-	
Collateralized mortgage obligations	2.00%	-	-	
State and municipal securities	8.52%	8.29%	6.27%	
Weighted average	8.51%	8.29%	6.27%	
Overall weighted average	6.26%	4.91%	5.94%	

SECURITIES GAINS AND LOSSES: Occasionally, the Company will sell securities prior to maturity to reposition the funds into a better yielding asset. This usually results in a loss. The Company generally does not follow a practice of selling securities to realize gains because future income is thereby reduced by the difference between the higher rates that were being earned on the sold securities and the lower rates that can be earned on new securities purchased with the proceeds. Gains are occasionally recognized when:

- o the issuer calls the securities;
- o the Company needs to reposition the maturities of securities to manage mismatch risk;

- o the Company needs to change the risk-weighting profile of its assets to manage its capital position (see the section below titled "Capital Resources"); or
- o the Company is selling small remaining portions of amortizing securities to reduce administrative burden.

HEDGES, DERIVATIVES, AND OTHER DISCLOSURES

The Company has policies and procedures that permit limited types and amounts of off-balance sheet hedges to help manage interest rate risk.

As mentioned above, the Company has occasionally purchased interest rate swaps from another financial institution to hedge large, fixed-rate loans or pools of fixed-rate loans.

The Company has not purchased any securities arising out of a highly leveraged transaction and its investment policy prohibits the purchase of any securities of less than investment grade or so-called "junk bonds."

MONEY MARKET INSTRUMENTS-FEDERAL FUNDS SOLD, SECURITIES PURCHASED UNDER AGREEMENTS TO RESELL, AND COMMERCIAL PAPER

Cash in excess of amounts immediately needed for operations is generally lent to other financial institutions as Federal funds sold or as securities purchased under agreements to resell (for brevity termed "reverse repos"). Both transactions are overnight loans. Federal funds sold are unsecured; reverse repos are secured.

Excess cash expected to be available for longer periods is generally used to purchase short-term securities or COMMERCIAL PAPER. Commercial paper instruments are short-term notes issued by companies. They are actively traded among investors after issuance. As a percentage of average earning assets, the amount of these instruments tends to vary based on changes and differences in short-term market rates. The amount is also impacted in the first quarter of the year by the large cash flows associated with the tax refund loan and transfer programs.

As with securities, the average balances invested by the Company in these instruments increased from 1999 to 2000 as deposits increased more than loans, and then decreased from 2000 to 2001 as loan growth exceeded deposits. The new loans were funded by drawing down the balances of securities and money market instruments.

The one-day term of the Federal funds sold and reverse repos means that they are highly liquid as the funds are returned to the Company the next day and are not subjected to market risk. Commercial paper issued by highly rated domestic companies is highly liquid as there is an active market for these instruments should the Company desire to sell them before their maturity. However, they are subject to market risk, should interest rates change while they are held by the

Company. As discussed below in "Liquidity," the Company has developed and maintains numerous other sources of liquidity than these overnight and short-term funds.

LOAN PORTFOLIO

The Company offers a wide variety of loan types and terms to customers along with very competitive pricing and quick delivery of the credit decision. Table 5 sets forth the distribution of the Company's loans at the end of each of the last five years.

The amounts shown in the table for each category are net of the deferred or unamortized loan origination, extension, and commitment fees and the deferred origination costs for loans in that category. These deferred net fees and costs included in the loan totals are shown for information at the bottom of the table. These deferred amounts are amortized over the lives of the loans to which they relate.

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The year-end balance for all loans increased about $427 million from the end of 1999 to the end of 2000 and about $282 million from the end of 2000 to the end of 2001. Though overall growth was lower in 2001, all of the major categories except leasing showed growth during the year. The balance of consumer loans for December 31, 2001 reported in the table is lower than the balance at the prior year-end, but that is because in early January, 2001, the Company sold approximately $58.2 million of the indirect auto loans included in this category through a securitization for the purposes of capital management as described in the section below titled "Capital Resources."

The Company makes both adjustable rate and fixed rate 1-4 family mortgage loans. In general, the Company retained the adjustable loans and sold the fixed rate loans to minimize market risk. In the last several years, the Company has retained some of the fixed rate loans, hedging a portion of them with the interest rate swaps mentioned above. The adjustable loans generally have low initial "teaser" rates. While these loans have interest rate "caps," all are repriced to a market rate of interest within a reasonable time. A few loans have payment caps that would result in negative amortization if interest rates rise appreciably.

Net of the sale mentioned above, consumer loans grew $51.6 million or 33.4% in 2000 and $39.0 million or 18.9% in 2001. This growth in consumer loans reflects an expanded product line and continued efforts to make auto loans through dealers. During the last four years, the Company has entered into indirect financing agreements with a number of automobile dealers whereby the Company purchases loans dealers have made to customers. While automobile dealers frequently provide financing to customers through manufacturers' finance subsidiaries, some customers prefer loan terms that are not included in the standard dealer packages. Other customers are purchasing used cars not covered by the manufacturers' programs. Based on parameters agreed to by the Company, the dealer makes the loan to the customer and then sells the loan to the Company.

TABLE 5-LOAN PORTFOLIO ANALYSIS BY CATEGORY

(IN THOUSANDS)	DECEMBER 31			
	2001	2000	1999	1998

Real estate:				
Residential	$ 728,026	$ 586,904	$ 494,540	$ 376,871
Nonresidential	593,675	564,556	457,575	496,050
Construction and development	185,264	172,331	200,804	131,912
Commercial, industrial, and agricultural	874,294	775,365	614,897	388,262
Home equity lines	85,025	71,289	49,902	47,123
Consumer	187,949	205,992	154,381	129,957
Leases	126,744	129,159	97,005	84,198
Municipal tax-exempt obligations	8,043	4,102	12,530	9,286
Other	10,072	7,406	8,399	6,619
	$2,799,092	$2,517,104	$2,090,033	$1,670,278
Net deferred fees	$ 4,908	$ 5,813	$ 5,240	$ 5,002

This program is neither a factoring nor a flooring arrangement. The individual customers, not the dealers, are the borrowers and thus there is no large concentration of credit risk. In addition, there is a review of underwriting practices of a dealer prior to acceptance into the program. This is done to ensure process integrity, to protect the Company's reputation, and to monitor compliance with consumer loan laws and regulations. There were approximately $124 million of such loans included in the consumer loan total above for December 31, 2001, as compared with $139 million at December 31, 2000. Originations did slow some in 2001 with the slower economy and the introduction by the auto manufacturers of 0% financing, but the balance at the end of 2001 would have been $181 million were it not for the securitization mentioned above.

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Although approximately two-thirds of the loans held by the Company have floating rates of interest tied to the Company's base lending rate or to another market rate indicator so that they may be repriced as interest rates change, fixed rate loans still make up a significant portion of the portfolio. The same interest rate and liquidity risks that apply to securities are also applicable to lending activity. Fixed-rate loans are subject to market risk: they decline in value as interest rates rise. The Company's loans that have fixed rates generally have relatively short maturities or amortize monthly, which effectively lessens the market risk. Nonetheless, the table in Note 14 to the consolidated financial statements shows that at December 31, 2000, the difference in carrying amount ofloans, i.e., their face value, is about $41.9 million or 1.7% more than their fair value. At the end of 2001, the fair value of loans exceeded their carrying amount by $58.4 million or 2.1%, reflecting the decreases in market rates during 2001.

Table 6 shows the maturity of selected loan types outstanding as of December 31, 2001, and shows the proportion of fixed and floating rate loans for each type. Net deferred loan origination, extension, and commitment fees are also not shown in the table. There is no maturity or interest sensitivity associated with the fees because they have been collected in advance.

TABLE 6-MATURITIES AND SENSITIVITIES OF SELECTED
LOAN TYPES TO CHANGES IN INTEREST RATES

DUE AFTER

(IN THOUSANDS)	DUE IN ONE YEAR OR LESS	ONE YEAR TO FIVE YEARS	DUE AFTER FIVE YEARS
Commercial, industrial, and agricultural			
Floating rate	$550,147	$ 49,970	$ 11,182
Fixed rate	74,972	88,444	99,579
Real estate-construction and development		-	
Floating rate	303	3,068	-
Fixed rate	158,000	19,534	4,359
Real estate-residential			
Floating rate	82,685	156,698	128,332
Fixed rate	23,356	5,766	331,189
Municipal tax-exempt obligations	1,000	5,154	1,889
	$890,463	$328,634	$576,530

The amortization and short maturities generally present in the Company's fixed rate loans also help to maintain the liquidity of the portfolio and reduce credit risk. However, they result in lower interest income if rates are falling because the cash received from monthly principal payments is reinvested at lower rates. At present, except for the specific market risk incurred by the decision to hold some of the fixed-rate residential and non-residential real estate mortgages, Management prefers to incur market risk from longer maturities in the securities portfolios, and avoid such risk in the loan portfolio. The reason for this preference is that there are more limited secondary markets for longer-term loans than for longer-term securities. In the event that the Company should want to sell such loans for either liquidity or capital management reasons when interest rates are above the original issue rates, the loss taken would be greater than for the sale of securities with comparable maturities.

POTENTIAL PROBLEM LOANS: From time to time, Management has reason to believe that certain borrowers may not be able to repay their loans within the parameters of the present repayment terms, even though, in some cases, the loans are current at the time. These loans are regarded as potential problem loans, and a portion of the allowance is assigned and/or allocated, as discussed below, to cover the Company's exposure to loss should the borrowers indeed fail to perform according to the terms of the notes. This class of loans does not include loans in a nonaccrual status or 90 days or more delinquent but still accruing, which are shown in Table 10.

At year-end 2001, these loans amounted to $138.3 million or 4.9% of the portfolio. The corresponding amounts for 2000 and 1999 were $58.7 million or 2.3% of the portfolio and $76.9 million or 2.9% of the portfolio, respectively. The 2001 amount is comprised of loans of all types.

OTHER LOAN PORTFOLIO INFORMATION

Other information about the loan portfolio that may be helpful to readers of the financial statements follows.

FOREIGN LOANS: The Company does not assume foreign credit risk through either loan or deposit products. However, the Company does make loans to borrowers that have foreign operations and/or have foreign customers. Economic and currency developments in the international markets may therefore affect our domestic customers' activities.

PARTICIPATIONS: Occasionally, the Company will sell or purchase a portion of a loan to or from another bank. The usual reasons that banks sell a portion of a loan are (1) to stay within their regulatory maximum limit for loans to any one borrower; (2) to reduce the concentration of lending activity to a particular industry or geographical area; and (3) to manage regulatory capital ratios. Occasionally, a portion of another bank's loan may be purchased by the Company when the originating bank is unable to lend the whole amount under its regulatory lending limit to its borrower. However, this would be done only if the loan represents a good investment for the Company and the borrower or project is in one of the Company's market areas. In these cases, the Company conducts its own independent credit review and formal approval prior to committing to purchase.

LOAN TO VALUE RATIO: The Company follows a policy of limiting the loan to collateral value ratio for real estate construction and development loans. Depending on the type of project, policy limits range from 60-90% of the appraised value of the collateral. For permanent real estate loans, the policy limits generally are 75% of the appraised value for commercial property loans and 80% for residential real estate property loans. Mortgage insurance is generally required on most residential real estate loans with a loan to value ratio in excess of 80%. Such loans, which can reach up to 90% loan to appraised value, are strictly underwritten according to mortgage insurance standards. The above policy limits are sometimes exceeded when the loan is being originated for sale to another institution that does lend at higher ratios and the sale is immediate; when the exception is temporary; or when other special circumstances apply. There are other specific loan to collateral limits for commercial, industrial and agricultural loans which are secured by non-real estate collateral. The adequacy of such limits is generally established based on outside asset valuations and/or by an assessment of the financial condition and cash flow of the borrower, and the purpose of the loan. Consumer loans which are secured by collateral also have loan to collateral limits which are based on the loan type and amount, the nature of the collateral, and other financial factors on the borrower.

LOAN CONCENTRATIONS: The concentration profile of the Company's loans is discussed in Note 18 to the accompanying Consolidated Financial Statements.

LOAN SALES AND MORTGAGE SERVICING RIGHTS: The Company sells or brokers some of the fixed-rate single family mortgage loans it originates as well as other selected portfolio loans. While originated by the Company, they are sold if the loan terms are not favorable enough to offset the market risk inherent in fixed-rate assets. Most of those sold are sold "servicing released" and the purchaser takes over the collection of the payments. However, some are sold with "servicing retained" and the Company continues to receive the payments from the borrower and forwards the funds to the purchaser. The Company earns a fee for this service. The sales are made without recourse, that is, the purchaser cannot look to the Company in the event the borrower does not perform according to the terms of the note. Generally Accepted Accounting Principles ("GAAP") requires companies engaged in mortgage banking activities to recognize the rights to service mortgage loans for others as separate

assets. For loans originated for sale, a portion of the investment in the loan is ascribed to the right to receive this fee for servicing and this value is recorded as a separate asset.

TAX REFUND ANTICIPATION LOAN AND REFUND TRANSFER PROGRAMS

As indicated in the overall summary at the beginning of this discussion, part of the upward trend in earnings is attributable to the RAL and RT programs. The

Company is one of three financial institutions which together provide over 90% of these products on a national basis. The Company provides these services to taxpayers who file their returns electronically. RALs are a loan product; RTs are strictly an electronic transfer service.

DESCRIPTION OF THE RAL AND RT PRODUCTS

For the RAL product, a taxpayer requests a loan from the Company through a tax preparer, with the anticipated tax refund as the source of repayment. The Company subjects the application to an automated credit review process. If the application passes this review, the Company advances to the taxpayer the amount of the refund due on the taxpayer's return up to specified amounts based on certain criteria less the loan fee due to the Company. Each taxpayer signs an agreement permitting the Internal Revenue Service (the "IRS") to send their refund directly to the Company instead of to the taxpayer. The refund received from the IRS is used by the Company to pay off the loan. Any amount due the taxpayer above the amount of the RAL is then sent by the Company to the taxpayer. The fee is withheld by the Company from the advance, but the fee is recognized as income only after the loan is collected from the IRS payment. The fee varies based on the amount of the loan. However, unlike interest earned on most loans, it does not vary with the length of time the loan is outstanding. Nonetheless, because the taxpayer must sign a loan document, the advance on the refund is considered a loan and the fee is classified as interest income.

The IRS closely scrutinizes returns where a major portion of the refund is based on a claim for Earned Income Tax Credit ("EIC"). The Company closely monitors and, in many cases, does not lend on those returns where EIC represents an overly large portion of the refund. Many taxpayers not qualifying for loans or not desiring to pay the loan fee still choose to receive their refunds more quickly by having the refund sent electronically by the IRS to the Company. The Company then prepares a check or authorizes the tax preparer to issue a check to the taxpayer. This service is termed a refund transfer. There is no credit risk associated with the RT product because funds are not sent to the customer until received by the Company from the IRS.

The following table shows fees by product for the last three years and the percentage of growth:

TABLE 7-RAL AND RT FEES

(IN MILLIONS)	RAL FEES	RT FEES	PRE-TAX INCOME
1999	$8.1	$6.6	$9.4
$ change	$10.9	$0.7	$7.3
% change	134.6%	10.6%	77.7%
2000	$19.0	$7.3	$16.7
$ change	$7.4	$7.0	$8.4
% change	38.9%	95.9%	50.3%
2001	$26.4	$14.3	$25.1

RAL CREDIT LOSSES

Losses are higher for RALs than for most other loan types because the IRS may reject or partially disallow the refund. The tax preparers participating in the program are located across the country and few of the taxpayers have any customer relationships with the Company other than their RAL. Many taxpayers make use of the service because they do not have a permanent and/or safe mailing

address at which to receive their refund. Therefore, if a problem occurs with the return, collection efforts may be less effective than with local customers.

The Company has taken several steps to minimize losses from these loans. Preparers are screened before they are allowed to submit their electronic filings; procedures have been defined for the preparers to follow to ensure that the agreement signed by the taxpayer is a valid loan; and the preparers' IRS reject rates are monitored very carefully. If a preparer's rejects are above normal, he or she may be dropped from the program. If rejects are below expectations, the preparer may be paid an incentive fee.

In addition, the Company has entered into cooperative agreements with the other banks with RAL programs. Under those agreements, if a taxpayer owing money to one bank from a prior year applies for a loan from another bank, the second bank repays the delinquent amount to the first bank before remitting the refund to the taxpayer. As shown in Table 9, these cooperative agreements result in a relatively high rate of recovery on the prior year's losses, but net losses remain about four to five times higher than for other loans.

Total net charge-offs in 2001 were $4.2 million compared to $3.2 million in 2000 and $2.7 million in 1999. A significant portion of the 2001 charged-off loans are expected to be collected in 2002 under the continuing cooperative agreement between the banks providing this product.

RAL/RT PRODUCT MIX

As shown in Table 7, the increase in RAL fees from 1999 to 2000 was relatively large compared to the increase in RT fees, while the increase in RT fees from 2000 to 2001 was larger than the increase in RAL fees. These differences in the rate of increase are the result of substantial shifts in the mix of the two products in 2000 and again in 2001. RALs increased substantially in 2000 over 1999 because of the re-instatement of a notification from the IRS to the banks providing the service of any delinquent amounts for taxes or other debts owed by the taxpayer to the Federal government. This debt indicator, which had been provided in a similar form prior to 1995, was instituted as a means of assisting the taxpayer and the tax preparer. It also assists the banks with their credit review. With this indicator, losses for the banks would be expected to be significantly reduced and consequently loan fees reduced. The fees were reduced and increased numbers of taxpayers availed themselves of the loans in 2000. This was the intended result of the IRS action, because it is under a Congressional mandate to significantly increase the proportion of the returns filed electronically.

FUNDING AND LIQUIDITY ISSUES

RALs present the Company with some special funding or liquidity needs. Funds are needed for lending only the very short period of time that RAL loans are made. The season starts in the middle of January and continues into April, but even within that time frame, they are highly concentrated in the first three weeks of February. The first issue then is that the Company must arrange for very short term borrowings. A portion of the need can be met by borrowing overnight from other financial institutions through the use of Federal funds purchased (unsecured) and repurchase agreements (borrowings collateralized by securities or loans). These two sources match the short term nature of the RALs and therefore are an efficient source of funding. However, they are not sufficient to meet the total need for funds, and once other sources must be utilized, funding becomes more expensive. The Company must make use of other less efficient sources, specifically some term advances from the FHLB and brokered deposits. In 2000, the Company issued approximately $415 million in brokered certificates of deposit in the first quarter of the year. To obtain these funds In the relatively short period in which the CDs had to be issued, the Company had to issue them in two, three, and six month terms. This resulted in funding costs continuing past the point of the specific need, and it negatively impacted net interest income.

In 2001, the Company arranged for a different type of short term financing arrangement using the RALs themselves as collateral. This arrangement, in conjunction with the overnight borrowing,

provided a substantial portion of the funding needed more efficiently and reduced the need for brokered CDs to $130 million.

For 2002, the Company is again using a combination of funding sources including the arrangement established for the 2001 season. The program is expected to be even larger and require more funding in 2002, but as of this writing, the funding sources arranged have been sufficient.

A portion of the cost of the funding is charged to the program, but some of the costs, specifically the opportunity cost of holding more liquid and therefore more easily pledged securities is difficult to allocate.

The balances outstanding during each tax filing season are included in the average balance for consumer loans shown in Table 2, but there are no such loans included in the Consolidated Balance Sheets as of December 31, 2001 and 2000, because all loans not collected from the IRS are charged-off at June 30 of each year. The fees earned on the RALs are included in the accompanying Consolidated Income Statements for 2001, 2000 and 1999 within interest and fees on loans. The fees earned on the RTs are included in other service charges, commissions, and fees.

The Company expects that the programs will continue to increase in volume because the IRS is encouraging more taxpayers to file electronically.

ALLOWANCE FOR CREDIT LOSS

Credit risk is inherent in the business of extending loans and leases to individuals, partnerships, and corporations. The Company sets aside an allowance or reserve for credit losses through charges to earnings. These charges are shown in the Consolidated Statements of Income as provision for credit losses. All specifically identifiable and quantifiable losses are immediately charged off against the allowance. However, for a variety of reasons, not all losses that have occurred are immediately made known to the Company and of those that are known, the full extent of the loss may not be able to be quantified. In this discussion, "loans" include the lease contracts purchased and originated by the Company.

DETERMINATION OF THE ADEQUACY OF THE ALLOWANCE FOR CREDIT LOSSES AND THE ALLOCATION PROCESS

The Company formally determines the adequacy of the allowance on a quarterly basis. This determination is based on the periodic assessment of the credit quality or "grading" of loans. Loans are initially graded when originated. They are re-graded as they are renewed, when there is a new loan to the same borrower, when identified facts demonstrate heightened risk of nonpayment, or if they become delinquent. Re-grading of larger problem loans will occur at least quarterly. Confirmation of the quality of the grading process is obtained both by independent credit reviews conducted by firms specifically hired by the Company for this purpose and by banking examiners.

After reviewing the gradings in the loan portfolio, the second step is to assign or allocate a portion of the allowance to groups of loans and to individual loans to cover Management's estimate of their potential loss. Allocation is related to the grade and other factors, and is done by the methods discussed below.

The last step is to compare the amounts allocated for estimated losses to the current available allowance. To the extent that the current allowance is insufficient to cover the estimate of unidentified losses, Management records additional provision for credit loss. If the allowance is greater than appears to be required at that point in time, provision expense is adjusted accordingly.

THE COMPONENTS OF THE ALLOWANCE FOR CREDIT LOSSES

Consistent with GAAP and with the methodologies used in estimating the unidentified losses in the loan portfolio, the allowance is comprised of several components.

First, the allowance includes a component resulting from the application of the measurement criteria of Statements of Financial ACCOUNTING STANDARDS NO. 114, ACCOUNTING BY CREDITORS FOR IMPAIRMENT OF A LOAN ("SFAS 114") and No. 118, ACCOUNTING BY CREDITORS FOR IMPAIRMENT OF A LOAN- INCOME RECOGNITION AND DISCLOSURES ("SFAS 118"). The amount of this component is disclosed in Note 3 to the consolidated financial statements that accompany this discussion.

The second component is statistically-based and is intended to provide for losses that have occurred in large groups of smaller balance loans, the individual credit quality of which is impracticable to re-grade at each period end. These loans would include 1-4 family residential real estate, installment and overdraft lines for consumers, and loans to small businesses generally of $250,000 and less. The amount allocated is determined by applying loss estimation factors to outstanding loans. The loss factors are based primarily on the Company's historical loss experience tracked over a fiveyear period and accordingly will change over time. Because historical loss experience varies for the different categories of loans, the loss factors applied to each category also differ. In addition, there is a greater chance that the Company has suffered a loss from a loan that was graded less than satisfactory at its most recent grading than if the loan was last graded satisfactory. Therefore, for any given category, a larger loss estimation factor is applied to less than satisfactory loans than to those that the Company last graded as satisfactory. The statistical component is the sum of the assignments determined in this manner.

The third component is needed to address specific characteristics of individual loans that are not addressed in the statistically determined historical loss factors that would ordinarily apply. These characteristics might relate to a variety of factors such as the size of the loan, the industry of the borrower, or the terms of the loan. When situations warrant, Management will increase the assignment that would be indicated by the applicable loss estimation factor to an amount adequate to absorb the probable loss that has occurred. The specific component is made up of the sum of these specific assignments.

There are several primary reasons that the other components discussed above might not be sufficient to recognize the losses present in portfolios. The fourth or "allocated" component of the allowance is used to provide for the losses that have occurred because of these reasons.

The first reason is that there are limitations to any credit risk grading process. The volume of loans makes it impracticable to re-grade every loan every quarter. Therefore, it is possible that some currently performing loans not recently graded will not be as strong as their last grading and an insufficient portion of the allowance will have been allocated to them. Grading and loan review often must be done without knowing whether all relevant facts are at hand. Troubled borrowers may inadvertently or deliberately omit important information from reports or conversations with lending officers regarding their financial condition and the diminished strength of repayment sources.

The second reason is that the loss estimation factors are based on historical loss totals. As such, the factors may not give sufficient weight to such considerations as the current general economic and business conditions that affect the Company's borrowers and specific industry conditions that affect borrowers in that industry. The factors might also not give sufficient weight to current trends in credit quality and collateral values and the long duration of the current business cycle. Specifically, in assessing how much allocated allowance needed to be provided at December 31, 2001, Management considered the following:

- With respect to loans to the agriculture industry, Management considered the effects on borrowers of weather conditions and overseas market conditions for exported products;

- With respect to loans to the construction industry, Management considered the market absorption rates for developed properties; the availability of permanent financing to replace the construction loan; construction delays, increased costs, and financial difficulties of contractors, subcontractors, and suppliers resulting from weather; and the significant concentration in construction lending in the market area served by FNB;

- With respect to loans to borrowers who are influenced by trends in the local tourist industry, Management considered the effects of the terrorist attacks of September 11 on traveling, weather conditions, tourist preferences, and the competition faced by borrowers from other resort destinations and tourist attractions;

Third, neither the loss estimation factors nor the review of specific individual loans give consideration to loan concentrations, yet this could impact the magnitude of losses inherent in the portfolios. Specifically, as disclosed in Note 18 to the consolidated financial statements, there are certain concentrations with respect to geographical area, industry, and type of collateral among the loans that the Company has outstanding. Because economic factors could impact these borrowers as a group, losses inherent in the portfolio could be greater and more volatile than would be expected if the Company simply used the loss estimation factors.

Fourth, the loss estimation factors do not give consideration to the seasoning of the portfolios. Seasoning is relevant because losses are less likely to occur in loans that have been performing satisfactorily for several years than in loans that are more recent. In addition, term loans usually have monthly scheduled payments of principal and interest. With a term loan, a missed or late payment gives an immediate signal of a decline in credit quality. However, most of the Company's commercial loans and lines of credit have short-term maturities and frequently require only interest payments until maturity. Because they have shorter maturities and lack regular principal amortization, the process of seasoning does not occur and the signaling of the missed principal payment is not available.

Lastly, the loss estimation factors do not give consideration to the interest rate environment. Most obviously, borrowers with floating-rate loans may be less able to manage their debt service if interest rates rise. However, there can also be an indirect impact. For example, a rise in interest rates may adversely impact the amount of home mortgage lending. This will cause a reduction in the amount of home building initiated by developers, and this will have an impact on the credit quality of loans to building contractors in the commercial segment of the portfolio.

Each of these considerations could perhaps be addressed by developing additional loss estimation factors for smaller, discrete groups of loans. However, the factors are used precisely so that the losses in smaller loans do not have to be individually estimated. Segmenting the loan portfolio and then developing and applying separate factors becomes impracticable and, with the smaller groups, the factors themselves become less statistically valid. Even for experienced reviewers, grading loans and estimating possible losses involves a significant element of judgment regarding the present situation with respect to individual loans and the portfolio as a whole. Therefore, Management regards it as both a more practical and prudent practice to allocate allowance for the above risk elements in addition to the allowance assigned by specific or historical loss factors.

ASSIGNMENT TABLE

Table 8 shows the amounts of allowance assigned for the last three years to each loan type disclosed in Table 5. It also shows the percentage of balances for each loan type to total loans. In general, it would be expected that those types of loans which have historically more loss associated with them will have a proportionally larger amount of the allowance assigned to them than do loans which have less risk.

It would also be expected that the amount assigned for any particular category of loan will increase or decrease proportionately to both the changes in the loan balances and to increases or decreases in the estimated loss in loans of that category. Occasionally, changes in the amount assigned to a specific loan category will vary from changes in the total loan balance for that category due to the impact of the changes in credit rating for larger individual loans. In general, changes in the risk profile of the various parts of the loan portfolio should be reflected in the allowance assignment.

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There is no assignment of allowance to RALs at December 31, 2001 because all loans unpaid are charged-off prior to year-end. At the bottom of Table 8 is the ratio of the allowance for credit losses to total loans for each year.

TABLE 8-ASSIGNMENT OF THE ALLOWANCE FOR CREDIT LOSSES

(DOLLARS IN THOUSANDS)	DECEMBER 31, 2001		DECEMBER 31, 2000		DECEMBER
	AMOUNT	PERCENT OF LOANS TO TOTAL LOANS	AMOUNT	PERCENT OF LOANS TO TOTAL LOANS	AMOUNT
Real estate:					
Residential	$ 1,749	26.1%	$ 1,870	23.4%	$ 2,601
Nonresidential	3,578	21.2%	2,789	22.4%	3,038
Construction and development	1,000	6.6%	892	6.8%	935
Commercial, industrial, and agricultural	18,780	31.2%	14,616	30.8%	10,851
Home equity lines	747	3.0%	290	2.8%	343
Consumer	3,707	6.7%	3,288	8.2%	2,954

Leases	4,791	4.5%	3,371	5.1%	1,739
Municipal tax-exempt obligations	-	0.3%	-	0.2%	-
Other	1,065	0.4%	730	0.3%	663
Not specifically allocated	13,455		7,279		7,330
Total allowance	$ 48,872	100.0%	$ 35,125	100.0%	$ 30,454
Allowance for credit loss as a percentage of year-end loans	1.75%		1.40%		1.46%
Year-end loans	$2,799,092		$2,517,104		$2,090,033

CREDIT LOSSES

Table 9, "Summary of Credit Loss Experience," shows the additions to, charge-offs against, and recoveries for the Company's allowance for credit losses. Also shown is the ratio of charge-offs to average loans for each of the last five years.

There are only two other banks in the country that have national RAL programs. Therefore, for comparability, net charge-off ratios for the Company are shown both with and without the RAL net charge-offs. The corresponding ratios for the Company's FDIC peers are 0.90% for 2001, 0.63% for 2000, 0.68% for 1999, 1.08% for 1998, and 1.03% for 1997 (Note C).

The Company's concentration in loans secured by real estate-specifically loans secured by nonresidential properties-and other larger loans in the commercial category may cause a higher level of volatility in credit losses than would otherwise be the case. Large pools of loans made up of numerous smaller loans tend to have consistent loss ratios. A group consisting of a smaller number of larger loans in the same industry is statistically less consistent and losses may tend to occur at roughly the same time. Because the amount of loss is not consistent period to period, the estimate of loss and therefore the amount of allowance adequate to cover losses inherent in the portfolio cannot be determined simply by reference to net charge-offs in the prior year or years.

The lower net charge-offs to average loans ratios experienced by the Company in the years 1997 and 1998 were in large part due to the high levels of recoveries. At the end of each of the years 1996 through 1998, the Company had a number of previously charged-off loans that it reasonably had hopes of recovering, and which were in fact recovered. With these recoveries, net charge-offs for 1996 through 1998 were relatively low in proportion to the allowance for credit loss. As of year end 2000, there were few such potential recoveries aside from RALs. As expected, recoveries were less in 2000 and net charge-offs higher than in prior years. Nonetheless, the 2000 ratio without RALs was still only slightly more than one half that of the Company's peers. As noted in last year's Annual Report on Form 10-K, the Company had one loan of approximately $7 million, most of which was charged-off in 1999 and 2000, for which it had some prospect of recovery. In fact, the Company recovered approximately $3.3 million of this loan in 2001. No further amount of this loan is expected to be recovered. In 2001, the Company's net charge-off ratio to total loans is only slightly more than a third that of its peers.

TABLE 9-SUMMARY OF CREDIT LOSS EXPERIENCE
(DOLLAR IN THOUSANDS)

	2001	2000	1999	1998
Balance of allowance for credit losses at beginning of year	$ 35,125	$ 30,454	$ 30,499	$ 26,5
Charge-offs:				
Real estate:				
Residential	457	112	10	3
Nonresidential	-	107	252	1
Construction and development	127	-	-	
Commercial, industrial, and agricultural	7,490	8,118	4,924	1,8
Home equity lines	-	-	30	
Tax refund anticipation	9,189	6,226	5,518	7,2
Other consumer	6,046	1,910	1,729	1,7
Total charge-offs	23,309	16,473	12,463	11,3
Recoveries:				
Real estate:				
Residential	93	65	175	3
Nonresidential	228	184	35	1,3
Construction and development	-	-	6	
Commercial, industrial, and agricultural	3,918	1,255	1,162	1,1
Home equity lines	-	26	35	
Tax refund anticipation	4,769	3,059	2,857	2,2
Other consumer	1,377	976	1,105	8
Total recoveries	10,385	5,565	5,375	6,0
Net charge-offs	12,924	10,908	7,088	5,3
Allowance for credit losses recorded				

in acquisition transactions	-	1,139	-	
Provision for credit losses refund anticipation loans	4,420	2,726	2,816	4,9
Provision for credit losses all other loans	22,251	11,714	4,227	4,3
Balance at end of year	$ 48,872	$ 35,125	$ 30,454	$ 30,4
Ratio of net charge-offs to average loans outstanding	0.48%	0.46%	0.37%	0.3
Ratio of net charge-offs to average loans outstanding exclusive of RALs	0.33%	0.33%	0.23%	0.0
Average Loans	$2,678,225	$2,388,740	$1,908,227	$1,486,6
Average RALs	(58,900)	(60,437)	(12,391)	(9,1
Average Loans, net of RALs	$2,619,325	$2,328,303	$1,895,836	$1,477,5
Net Charge-offs	$ 12,923	$ 10,908	$ 7,088	$ 5,3
RAL Net Charges-offs	4,194	3,167	2,661	4,9
Net Charge-offs, exclusive of RALs	$ 8,729	$ 7,741	$ 4,427	$ 4

NONACCRUAL, PAST DUE, AND RESTRUCTURED LOANS.

Table 10 summarizes the Company's nonaccrual and past due loans for the last five years.

PAST DUE LOANS: Included in the amounts listed below as 90 days or more past due are commercial and industrial, real estate, and a diversity of secured consumer loans. These loans are well secured and in the process of collection. These figures do not include loans in nonaccrual status.

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NONACCRUAL LOANS: If there is reasonable doubt as to the collectibility of principal or interest on a loan, the loan is placed in nonaccrual status, i.e., the Company stops accruing income from the interest on the loan and reverses any uncollected interest that had been accrued but not collected. These loans may or may not be collateralized. Collection efforts are being pursued on all nonaccrual loans. Consumer loans are an exception to this reclassification. They are charged-off when they become delinquent by more than 120 days if unsecured and 150 days if secured. Nonetheless, collection efforts are still pursued.

RESTRUCTURED LOANS: The Company's restructured loans have generally been classified as nonaccrual even after the restructuring. Consequently, they have been included with other nonaccrual loans in Table 8. The only restructured loans the Company has had at the end of the last five years that have not been classified as nonaccrual are reported in Table 10 on a separate line.

TABLE 10-NONACCRUAL AND PAST DUE LOANS

(DOLLARS IN THOUSANDS)

	DECEMBER 31 2001	2000	1999	1998	1997
Nonaccrual	$16,940	$15,975	$15,626	$8,855	$11,709
90 days or more past due	3,179	2,427	715	78	855
Restructured Loans	-	-	10	-	174
	$20,119	$18,402	$16,351	$8,933	$12,738
Total noncurrent loans as percentage of total loan portfolio	0.72%	0.73%	0.78%	0.53%	0.92%
Allowance for credit losses as a percentage of noncurrent loans	243%	191%	186%	341%	208%

TABLE 11-FOREGONE INTEREST

(DOLLARS IN THOUSANDS)	YEAR ENDED DECEMBER 31 2001	2000	1999
Interest that would have been recorded under original terms	$1,296	$2,934	$1,636
Gross interest recorded	593	1,467	772
Foregone interest	$ 703	$1,467	$ 864

Total nonperforming loans increased during 1997 to $12.7 million because of noncurrent loans in the portfolios of two small banks acquired that year, but as a percentage of total loans, noncurrent loans slightly decreased. The total was reduced during 1998 due principally to a reclassification of a large loan out of nonaccrual status and to rigorous collection efforts. The total rose again at the end of 1999 and 2000 with the classification of a few larger loans as nonaccrual during both years. Some of the loans reclassified in 2000 were acquired in the SBB and LRB transactions. While amounts in the Company's financial statements have been restated to include SBB amounts, the loans had not been classified as nonaccrual by SBB or LRB. Despite the slower economy of 2001, and an increase in nonperforming loans of $1.7 million, the ratio of nonperforming loans to total loans remained the same at the end of 2001 as at the end of the prior year.

Table 11 sets forth interest income from nonaccrual loans in the portfolio at year-end that was not recognized.

DEPOSITS

An important component in analyzing net interest margin and, therefore, the results of operations of the Company is the composition and cost of the deposit base. Net interest margin is improved to the extent that growth in deposits can be focused in the lower cost core deposit accounts-demand deposits, NOW accounts, and savings. The average daily amount of deposits by category and the average rates paid on such deposits is summarized for the periods indicated in Table 12.

TABLE 12-DETAILED DEPOSIT SUMMARY
(DOLLARS IN THOUSANDS)

	YEAR ENDED DECEMBER 31				
	2001		2000		19
	AVERAGE BALANCE	RATE	AVERAGE BALANCE	RATE	AVERAGE BALANCE
NOW accounts	$ 372,443	0.39%	$ 358,921	0.75%	$ 321,652
Money market deposit accounts	739,040	2.77	707,063	3.85	586,349
Savings accounts	213,112	1.28	223,795	1.81	230,853
Time certificates of deposit for less than $100,000 and IRAs	555,218	5.05	497,230	5.34	478,377
Time certificates of deposit for $100,000 or more	630,482	4.82	650,793	5.81	390,038
Interest-bearing deposits	2,510,295	3.31%	2,437,802	4.03%	2,007,269
Demand deposits	725,267		703,531		565,525
	$3,235,562		$3,141,333		$2,572,794

The average rate paid on all deposits, which had increased from 3.28% in 1999 to 4.03% in 2000, decreased in 2001 to 3.31%. The increase from 1999 to 2000 and the decrease from 2000 to 2001 was primarily due to the changes in interest rates brought about by Fed actions (Note F). The average rates that are paid on deposits generally trail behind money market rates because financial institutions do not try to change deposit rates with each small increase or decrease in short-term rates. This trailing characteristic is stronger with time deposits, such as certificates of deposit that pay a fixed rate for some specified term, than with deposit types that have administered rates.

With time deposit accounts, even when new offering rates are established, the average rates paid during the year are a blend of the rates paid on individual accounts. Only new accounts and those that mature and are renewed will bear the new rate.

The Fed seems to have signaled that there will not be further rate decreases and the economy is generally expected to recover in mid-2002. Therefore, Management anticipates that the average deposit rates will be lower in early 2002 than in 2001 as CDs reprice at lower rates while administered rates may start to inch up later in 2002.

Table 13 discloses the distribution of maturities of CDs of $100,000 or more at the end of each of the last three years.

TABLE 13-MATURITY DISTRIBUTION OF TIME
CERTIFICATES OF DEPOSIT OF $100,000 OR MORE

(IN THOUSANDS)	DECEMBER 31		
	2001	2000	1999
Three months or less	$451,086	$198,325	$192,347

Over three months through six months	214,821	171,800	121,058
Over six months through one year	118,582	141,109	98,430
Over one year	42,933	60,359	16,225
	$827,422	$571,593	$428,060

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The balance of certificates of deposit of $100,000 or more is substantially higher at the end of 2001 than at year-end 2000. As part of its efforts to fund the RAL program for 2002, in December 2001 the Company began to issue brokered certificates with terms of three months or less. As of December 31, 2001, there were $158 million in short-term certificates that had been issued. In prior years, the issuance of brokered certificates had not been initiated until January.

SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE AND FEDERAL FUNDS PURCHASED

Securities sold under agreements to repurchase ("repos") are a form of borrowing that is secured by securities owned by the borrower. Banks use these agreements to borrow from other banks in order to provide temporary liquidity and they may also be used to provide business customers with a secured alternative to deposits in excess of the $100,000 insured amount. Prior to 1999, the Company had almost exclusively used repos for the latter "retail" purpose. Most of the retail agreements are for terms of a few weeks to 90 days. Like the rate paid on Federal funds purchased, the interest rate paid on repos is tied to the Federal funds sold rate. Beginning in 1999 and then continuing into 2000, funds were needed to make loans in an amount substantially in excess of the amount generated by deposit growth. Overnight borrowing from other banks was frequently used to provide this liquidity until securities matured or term borrowings could be arranged, accounting for the increase in the average balances for this category of asset from 1999 to 2000 in Table 2. There was a slight increase in average balances from 2000 to 2001 because of an increased use of these borrowing to fund part of the expansion in the 2001 RAL program. The amounts outstanding at year end 2001 were less than half the amounts at year-end 2000 as deposit growth exceeded loan growth during the remainder of 2001.

Information about the balances and rates paid is shown in Note 10 to the consolidated financial statements. Because these borrowings have only a one-day maturity, they are extremely responsive to changes in market interest rates. The average rates paid of 4.66% for 1999, 5.61% for 2000, and 3.64% for 2001 reflect the pattern of rate changes in Note F after considering that their use is heavier in the first quarter of the year.

Federal funds purchased are a second form of overnight borrowing from other banks. Prior to 1999, the Company primarily used this borrowing to accommodate other local community financial institutions on the Central Coast that had excess cash to invest overnight. However, the Company occasionally purchased additional funds from money center banks to meet liquidity needs, especially during the RAL season. In 1999, there was an increasing use of this source of funds to manage shortterm liquidity. Information on the balances and rates paid for these funds is also disclosed in Note 10 to the consolidated financial statements. Because these are overnight borrowings, the average rate paid to various parties on any one day may vary substantially from the average rate for the year, and frequently, the Federal funds rate may be quite volatile on the last day of the year. The higher rate at the end of 1999 than the average for the year was due to rising interest rates during the latter part of that year. The higher average rate for 2000 compared to the average rate for 1999 was due to increases in the targeted Fed funds rates announced by the Fed several times during 2000. The very low rate at the end of 2001 compared to both the year-end figure for 2000 and the average rate for 2001 is reflective of the steep decline in interest rates throughout 2001.

OTHER REAL ESTATE OWNED

Real property owned by the Company that was acquired in foreclosure proceedings is termed Other Real Estate Owned. As explained in Note 1 to the consolidated financial statements, the Company held some properties at December 31, 2001 and 2000, but had written their carrying value down to zero to reflect the uncertainty of realizing any net proceeds from their disposal.

As part of the loan application process, the Company reviews real estate collateral for possible problems from contamination by hazardous waste. This is reviewed again before any foreclosure proceedings are initiated.

NONEARNING ASSETS

For a bank, nonearning assets are those assets like cash reserves, equipment, and premises that do not earn interest. The ratio of nonearning assets to total assets is watched carefully by Management because it represents the efficiency with which funds are used. Tying up funds in nonearning assets either lessens the amount of interest that may be earned or it requires the investment of the smaller earning asset base in higher yielding but riskier assets to achieve the same income level. Management therefore believes that a low level of nonearning assets is part of a prudent asset/liability management strategy to reduce volatility in the earnings of the Company.

The ratio of average nonearning assets to average total assets has increased during the last three years with an average of 7.12% in 1999, 7.48% in 2000, and 8.23% in 2001. Some of the increase in nonearning assets in 1999 was due to holding extra amounts of cash on hand during November and December in case there was a large demand for currency as 2000 approached. A significant reason for the increase in 2000 and 2001 has been that after the fire that destroyed the Company's Administrative Center, additional costs were incurred for leasehold improvements and furniture related to the new center. The Company completed its move into a new Operations Center in 2000 and into its new Executive Headquarters in 2001. The space available in the old operations center (initially rented when the Company had assets of less than $500 million) was inadequate to handle the increasing volume of transactions. The new Executive Headquarters also houses SBB&T's Trust and Investment Services division which had outgrown its former facilities as well. These construction projects coming within a relatively short space of time have added to the average balance of nonearning assets. It is not anticipated that there will be a corresponding increase in 2002. In addition, the Company added approximately $20 million in nonearning assets due to the goodwill recognized in the LRB acquisition. As of September 30, 2001, the latest date peer information is available, the average ratio of nonearning assets to total assets for bank holding companies of comparable size was 7.56%.

NONINTEREST REVENUE

Fees earned by the Trust and Investment Services Division are a large component of noninterest revenue, reaching $13.0 million in 2001. Fees decreased by $821,000 or 6% over fees for 2000 which were in turn $695,000 more than fees in 1999. The market value of assets under administration on which the majority of fees are based decreased from $2.4 billion at the end of 1999 to $2.1 billion at the end of 2000, but decreased to $2.0 billion at the end of 2001. The majority of fees are based on the market value of the assets under administration. Most of these assets are held in equity securities, and the declining stock markets in 2000 and 2001 reduced the value of the assets. Most of the reduction in assets came in accounts for which the Company does not manage the accounts, i.e., does not have investment authority, but is only the custodian. Included within total fees in 2001 were $957,000 for trusteeship of employee benefit plans and $1,194,000 from the sales of mutual funds and annuities. The Company provides assistance to customers to determine what investments best match their financial goals and helps the customers allocate their funds according to the customers' risk tolerance and need for diversification. The mutual funds and annuities are not operated by the Company, but instead are managed by registered investment companies. The Division also provides investment management services to individuals and organizations.

Included within other service charges, commissions and fees are service fees arising from the processing of merchants' credit card deposits, escrow fees, and a number of other fees charged for special services provided to customers. A significant source of income in this category is tax refund transfer fee income which totaled $14.3 million in 2001 compared to $7.3 million in 2000 and $6.6 million in 1999. As explained in the previous discussion on the tax refund programs, many of the taxpayers not qualifying for loans still had their refunds sent by the IRS to the Company which then issued the refund check more quickly than the IRS. The Company began earning substantial fees for this service in 1995. Management expects that this will continue to provide a significant source of

income in 2002 and beyond. The Company continues to work on increasing other income and fees due to its importance as a potential contributor to profitability.

Included in other noninterest income is a gain of $2.9 million from the sale of the Company's merchant card processing business. There were no assets that were sold with this business, only the customer relationships. No material costs were incurred in the disposal. The employees were transferred to other areas. The Company will share in the revenue from these relationships over the next 10 years. While the sale occurred in 2001, the buyer will not take over all of the processing until the first quarter of 2002.

OPERATING EXPENSES

Total operating expenses have increased over the last three years as the Company has grown. These expenses are often calculated as a proportion of average assets as a means of providing comparisons with other financial institutions. As a percentage of average assets, these expenses have remained relatively steady during the last three years. The ratios were 3.96% in 1999, 3.60% in 2000, and 3.71% in 2001.

The ratios for 1999 and 2000 were impacted by some unusual expenses. In 1999, substantial consulting expenses were incurred to integrate PCB's processing system into the Company's system and to address the century date change ("Y2K") issue. In 2000, the Company incurred $4.5 million in transaction costs, included in other expenses, to complete the SBB and LRB transactions. Some of the increase for 2001 over 2000 is due to increased occupancy expense as the costs mentioned in "Nonearning Assets" for leasehold improvements began to be amortized in 2001.

Another ratio that is used to compare the Company's expenses to those of other financial institutions is the operating efficiency ratio. This ratio takes into account the fact that for many financial institutions much of their income is not asset-based, i.e., it is based on fees for services provided rather than income earned from a spread between the interest earned on assets and interest paid on liabilities. The operating efficiency ratio measures how much noninterest expense is spent in earning a dollar of revenue irrespective of whether the revenue is asset-based or fee-based. The Company spent 54.0 cents in 2001 for each dollar of revenue compared to 59.6 cents for its holding company peers. In 2000, the ratios were 55.9 cents for the Company and 58.5 cents for its peers. In 1999, the ratios were 57.9 cents for the Company and 61.2 cents for its peers. Without the merger expenses of 2000, the Company's ratios would have been 54.0 cents for 2000.

Within the whole category of operating expense, salary and benefit expenses increased 26.1% from 1999 to 2001 compared to a 28.5% increase in average earning assets and a 32.4% growth in net revenues (exclusive of gains or losses on securities) for the same period.

Net occupancy and equipment expense increased from 1999 to 2001 by 21.2% because of some branch office renovation; increases in lease expense; upgrading of equipment to handle increased transaction volumes and to maintain technological competitiveness; the addition of new branch offices; and the increase in depreciation relating to the new administrative, operations and executive buildings.

CAPITAL RESOURCES

As of December 31, 2001, under current regulatory definitions, the Company and its bank subsidiaries are "well-capitalized," the highest rating of the five categories defined under the Federal Deposit Insurance Corporation Improvement Act ("FDICIA").

CAPITAL ADEQUACY STANDARDS

The primary measure of capital adequacy for regulatory purposes is based on the ratio of total risk-based capital to risk-weighted assets. This method of measuring capital adequacy is meant to

accomplish several objectives: 1) to establish capital requirements that are more sensitive to the differences in risk associated with various assets; 2) to explicitly take into account off-balance sheet exposure in assessing capital adequacy; and, 3) to minimize disincentives to holding liquid, low-risk assets.

The Company, as a bank holding company, is required by the FRB to maintain a total risk-based capital to risk-weighted asset ratio of at least 8.0%. To be considered "well-capitalized" the ratio must be at least 10%. At the end of 2001, the Company's ratio was 12.2% The Company also must maintain a Tier 1 capital to risk-weighted asset ratio of 6% and a Tier 1 capital to average assets of 5% to be considered well-capitalized. The minimum levels established by the FRB, the minimum levels necessary to be considered well-capitalized by regulatory definition and the Company's ratios as of December 31, 2001 are presented in Note 17. It is Management's intent to maintain capital in excess of the well-capitalized requirement, and as of year-end all ratios exceed this threshold. SBB&T, FNB, and LRB are also required to maintain a total risk-based capital to risk-weighted asset ratio of 10.0% to be considered well-capitalized. SBB&T's ratio at the end of 2001 was 13.1% and FNB's was 10.6%.

The risk-based capital ratio is impacted by three factors: (1) the growth in assets compared to the growth in capital; (2) the relative size of the various asset categories; and (3) the composition of the securities and money market portfolios. The Company's ratio increased from 10.5% for year-end 2000 to 12.2% for year-end 2001. This occurred first as the result of assets growing by 7.7% from year-end 2000 to year-end 2001 while capital increased by 10.0%. In addition, the SBB&T issued $36 million in subordinated debt during 2001. While shown on the 2001 consolidated balance sheet as long-term debt, for the first half of its term it is included as Tier II capital in the computation of the Total Capital to Risk-Weighted Asset ratio. In the second half of its 10 year term, one fifth of the balance will be excluded each year from capitalin this computation.

FUTURE SOURCES AND USES OF CAPITAL AND EXPECTED RATIOS

Over the last five years, the Company's assets have been increasing at a compound annual growth rate of 14.3%. To maintain its capital ratios, the Company must continue to increase capital at the same rate. Net income, the major source of capital growth for the Company, has been increasing at a compound annual growth rate of 20.4%, but 35%-40% of net income has been distributed to shareholders in the form of dividends. Together with some share repurchases, this has resulted in capital increasing at a compound annual growth rate of 12.1%.

During the last several years, the Company has experienced strong loan demand and expects this to continue. This requires the Company to more closely monitor its capital position than was necessary in prior years when the challenge was to effectively utilize excess capital.

The process of managing the capital ratios to remain classified as well capitalized involves three primary considerations. First, it is essential that management avoid alternating between being able to make loans and not able to make loans. Customers are attracted to the Company's subsidiary banks because of the relationship that is built with the customer, not the individual transaction. This requires the Company to be able to meet the credit needs of the borrower when they need to borrow.

The second consideration is that to maintain the ability to provide for those customers, the Company must be prepared to sell some of the loans it originates. This involves structuring loans to meet the purchase requirements of secondary markets, or charging an interest rate premium for those loans that cannot be sold. As mentioned above, in 2000 and early 2001, the Company has already sold loans as a means of limiting the rate of asset increase and will probably continue to do so in 2002.

The third consideration is that raising additional capital is likely to be beneficial. Because the capital ratios are a regulatory issue, it is not necessary for the Company to issue more common stock. It is more likely that the Company would use other forms of regulatory capital like additional

subordinated debt or Trust Preferred Stock. Interest would need to be paid on this capital, but the current shareholders would not have their ownership diluted by additional shares. The Company has had preliminary discussions with investment bankers regarding the issuance of such capital and has been informed that it could be accomplished with relative ease.

In addition to the capital generated from the operations of the Company, over the years a secondary source of capital growth has been the exercise of employee and director stock options. The extent of the growth from this source in any one year depends on a number of factors. These include the current stock price in relation to the price at the time options were granted and the number of options that would expire if not exercised during the year.

The net increase to capital from the exercise of options is lessened by the ability of option holders to pay the exercise price of options by trading shares of stock they already own, termed "swapping". In 2001, the increase to capital from the exercise of options (net of shares surrendered as payment for exercises and taxes) was $2.9 million or 9.8% of the net growth in shareholders' equity in the year. At December 31, 2001, there were approximately 556,000 options outstanding and exercisable at less than the then-current market price, with an average exercise price of $19.98. This represents a potential addition to capital of $11.1 million, if all options were exercised with cash. Because many options are likely to be exercised by swapping, some amount less than the $11.1 million in new capital will result from the exercise of options, and the options are likely to be exercised over a number of years.

In any case, Management intends to take the actions necessary to ensure that the Company and the subsidiary banks will continue to exceed the capital ratios required for well-capitalized institutions.

SHARE REPURCHASES

In prior years, the Company occasionally repurchased shares of its common stock to offset the increased number of shares issued as a result of the exercise of employee stock options. In 1998, because the merger with PCB was accounted for as a pooling-of-interests, the Company suspended purchases at the initiation of the merger discussions and repurchased only 150,000 shares compared to the issuance of 807,000 shares resulting from the exercise of stock options. In 1999, the Company repurchased 68,000 shares to partially offset the issuance of 413,000 shares resulting from the exercise of stock options. There were no repurchases of shares in 2000.

In 2001, as explained in Note 11 to the consolidated financial statements, the Company issued $40 million in senior debt. A portion of this was used to repay a short-term note issued by the Company to partially finance the purchase of LRB. $20 million of the proceeds was authorized by the Board of Directors to be used to repurchase stock. Through December 31, 2001, $15.0 million had been used to purchase in excess of 518,000 shares.

There are no material commitments for capital expenditures or "off-balance sheet" financing arrangements as of the end of 2001, except as reported in Note 18 to the consolidated financial statements. There are legal limitations on the ability of the subsidiary banks to declare dividends to the Bancorp based on earnings over the last three years.

REGULATION

The Company is strongly impacted by regulation. The Company and its subsidiaries may engage only in lines of business that have been approved by their respective regulators, and cannot open, close, or relocate offices without their approval. Disclosure of the terms and conditions of loans made to customers and deposits accepted from customers are both heavily regulated as to content. FDICIA, effective in 1992, required banks to meet new capitalization standards, follow stringent outside audit rules, and establish stricter internal controls. There were also new requirements to ensure that the Audit Committee of the Board of Directors is independent.

The subsidiary banks are required by the provisions of the federal Community Reinvestment Act ("CRA"), to make significant efforts to ensure that access to banking services is available to every segment of the community. They are also required to comply with the provision of various other consumer legislation and regulations. The Company and the banks must file periodic reports with the various regulators to keep them informed of their financial condition and operations as well as their compliance with all the various regulations.

The three regulatory agencies-the FRB for the Company and SBB&T, the California Department of Financial Institutions for SBB&T, the OCC for FNB-conduct periodic examinations of the Company and its subsidiary banks to verify that their reporting is accurate and to ascertain that they are in compliance with regulations.

A banking agency may take action against a bank holding company or a bank should it find that the financial institution has failed to maintain adequate capital. This action has usually taken the form of restrictions on the payment of dividends to shareholders, requirements to obtain more capital from investors, and restrictions on operations. The FDIC may also take action against a bank which is not acting in a safe and sound manner. Given the strong capital position and performance of the Company and the banks, Management does not expect to be impacted by these types of restrictions in the foreseeable future.

The Gramm-Leach-Bliley Act was enacted as Federal legislation in late 1999 with an effective date of March 11, 2000. The provisions of the act permit banking organizations to enter into areas of business from which they were previously restricted. Similarly, other kinds of financial organizations are permitted to conduct business provided by banks. Management expects that over the next several years the Company will develop new opportunities for business and will face increased competition as a result of the passage of this act.

IMPACT OF INFLATION

Inflation has been minimal for the last several years and has had little or no impact on the financial condition and results of operations of the Company during the periods discussed here.

LIQUIDITY

Liquidity is the ability to raise funds on a timely basis at an acceptable cost in order to meet cash needs. Adequate liquidity is necessary to handle fluctuations in deposit levels, to provide for customers' credit needs, and to take advantage of investment opportunities as they are presented in the market place.

The Company's objective is to ensure adequate liquidity at all times by maintaining liquid assets, by being able to raise deposits and liabilities, and by having access to funds via capital markets. Having too little liquidity can result in difficulties in meeting commitments and lost opportunities. Having too much liquidity can result in less income because liquid assets usually do not earn as high an interest rate as less liquid assets.

As indicated in the Consolidated Statements of Cash Flows principal sources of cash for the Company have included proceeds from the maturity or sale of securities, and the growth in deposits and other borrowings.

To manage the Company's liquidity properly, however, it is not enough to merely have large cash inflows; they must be timed to coincide with anticipated cash outflows. Also, the available cash on hand or cash equivalents must be sufficient to meet the exceptional demands that can be expected from time to time relating to natural catastrophes such as flood, earthquakes, and fire.

The Company manages its liquidity adequacy by monitoring and managing its immediate liquidity, intermediate liquidity, and long term liquidity.

Immediate liquidity is the ability to raise funds today to meet today's cash obligations. Sources of immediate liquidity include cash on hand, the prior day's Federal funds sold position, unused Federal funds and repurchase agreement lines and facilities extended by other banks and major brokers to the Company, access to the FHLB for short-term advances, and access to the FRB's Discount Window. The Company has established a target amount for sources of available immediate liquidity. This amount is increased during certain periods to accommodate any liquidity risks of special programs like RALs.

As discussed in various sections above, at various times strong loan demand outpaced deposit growth. At these times, the Company had to rely more on overnight borrowing to maintain immediate liquidity. The rate paid on these borrowings is more than would be paid for deposits, but aside from this, there have been no adverse consequences from relying more on borrowing ability than on holding liquid assets in excess of the immediate amounts needed. The Company's strong capital position and earnings prospects have meant that these sources of borrowing have been readily available.

Intermediate liquidity is the ability to raise funds during the next few months to meet cash obligations over those next few months. Sources of intermediate liquidity include maturities or sales of commercial paper and securities, term repurchase agreements, and term advances from the FHLB. The Company monitors the cash flow needs of the next few months and determines that the sources are adequate to provide for these cash needs.

Long-term liquidity is the ability to raise funds over the entire planning horizon to meet cash needs anticipated due to strategic balance sheet changes. Long-term liquidity sources include: initiating special programs to increase core deposits in expanded market areas; reducing the size of securities portfolios; taking long-term advances from the FHLB, securitizing loans; and accessing capital markets. The fixed-rate loans the Company borrowed from FHLB to fund the retention of a portion of the 30-year fixed rate residential real estate loans is an example of coordinating a source of long term liquidity with asset/liability management.

INCOME TAX EXPENSE

Income tax expense is the sum of two components: the CURRENT TAX EXPENSE or provision and the DEFERRED EXPENSE or provision. Current tax expense is the result of applying the current tax rate to taxable income.

The deferred tax provision is intended to account for the fact that income on which the Company pays taxes with its returns differs from pre-tax income in the accompanying Consolidated Statements of Income. Some items of income and expense are recognized in different years for income tax purposes than in the financial statements. For example, the Company is only permitted to deduct from Federal taxable income actual net loan charge-offs, irrespective of the amount of provision for credit loss (bad debt expense) recognized in its financial statements. This causes what is termed a "temporary difference." Eventually, as loans are charged-off, the Company will be able to deduct for tax purposes what has already been recognized as an expense in the financial statements. Another example is the ACCRETION of discount on certain securities. Accretion is the recognition as interest income of the excess of the par value of a security over its cost at the time of purchase. For its financial statements, the Company recognizes income as the discount is accreted. For its tax return, however, the Company can defer the recognition of that income until the cash is received at the maturity of the security. The first example causes a deferred tax asset to be created because the Company has recognized as an expense for its current financial statements an item that it will be able to deduct from its taxable income in a future year's tax return. The second example causes a deferred tax liability, because the Company has been able to delay until a subsequent year the paying of tax on an item of current year financial statement income.

The Company measures all of its deferred tax assets and liabilities at the end of each year. The difference between the net asset or liability at the beginning of the year and the end of the year is the deferred tax provision for the year.

Most of the Company's temporary differences involve recognizing substantially more expenses in its financial statements than it has been allowed to deduct for taxes in the return for the year. This results in a net deferred tax asset. Deferred tax assets are dependent for realization on past taxes paid, against which they may be carried back, or on future taxable income, against which they may be offset. If there were a question about the Company's ability to realize the benefit from the asset, then it would have to record a valuation allowance against the asset to reflect the uncertainty. Given the amount and nature of the Company's deferred assets, the past taxes paid, and the likelihood of future taxable income, realization is assured for the fullamount of the net deferred tax asset and no valuation allowance is needed.

The amounts of the current expense and deferred benefit, the amounts of the various deferred tax assets and liabilities, and the tax effect of the principal temporary differences between taxable income and pre-tax financial statement income are shown in Note 8 to the accompanying consolidated financial statements.

COMMON STOCK AND DIVIDENDS

Stock prices and cash dividends declared for the last eight quarters are shown on page 5. The Company's stock is listed on the Nasdaq National Market System. The trading symbol is SABB. Stock prices represent trading activity through the Nasdaq National Market System.

For the years 2001, 2000, and 1999, the Company has declared cash dividends which were 32.1%, 40.6%, and 39.0%, respectively, of its net income. The Company's policy is to pay dividends of approximately 35%-40% of the last 12 months earnings. The lower payout ratio in 2001 was not because the Company reduced its dividend rate, but because the timing of the declaration of the quarterly dividends was changed in 2001 as explained in Note 21 to the consolidated financial statements. Because earnings were significantly reduced in 2000 by the one-time merger expenses, the ratio for 2000 is higher than usual. The most recent information for the Company's peers shows an average payout ratio of 30.0%. The Board of Directors periodically increases the dividend rate in acknowledgment that earnings have been increasing by a sufficient amount to ensure adequate capital and also provide a higher return to shareholders. The last increase was declared in the third quarter of 2000.

MERGERS AND ACQUISITIONS

On December 30, 1998, Santa Barbara Bancorp completed its merger with the former Pacific Capital Bancorp and assumed the name of its merger partner to most clearly reflect the broad geography of the new multi-bank organization.

After the close of business June 30, 2000, the Company completed its acquisition of Los Robles Bancorp. The shareholders of Los Robles Bancorp were paid cash in the amount of $23.12 per share for their stock for a total transaction amount of $32.5 million. The acquisition was accounted for as a purchase. The Company recognized goodwill of $20.0 million in the transaction for the excess of the purchase price over the fair value of the net assets obtained.

The only subsidiary of Los Robles Bancorp, LRB, became a subsidiary of the

Company. In the second quarter of 2001, LRB was merged into SBB&T.

After the close of business July 31, 2000, the Company completed its merger with San Benito Bank. The merger agreement provided for SBB shareholders to receive 0.605 shares of the Company's stock in exchange for each of their shares. Based on the closing price of the Company's stock as of the date of the merger, the value of the merger was approximately $43.8 million, 2.8 times the book value of San Benito Bank. The transaction was accounted for as a pooling-of-interests. As such, all financial results for periods prior to the merger are reported as if the merger occurred at the beginning of the earliest period presented.

In December 2001, the Company signed an agreement with another financial institution to acquire certain assets and liabilities of two of its branches in Monterey and Watsonville. The deposits and loans acquired in this transaction will be combined with FNB's existing branches in those communities. The transaction is expected to close in the second quarter of 2002.

NOTES TO MANAGEMENT'S DISCUSSION AND
ANALYSIS OF FINANCIAL CONDITION AND
RESULTS OF OPERATIONS

NOTE A

The Company incurred merger related expenses of $7.9 million in 2000 to complete the acquisition of San Benito Bank and Los Robles Bank. $4.6 million was for severance, change of control contracts, consulting and computer system conversion. $3.3 million of provision expense was taken to recognize differences in loan grading and allowance allocation methods used by the Company and acquired banks.

NOTE B

Offices obtained in purchase or acquisition transactions are included as a reason for growth in net income over the last five years, while offices obtained in pooling or merger transactions are not a reason for growth. This is because of the difference in the accounting for these two types of business combinations.

Accounting standards for business combinations accounted for as poolings require that the figures for prior years be restated as if the combination occurred at the beginning of the first year presented. Therefore, the assets, deposits, and net income obtained in pooling transactions are included in both the current numbers and the prior period numbers and a difference between the two would not be explained by the transaction. There is no such restatement for prior year figures for purchase transactions -the balances or net income are included only from the date of the acquisition.

NOTE C

In various places throughout this discussion, comparisons are made between ratios for the Company and for its holding company or FDIC peers.

The Bancorp peer is a group of 66 companies with an asset size of $3 billion to $10 billion. The peer information is reported in the BANK HOLDING COMPANY PERFORMANCE REPORT received from the FRB for the 3rd Quarter of 2001, the latest quarter for which the report has been distributed as of this writing.

The FDIC peer group comprises 300+ banks with an asset size of $1 billion to $10 billion, and the information set forth above is reported in or calculated from information reported in the FDIC QUARTERLY BANKING PROFILE, THIRD QUARTER 2001, which is the latest issue available. The publication does not report some of the statistics cited in this report by the separate size-based peer groups. In these instances, the figure cited is for all FDIC banks regardless of size.

The particular peer group used for comparison depends on the nature of the information in question. Company data like capital ratios and dividend payout are compared to other holding companies, because capital is generally managed at the holding company level and dividends to shareholders are paid from the holding company, not the individual banks. Expense and revenue ratios are also compared to other holding company data because many holding companies provide significant services to their subsidiary banks and may also provide services to customers as well. These items would not be included in FDIC bank-level data. Credit information relates to what is generally a bank-level activity, the making of loans, and the FDIC data in this area is more pertinent.

NOTE D

For Tables 1, 2, and 3, the yield on tax-exempt state and municipal securities and loans has been computed on a tax equivalent basis. To compute the tax equivalent yield for these securities one

must first add to the actual interest earned an amount such that if the resulting total were fully taxed, the after-tax income would be equivalent to the actual tax-exempt income. This tax equivalent income is then divided by the average balance to obtain the tax equivalent yield. The dollar amount of the adjustment is shown at the bottom of Table 2 as "Tax equivalent income included in interest income from non-taxable securities and loans."

NOTE E

When comparing interest yields and costs year to year, the use of average balances more accurately reflects trends since these balances are not significantly impacted by period-end transactions. The amount of interest earned or paid for the year is also directly related to the average balances during the year and not to what the balances happened to be on the last day of the year. Average balances are daily averages, i.e., the average is computed using the balances for each day of the year, rather than computing the average of the first and last day of the year.

NOTE F

From January 1, 1999 through December 31, 2001, the Fed changed the target rates for Federal funds as follows:

Date	Amount of Change	New Target Rate
June 1999	+0.25%	5.00%
August 1999	+0.25%	5.25%
November 1999	+0.25%	5.50%
February 2000	+0.25%	5.75%
March 2000	+0.25%	6.00%
May 2000	+0.25%	6.50%
January 2001	-0.50%	6.00%
January 2001	-0.50%	5.50%
March 2001	-0.50%	5.00%
April 2001	-0.50%	4.50%
May 2001	-0.50%	4.00%
June 2001	-0.25%	3.75%
August 2001	-0.25%	3.50%
September 2001	-0.50%	3.00%
October 2001	-0.50%	2.50%
November 2001	-0.50%	2.00%
December 2001	-0.25%	1.75%

NOTE G

For purposes of Table 2, loans in a nonaccrual status are included in the computation of average balances in their respective loan categories.

NOTE H

For purposes of the amounts in Table 3 relating to the volume and rate analysis of net interest margin, the portion of the change in interest earned or paid that is attributable to changes in rate is computed by multiplying the change in interest rate by the prior year's average balance. The portion of the change in interest earned or paid that is attributable to changes in volume is computed by multiplying the change in average balances by the prior year's interest rate. The portion of the change that is not attributable either solely to changes in volume or changes in rate is prorated on a weighted basis between volume and rate.

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NOTE I

A yield curve is a graphic representation of the relationship between the interest rate and the maturity term of financial instruments. Generally, interest rates on shorter maturity financial instruments are less than those for longer term instruments. For example, at December 31, 1999, 1 year U.S. Treasury notes sold at a price that yielded 5.96% while 30 year notes sold at a price that yielded 6.48%. A line drawn that plots this relationship for a whole range of maturities will be "steeper" when the rates on long-term maturities are substantially higher than those on shorter term maturities. The curve is said to be "flatter" when there is not as much of a difference. At December 31, 2000, the shape of the curve was partially "inverted" in that 10 year notes sold at a lower price than either 1 year or 30 year notes. 1 year U.S. Treasury notes sold at a price that yielded 5.36%, 10 year U.S. Treasury notes sold at a price that yielded 5.11%, and 30 year notes sold at a price that yielded 5.46%. By December 31, 2001, the curve started very low at the short end and its shape was quite steep, as 1 year notes sold at a price that yielded 2.17% and 30 year notes sold at a price that yielded 5.47%.

NOTE J

A large number of home mortgage loans may be grouped together by a financial institution into a pool. This pool may then be securitized and sold to investors. The payments received from the borrowers on their mortgages are used to pay the investors. The mortgage instruments themselves are the security or backing for the investors and the securities are termed mortgage-backed.

Collateralized mortgage obligations are like mortgage-backed securities in that they involve a pool of mortgages. However, payments received from the borrowers are not equally paid to investors. Instead, investors purchase portions of the pool that have different repayment characteristics. This permits the investor to better time the cash flows that will be received.

Asset-backed securities are like mortgage-backed securities except that loans other than mortgages are the source of repayment. For instance, these might be credit card loans or auto loans.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We have provided the required quantitative and qualitative disclosures about market risk in Management's Discussion and Analysis on pages 16 through 21.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Audited consolidated financial statements and related documents required by this item are included in this Annual Report on Form 10-K on the pages indicated:

The following unaudited supplementary data is included in this Annual Report on Form 10-K on the page indicated:

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

PACIFIC CAPITAL BANCORP AND SUBSIDIARIES

The Management of Pacific Capital Bancorp (the "Company") is responsible for the preparation, integrity, and fair presentation of the Company's annual consolidated financial statements and related financial data contained in this report. With the exception that some of the information in Management's Discussion and Analysis of Financial Condition and Results of Operations is presented on a tax-equivalent basis to improve comparability, all information has been prepared in accordance with accounting principles generally accepted in the United States and, as such, includes certain amounts that are based on Management's best estimates and judgments.

The consolidated financial statements presented on pages 54 through 58 have been audited by Arthur Andersen LLP, who have been given unrestricted access to all financial records and related data, including minutes of all meetings of shareholders, the Board of Directors, and committees of the Board. Management believes that all representations made to Arthur Andersen LLP during the audit were valid and appropriate.

Management is responsible for establishing and maintaining an internal control structure over financial reporting presented in conformity with both accounting principles generally accepted in the United States and the Federal Financial Institutions Examination Council Instructions for Consolidated Reports of

Condition and Income. Two of the objectives of this internal control structure are to provide reasonable assurance to Management and the Board of Directors that transactions are properly authorized and recorded in our financial records, and that the preparation of the Company's financial statements and other financial reporting is done in accordance with generally accepted accounting principles.

Management has made its own assessment of the effectiveness of the Company's internal control structure over financial reporting as of December 31, 2001, in relation to the criteria described in the report, INTERNAL CONTROL-INTEGRATED FRAMEWORK, issued by the Committee of Sponsoring Organizations of the Treadway Commission.

There are inherent limitations in the effectiveness of any internal control structure, including the possibility of human error and the circumvention or overriding of controls. Accordingly, even an effective internal control structure can provide only reasonable assurance with respect to reliability of financial statements. Furthermore, the effectiveness of any internal control structure can vary with changes in circumstances. Nonetheless, based on its assessment, Management believes that as of December 31, 2001, Pacific Capital Bancorp's internal control structure was effective in achieving the objectives stated above.

The Board of Directors is responsible for reviewing and monitoring the policies and practices employed by Management in preparing the Company's financial reporting. This is accomplished through its Audit Committee, which is comprised of directors who are not officers or employees of the Company. The Committee reviews accounting policies, control procedures, internal and independent audit reports, and regulatory examination reports with Management, the Company's internal auditors, and representatives of Arthur Andersen LLP. Both the Company's internal auditors and the representatives of Arthur Andersen LLP have full and free access to the Committee to discuss any issues which arise out of their examinations without Management present.

/s/ David W. Spainhour	/s/ William S. Thomas Jr.	/s/ Donald Lafler
David W. Spainhour Chairman of the Board Pacific Capital Bancorp	William S. Thomas, Jr. President and Chief Executive Officer Pacific Capital Bancorp	Donald Lafler Executive Vice President and Chief Financial Officer Pacific Capital Bancorp

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REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

PACIFIC CAPITAL BANCORP AND SUBSIDIARIES

To the Shareholders and the Board of Directors of Pacific Capital Bancorp:

We have audited the accompanying consolidated balance sheets of Pacific Capital Bancorp (a California corporation) and subsidiaries as of December 31, 2001 and 2000, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2001. These financial statements are the responsibility of Pacific Capital Bancorp's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of San Benito Bank for years prior to its merger during 2000 with Pacific Capital Bancorp in a transaction accounted for as a pooling of interests, as discussed in Note 19. Such statements are included in the consolidated financial statements of Pacific Capital Bancorp and subsidiaries and reflect net income of 5 percent for the year ended December 31, 1999, of the related consolidated totals. These statements were audited by other auditors whose report has been furnished to us and our opinion, insofar as it relates to amounts included for San Benito Bank prior to the merger, is based solely upon the report of the other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States. 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 and the report of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of the other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of Pacific Capital Bancorp and subsidiaries as of December 31, 2001 and 2000, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2001 in conformity with accounting principles generally accepted in the United States.

/s/ Arthur Andersen LLP

ARTHUR ANDERSEN LLP
Los Angeles, California
February 6, 2002

INDEPENDENT AUDITORS' REPORT

PACIFIC CAPITAL BANCORP
AND SUBSIDIARIES

The Board of Directors and Shareholders,
Pacific Capital Bancorp:

We have audited the statements of income, stockholders' equity, and cash flows of San Benito Bank for the year ended December 31, 1999 (not presented separately herein). 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 audit.

We conducted our audit 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 audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the results of operations and cash flows of San Benito Bank for the year ended December 31, 1999, in conformity with accounting principles generally accepted in the United States of America.

/s/ Deloitte & Touche LLP

DELOITTE & TOUCHE LLP
Hollister, California
January 24, 2000

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CONSOLIDATED BALANCE SHEETS

PACIFIC CAPITAL BANCORP AND SUBSIDIARIES

(AMOUNTS IN THOUSANDS EXCEPT SHARE AND PER SHARE AMOUNTS)	DECEMBER 31 2001	2000
ASSETS:		
Cash and due from banks (Note 5)	$ 136,457	$ 176,274
Federal funds sold and securities purchased under agreements to resell	94,500	19,500
Total cash and cash equivalents	230,957	195,774
Securities (approximate market value of $778,465 in 2001 and $806,037 in 2000) (Note 2):		
Held-to-maturity	71,967	139,294
Available-for-sale	699,076	657,595
Total securities	771,043	796,889
Loans (Note 3)	2,799,092	2,517,104
Less: allowance for credit losses (Note 4)	48,872	35,125
Net Loans	2,750,220	2,481,979
Premises and equipment, net (Note 6)	63,103	53,013
Accrued interest receivable	20,425	25,945
Other assets (Note 8 and 19)	125,181	124,025

Total assets	$3,960,929	$3,677,625
LIABILITIES:		
Deposits (Note 7):		
Noninterest bearing demand deposits	$ 718,441	$ 709,348
Interest bearing deposits	2,647,134	2,393,471
Total deposits	3,365,575	3,102,819
Securities sold under agreements to repurchase and Federal funds purchased (Note 10)	45,073	105,658
Long-term debt and other borrowings (Note 11)	188,331	129,658
Accrued interest payable and other liabilities (Notes 8, 13, and 15)	36,074	43,229
Total liabilities	3,635,053	3,381,364
Commitments and contingencies (Note 18)		
SHAREHOLDERS' EQUITY (Notes 9, 13 and 17):		
Common stock - no par value; $0.33 per share stated value; shares authorized: 60,000; shares issued and outstanding: 26,207 in 2001 and 26,481 in 2000	8,737	8,828
Preferred stock - no par value; shares authorized: 1,000; shares issued and outstanding: none	-	-
Surplus	106,929	115,664
Accumulated other comprehensive income (Note 9)	4,795	4,472
Retained earnings	205,415	167,297
Total shareholders' equity	325,876	296,261
Total liabilities and shareholders' equity	$3,960,929	$3,677,625

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

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CONSOLIDATED STATEMENTS OF INCOME

PACIFIC CAPITAL BANCORP AND SUBSIDIARIES

(IN THOUSANDS, EXCEPT PER SHARE DATA)	YEAR ENDED DECEMBER 31		
	2001	2000	1999
INTEREST INCOME:			
Interest and fees on loans (Note 3)	$242,050	$229,014	$174,539
Interest on securities	41,118	49,478	46,248
Interest on Federal funds sold and securities purchased under agreement to resell	5,852	9,870	4,033
Interest on commercial paper	2,088	1,602	307
Total interest income	291,108	289,964	225,127
INTEREST EXPENSE:			
Interest on deposits (Note 7)	83,061	98,293	65,894
Interest on securities sold under agreements to repurchase and Federal funds purchased (Note 10)	3,289	4,247	1,766

Interest on long-term debt and other borrowings (Note 11)	10,876	7,986	4,815
Total interest expense	97,226	110,526	72,475
NET INTEREST INCOME	193,882	179,438	152,652
Provision for credit losses (Note 4)	26,671	14,440	7,043
Net interest income after provision for credit losses	167,211	164,998	145,609
NONINTEREST REVENUE:			
Service charges on deposit accounts	12,927	11,176	9,608
Trust fees (Notes 1 and 12)	13,006	13,827	13,132
Other service charges, commissions and fees (Note 12)	31,051	21,757	18,717
Net gain (loss) on sales and calls of securities	309	(143)	(268)
Other income (Note 12)	8,433	3,723	2,730
Total noninterest revenue	65,726	50,340	43,919
OPERATING EXPENSE:			
Salaries and benefits (Notes 13, 15, and 16)	69,788	67,204	55,357
Net occupancy expense (Notes 6 and 18)	12,279	11,225	9,822
Equipment rental, depreciation, and maintenance (Note 6)	8,327	7,303	7,185
Other expense (Note 12)	52,756	46,225	45,061
Total operating expense	143,150	131,957	117,425
Income before provision for income taxes	89,787	83,381	72,103
Provision for income taxes (Note 8)	33,676	31,925	25,570
NET INCOME	$ 56,111	$ 51,456	$ 46,533
BASIC EARNINGS PER SHARE (NOTE 16)	$ 2.12	$ 1.95	$ 1.78
DILUTED EARNINGS PER SHARE (NOTE 16)	$ 2.11	$ 1.93	$ 1.75

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

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

PACIFIC CAPITAL BANCORP AND SUBSIDIARIES

(IN THOUSANDS)	YEAR ENDED DECEMBER 31		
	2001	2000	1999

Net income	$56,111	$51,456	$ 46,533
Other comprehensive income, net of tax (Note 8) -			
Unrealized gain (loss) on securities:			
Unrealized holding gains (losses) arising during period	502	11,154	(10,487)
Reclassification adjustment for (gains) losses included in net income	(179)	83	155
Other comprehensive income (loss), net of tax	323	11,237	(10,332)
Comprehensive income	$56,434	$62,693	$ 36,201

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

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

PACIFIC CAPITAL BANCORP AND SUBSIDIARIES

(IN THOUSANDS EXCEPT PER SHARE AMOUNTS)

	COMMON STOCK SHARES	COMMON STOCK AMOUNT	SURPLUS	ACCUMULATED OTHER COMPREHENSIVE INCOME	RETAINED EARNINGS
Balance, December 31, 1998	25,851	$8,618	$109,980	$ 3,567	$108,330
Activity for 1999:					
Exercise of stock options (Note 9)	499	167	6,498	-	-
Retirement of common stock (Note 9)	(71)	(24)	(2,142)	-	-
Cash dividends declared at $0.72 per share	-	-	-	-	(18,154)
Changes in unrealized loss on securities available for sale, net	-	-	-	(10,332)	-
Net income	-	-	-	-	46,533
Balance, December 31, 1999	26,279	8,761	114,336	(6,765)	136,709

Activity for 2000:					
Exercise of stock options (Note 9)	202	67	1,328	-	-
Cash dividends declared at $0.84 per share	-	-	-	-	(20,868)
Changes in unrealized loss on securities available for sale, net	-	-	-	11,237	-
Net income	-	-	-	-	51,456
Balance, December 31, 2000	26,481	$8,828	$115,664	$ 4,472	$167,297
Activity for 2001:					
Exercise of stock options (Note 9)	244	81	6,100	-	-
Retirement of common stock (Note 9)	(518)	(172)	(14,835)	-	-
Cash dividends declared at $0.66 per share	-	-	-	-	(17,993)
Changes in unrealized loss on securities available for sale, net	-	-	-	323	-
Net Income	-	-	-	-	56,111
Balance, December 31, 2001	26,207	$8,737	$106,929	$ 4,795	$205,415

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

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CONSOLIDATED STATEMENTS OF CASH FLOWS

PACIFIC CAPITAL BANCORP AND SUBSIDIARIES

(DOLLARS IN THOUSANDS)	YEAR ENDED DECEMB 2001	2000
CASH FLOWS FROM OPERATING ACTIVITIES:		
NET INCOME	$ 56,111	$ 51,456
ADJUSTMENTS TO RECONCILE NET INCOME TO NET CASH PROVIDED BY OPERATIONS:		
Depreciation and amortization	10,918	7,963
Provision for credit losses	26,671	14,440
Gain on life insurance	-	-
Benefit for deferred income taxes	(7,275)	(2,296)
Net recovery on other real estate owned	-	-
Net amortization of discounts and premiums for securities and bankers' acceptances and commercial paper	(4,074)	(7,557)
Net change in deferred loan origination fees and costs	(905)	1,525

Change in accrued interest receivable and other assets	16,630	(7,375)
Change in accrued interest payable and other liabilities	(1,282)	1,481
Net loss (gain) on sales and calls of securities	(309)	143
Decrease in income taxes payable	(47)	(3,126)
Other operating activities	-	(9,292)
NET CASH PROVIDED BY OPERATING ACTIVITIES	96,438	47,362
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of common stock of Los Robles Bank (Note 19)	-	(32,500)
Proceeds from sales, calls, and maturities of securities	319,779	228,338
Purchase of securities	(289,317)	(259,294)
Proceeds from sale or maturity of commercial paper	531,343	9,966
Purchase of commercial paper	(531,343)	(9,972)
Net increase in loans made to customers	(294,007)	(443,930)
Disposition of property from defaulted loans	-	5,565
Purchase of tax credit investment	(7,468)	-
Net purchase of premises and equipment	(18,441)	(22,279)
Proceeds from sale of equipment	-	-
NET CASH USED IN INVESTING ACTIVITIES	(289,454)	(524,106)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in deposits	262,756	481,362
Net (decrease) increase in borrowings with maturities of 90 days or less	(60,585)	19,725
Proceeds from long-term debt and other borrowing	80,955	189,783
Payments on long-term debt and other borrowing	(22,282)	(153,500)
Proceeds from issuance of common stock (Note 9)	6,181	1,395
Payments to retire common stock (Note 9)	(15,007)	-
Dividends paid	(23,819)	(20,868)
NET CASH PROVIDED BY FINANCING ACTIVITIES	228,199	517,897
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	35,183	41,153
Cash and cash equivalents at beginning of year	195,774	143,617
Cash and cash equivalents acquired in acquisitions	-	11,004
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 230,957	$ 195,774
SUPPLEMENTAL DISCLOSURE:		
Interest paid during the year	$ 94,824	$ 94,051
Income taxes paid during the year	$ 33,241	$ 35,090
Non-cash additions to other real estate owned (Note 1)	$ -	$ -

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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

PACIFIC CAPITAL BANCORP AND SUBSIDIARIES

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

NATURE OF OPERATIONS

Pacific Capital Bancorp (the "Company") is a bank holding company organized under the laws of California. Through its banking subsidiaries, Santa Barbara Bank & Trust ("SBB&T") and First National Bank of Central California ("FNB"), the Company provides a full range of commercial banking servicesto individuals and business enterprises. The banking services include making commercial, leasing, consumer, and Small Business Administration guaranteed loans, and commercial and residential real estate loans. Deposits are accepted for checking, interest-bearing checking ("NOW"), money-market, savings, and time accounts. The banks offer safe deposit boxes, travelers checks, money orders, foreign exchange services, and cashiers checks. A wide range of wealth management services are offered through the Trust and Investment Services divisions of SBB&T and FNB. The offices of SBB&T are located in Santa Barbara and Ventura Counties. Offices of FNB are located in the counties of Monterey and Santa Cruz. Offices in southern Santa Clara County are maintained under the name "South Valley National Bank", an affiliate of FNB, and offices in San Benito County are maintained under the name "San Benito Bank," ("SBB") also an affiliate of FNB. The Company acquired Los Robles Bank ("LRB") when it purchased all of the outstanding shares of Los Robles Bancorp in 2000. Initially operated as a separate banking subsidiary of the Company, LRB was merged into SBB&T at the end of May 2001.

The Company's third subsidiary is Pacific Capital Commercial Mortgage Company. Its primary business activities had been directed to brokering commercial real estate loans and servicing those loans for a fee, but it was made inactive in 2001. A fourth subsidiary, Pacific Capital Services Corporation, is also inactive.

BASIS OF PRESENTATION

The accounting and reporting policies of the Company are in accordance with GAAP and conform to practices within the banking industry. The consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany balances and transactions are eliminated.

The preparation of consolidated financial statements in accordance with GAAP requires Management to make certain estimates and assumptions which affect the amounts of reported assets and liabilities as well as contingent assets and liabilities as of the date of these financial statements. These estimates and assumptions also affect the reported amounts of revenues and expenses during the reporting period(s). Although Management believes these estimates and assumptions to be reasonably accurate, actual results may differ.

GAAP requires that all amounts and figures presented in the Company's financial statements be restated for any business combinations that occurred prior to July 1, 2001 that were accounted for as poolings of interest. GAAP does not permit business combinations after that date to be accounted for as poolings of interest.

Certain amounts in the 2000 and 1999 financial statements have been reclassified to be comparable with classifications used in the 2001 financial statements.

SECURITIES

The Company purchases securities with funds that are not needed for immediate liquidity purposes and have not been lent to customers. These securities are classified either as held-tomaturity or available-for-sale. This appropriate classification is decided at the time of purchase.

Only those securities that the Company intends to hold and has the ability to hold until their maturity may be classified as held-to-maturity. Securities that might be sold prior to maturity because of interest rate changes, to meet liquidity needs, or to better match the repricing characteristics of funding sources are classified as available-for-sale. The Company purchases no securities specifically for later resale at a gain and therefore holds no securities that should be classified as trading securities.

The Company's securities that are classified as held-to-maturity are reported in thefinancial statements at "amortized historical cost". This amount is the purchase price increased by the accretion of discounts or decreased by the amortization of premiums using the effective interest method. Discount is the excess of the face value of the security over the cost, and accretion of the discount is the periodic recognition of interest income above any cash interest received to increase the carrying amount up to the face value that will be received at maturity. Accretion thus increases the effective yield for the security above the interest rate for its coupon. Premium is the excess of cost over the face value of the security, and amortization of the premium is a periodic charge to interest income to reduce the carrying amount to the face value that will be received at maturity. Amortization reduces the effective yield for the security below the coupon rate. Discounts are accreted and premiums are amortized over the period to maturity of the related securities, or to earlier call dates, if appropriate. There is no recognition of unrealized gains or losses for securities classified as held to maturity.

For securities that are classified as available-for-sale, the interest income is recognized in the same manner as for securities that are classified as held-to-maturity, including the accretion of discounts and the amortization of premiums. However, unlike the securities that are classified held-to-maturity, securities classified available-for-sale are reported on the consolidated balance sheets at their fair value. As the fair value of these securities changes, the changes are reported net of the tax effect on the consolidated balance sheets as a separate component of equity captioned "Accumulated other comprehensive income." The changes in fair value are included as elements of comprehensive income in the consolidated statements of comprehensive income.

LOANS AND INTEREST AND FEES FROM LOANS

Loans are carried at amounts advanced to the borrowers less principal payments collected. Interest on loans is calculated on a simple interest basis, that is, interest is not compounded. The Company collects loan origination and commitment fees. These fees are not recognized as income when they are collected, but instead they are offset by certain direct loan origination costs and then recognized over the contractual life of the loan as an adjustment to the interest earned. The net unrecognized fees represent unearned revenue, and they are reported as reductions of the loan principal outstanding, or as additions to the loan principal if the deferred costs are greater than the deferred fees.

Included with loans are receivables structured like leases, but which in substance are loans.

NONACCRUAL LOANS: When a borrower is not making payments as contractually required by the note, the Company must decide whether it is appropriate to continue to accrue interest. Generally speaking, loans are placed in a nonaccrual status when the loan has become delinquent by more than 90 days. Nonaccrual status means that the Company stops accruing or recognizing interest income on the loan. The Company may decide that it is appropriate to continue to accrue interest on some loans more than 90 days delinquent if they are well-secured by collateral and collection efforts are being actively pursued. Such loans are included among nonperforming loans.

When a loan is placed in a nonaccrual status, any accrued but uncollected interest for the loan is written off against interest income from other loans of the same type in the period in which the status is changed. No further interest income is recognized until all recorded amounts of principal are recovered in full or until circumstances have changed such that payments are again consistently received as contractually required.

IMPAIRED LOANS: A loan is identified as impaired when it is probable that interest and principal will not be collected according to the contractual terms of the loan agreement. Because this definition is very similar to that of a nonaccrual loan, most impaired loans will be classified as nonaccrual. However, there are some loans that are termed impaired because of doubt regarding collectibility of interest and principal according to the contractual terms, but which are presently both fully secured by collateral and are current in their interest and principal payments. These impaired loans are not classified as nonaccrual. Under GAAP, the term "impaired" only applies to certain types or classes of loans. Consequently, there are some nonaccrual loans which are not categorized as impaired.

ALLOWANCE FOR CREDIT LOSSES

If a borrower's financial condition becomes such that he or she is not able to fully repay a loan or lease obligation extended by the Company, a loss to the Company has occurred. When the Company has determined that such a loss has occurred, the principal amount of the loan, or a portion thereof, is charged-off so that the value of the Company's assets on the financial statements are not overstated by including within them an uncollectible loan. However, because loan officers cannot be in daily contact with each borrower, the Company almost never knows exactly when such a loss might have occurred, that is, when a loan becomes uncollectible. Therefore, in order to fairly state the value of the loan and leasing portfolios, it is necessary to make an estimate of the amount of loss inherent but unrecognized in these credit portfolios prior to the realization of such losses through charge-off.

GAAP, banking regulations, and sound banking practices require that the Company record this estimate of unrecognized losses in the form of an allowance for credit losses. The allowance is increased by the provision for credit losses, which is a charge to income in the current period. The allowance is decreased by the charge-off of loans and increased by any recoveries of loans previously charged-off.

The allowance for credit losses consists of several components. The first component is that portion of the allowance specifically related to those loans that are categorized as impaired under provisions of Statement of Financial Accounting Standards No. 114, ACCOUNTING BY CREDITORS FOR IMPAIRMENT OF A LOAN ("SFAS 114"). The remaining components include a statistically determined portion, a specifically assigned portion, and an allocated portion. These components are reported together in the allowance for credit loss in the accompanying consolidated balance sheets and in Note 4. In total, the allowance for credit losses is maintained at a level considered adequate to provide for losses inherent in the loan portfolio. However, the allowance is based on estimates, and ultimate losses may vary from the current estimates. These estimates are reviewed periodically and, as adjustments become necessary, they are reported as provisions against earnings in the periods in which they become known.

COMPONENT FOR IMPAIRED LOANS: Under GAAP, the Company is permitted to determine the valuation allowance for impaired loans on a loan-by-loan basis or by aggregating loans with similar risk characteristics. Because the number of loans classified as impaired is relatively small and because special factors apply to each, the Company determines the valuation allowance for impaired loans on a loan-by-loan basis. The amount of the valuation allowance for any particular impaired loan is determined by comparing the recorded investment in each loan with its value measured by one of three methods: (1) by discounting estimated future cash flows at the effective interest rate; (2) by observing the loan's market price if it is of a kind for which there is a secondary market; or (3) by valuing the underlying collateral. A valuation allowance is established for any amount by which the recorded investment exceeds the value of the impaired loan. If the value of the loan, as determined by one of the above methods, exceeds the recorded investment in the loan, no valuation allowance for that loan is established.

STATISTICAL OR HISTORICAL LOSS COMPONENT: The amount of this component is determined by applying loss estimation factors to outstanding loans and leases. The loss factors are based on the Company's historical loss experience for each category of credits. Because historical loss experience differs for the various categories of credits, the loss estimation factors applied to each category also differ.

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COMPONENT FOR SPECIFIC CREDITS: There are a number of credits for which an allowance computed by application of the appropriate loss estimation factor would not adequately provide for the unconfirmed loss inherent in the credit. This might occur for a variety of reasons such as the size of the credit, the industry of the borrower, or the terms of the credit. In these situations, Management will estimate an amount of allowance adequate to absorb the probable loss that has occurred. The specific component is made up of the sum of these specific amounts.

ALLOCATED COMPONENT: The allocated component of the allowance for credit losses is intended to provide for losses that may not be covered by the other components. Among the considerations addressed by this component are the following:

- the historical loss estimation factors used for statistical allocation may not give sufficient weight to such considerations as the current general economic and business conditions that affect the Company's borrowers or to specific industry conditions that affect borrowers in that industry;
- the historical loss factors may not give sufficient weight to current trends in credit quality and collateral values and the duration of the current business cycle.
- the historical loss factors are not derived in a manner that considers loan volumes and concentrations and seasoning of the loan portfolio;
- complete information on the financial condition of the borrower and the current disposal value of any collateral is not generally available at the time an estimation of the loss must be made; this introduces significant uncertainty in the estimation process used to determine the adequacy of component for impaired loans and specific allocations.

Allocation factors for these considerations are multiplied by the outstanding balances in the various loan categories to provide for estimated loss.

INCOME TAXES

The Company uses the accrual method of accounting for financial reporting purposes as well as for tax return purposes. However, there are still several items of income and expense that are recognized in different periods for tax return purposes than for financial reporting purposes. When items of income or expense are recognized in different years for financial reporting purposes than for tax return purposes, they represent temporary differences. The Company is required to provide in its financial statements for the eventual liability or deduction in its tax return for these temporary differences. The provision is recorded as they arise in the form of deferred tax expense or benefit, respectively.

PREMISES AND EQUIPMENT

Premises and equipment are stated at cost less accumulated depreciation and amortization. Depreciation is charged against income over the estimated useful lives of the assets. For most assets with longer useful lives, accelerated methods of depreciation are used in the early years, switching to the straight-line method in later years. Assets with shorter useful lives are generally depreciated by straight-line method. Leasehold improvements are amortized over the terms of the leases or the estimated useful lives of the improvements, whichever is shorter. Generally, the estimated useful lives of other items of premises and equipment are as follows:

Buildings and improvements	10-25 years
Furniture and equipment	5-7 years
Electronic equipment and software	3-5 years

TRUST FEES

Fees for most trust services are based on the market value of customer assets, and the fees are accrued monthly. Fees for unusual or infrequent services are recognized when the fee can be determined.

EARNINGS PER SHARE

The computation of earnings per share for all periods presented in the Consolidated Statements of Income are based on the weighted average number of shares outstanding during each year retroactively restated for stock dividends, stock splits and pooling transactions.

Diluted earnings per share include the effect of common stock equivalents for the Company, which include only shares issuable on the exercise of outstanding options. The number of options assumed to be exercised is computed using the "Treasury Stock Method." This method assumes that all options with an exercise price lower than the average stock price for the period have been exercised and that the proceeds from the assumed exercise would be used for market repurchases of shares. The Company receives a tax benefit for the difference between the market price and the exercise price of non-qualified options. The benefit from the assumed exercise of options is also assumed to be used to retire shares.

A reconciliation of the computation of basic earnings per share and diluted earnings per share is presented in Note 16.

STATEMENT OF CASH FLOWS

For purposes of reporting cash flows, cash and cash equivalents include cash and due from banks, Federal funds sold, and securities purchased under agreements to resell. Federal funds sold and securities purchased under agreements to resell are one-day transactions, with the Company's funds being returned to it the next business day.

POSTRETIREMENT HEALTH BENEFITS

The Company provides eligible retirees with postretirement health care and dental benefit coverage. These benefits are also provided to the spouses and dependents of retirees on a shared cost basis. Benefits for retirees and spouses are subject to deductibles, co-payment provisions, and other limitations. The expected cost of such benefits is charged to expense during the years that the employees render service to the Company and thereby earn their eligibility for benefits.

OTHER REAL ESTATE OWNED

Real estate acquired through foreclosure on a loan or by surrender of the real estate in lieu of foreclosure is called other real estate owned ("OREO"). OREO is carried in the Company's financial records at the lower of the outstanding balance of the loan before acquisition or the fair value of the OREO less estimated costs to sell. If the outstanding balance of the loan is greater than the fair value of the OREO at the time of the acquisition, the difference is charged-off against the allowance for credit losses. Any senior debt to which other real estate owned is subject is included in the carrying amount of the property and an offsetting liability is reported along with other borrowings.

During the time the property is held, all related operating or maintenance costs are expensed as incurred. Later decreases in the fair value of OREO are charged to operating expense by establishing valuation allowances in the period in which they become known. Increases in the fair value may be recognized as reductions of OREO operating expense but only to the extent that they represent recoveries of amounts previously written-down. Expenditures related to improvements are capitalized to the extent that they are realizable through increases in the fair value of the properties. Increases in market value in excess of the fair value at the time of foreclosure are recognized only when the property is sold.

At December 31, 2001 and 2000, the Company held real estate properties that had been acquired through foreclosure, but the value of the property less estimated disposal costs resulted in no amount being reported on the balance sheets for those dates.

STOCK-BASED COMPENSATION

GAAP permits the Company to use either of two methods for accounting for compensation cost in connection with employee stock options. The first method requires issuers to record compensation expense over the period the options are expected to be outstanding prior to exercise, expiration, or cancellation. The amount of compensation expense to be recognized over this term is the "fair value" of the options at the time of the grant as determined by an option pricing model. The option pricing model computes fair value for the options based on the length of their term, the volatility of the stock price in past periods, and other factors. Under this method, the issuer recognizes compensation expense regardless of whether the officer or director eventually exercises the options.

Under the second accounting method, if options are granted at an exercise price equal to the market value of the stock at the time of the grant, no compensation expense is recognized. The Company believes that the second method better reflects the motivation for its issuance of stock options, namely, that they are incentives for future performance rather than compensation for past performance. GAAP requires that issuers that elect the second method must present pro forma disclosures of net income and earnings per share as if the first method had been elected. The Company presents these disclosures in Note 16.

DERIVATIVE FINANCIAL INSTRUMENTS

Statement of Financial Accounting Standards No. 133, ACCOUNTING DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES ("SFAS 133"), was issued during the second quarter of 1998 and was adopted by the Company as of January 1, 2001. The adoption of SFAS 133 did not result in any material impact to the Company's financial position or results of operations. Upon adoption of SFAS 133 on

January 1, 2001, the Company was permitted to, and did, transfer securities totaling unamortized cost of $28.7 million from the held-to-maturity portfolio to the available-for-sale portfolio.

Derivative financial instruments may be constructed to act as hedges either to protect against adverse changes in the fair value of or the cash flows associated with assets, liabilities, firm commitments to purchase or sell specific assets or liabilities or other probable transactions. The asset, liability, or firm commitment is referred to as the hedged or underlying item. The hedge is constructed so that its fair value or cash flows change in response to certain events in an offsetting manner to the changes in the fair value or cash flows of the underlying item.

SFAS 133 requires that all derivatives be recorded at their current fair value on the balance sheet. A change in the fair value of the hedge results in a gain or loss for the holder, just like changes in the fair value of the underlying asset or liability being hedged results in a gain or loss for the holder. SFAS 133 specifies how and when the gains and losses relating to both the hedge itself and the hedged item are recognized. Recognition of the gains and losses depends on the how the hedge is classified. Under SFAS 133, if certain conditions are met, derivatives may be specifically classified or designated as fair value hedges or cash flow hedges.

Fair value hedges are intended to reduce or eliminate the exposure to adverse changes in the fair value of a specific underlying item. Gains or losses in the hedging instrument are recognized in the income statement during the period that the change in fair value occurred. The offsetting gain or loss on the hedged item which is attributable to the risk being hedged is also recognized in the income statement for the same period. Hedge ineffectiveness results if the changes in fair values do not exactly offset. This ineffectiveness is included in earnings in the period in which it occurs.

Cash flow hedges are intended to hedge exposure to variable cash flows of a forecasted transaction or an underlying instrument. They are effective to the extent that the holder receives additional cash flows from the hedge when it receives lower cash flows from the hedged item and vice-versa. The effective portion of a hedge gain or loss is initially reported as a component of other comprehensive income and subsequently reclassified into earnings when the forecasted transaction affects earnings. The ineffective portion of the gain or loss is reported in earnings immediately.

Hedges meeting certain other criteria may be classified as foreign exchange hedges. The Company does not currently make use of foreign exchange hedges.

If a hedge does not meet the requirements for designation as one of these specific categories of hedge, gains or losses associated with changes in its fair value are immediately recognized in the income statement. The accounting for the underlying instrument will follow normal accounting policies for the specific type of asset or liability.

The Company uses interest rate swaps to manage the Company's exposure to interest rate risks. As of December 31, 2001, the Company held one interest rate swap designated as a fair value hedge with a notional amount of $28.9 million. As explained in Note 22, the Company has also entered into covered or offsetting interest rate swaps with customers and other financial institutions. The notional amount of these swaps at December 31, 2001 was $16.4 million.

The term "notional amount" is a measure of quantity in a derivative instrument. In the case of a fair value or cash flow hedge, it will generally be the same amount as the balance of the underlying asset or liability. In the case of a nonspecific hedge, the amount may differ from the balance of the underlying instrument if the Company wishes to hedge risk for only a portion of the underlying instrument.

GOODWILL

In connection with the acquisition of LRB as described in Note 19, the Company recognized the excess of the purchase price over the estimated fair value of the assets received and liabilities assumed as goodwill. This goodwill, along with goodwill recognized in earlier acquisitions, was amortized on the straight-line method over 15 years. The unamortized carrying amount of the goodwill recorded for each acquisition was reviewed by Management in order to determine if facts and circumstances suggest that it is not recoverable. This is determined based on expected undiscounted cash flows from the net assets of the acquired entity, and consequently goodwill for the entity would be reduced by the estimated cash flow deficiency. No such reduction in goodwill occurred as of December 31, 2001 and 2000.

In June 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 142, GOODWILL AND OTHER INTANGIBLE ASSETS ("SFAS 142"). The Company adopted this statement January 1, 2002 and will change its accounting for goodwill as described below in the subsection titled "Accounting for Business Combinations."

COMPREHENSIVE INCOME

Comprehensive income includes all revenues, expenses, gains, and losses that affect the capital of the Company aside from issuing or retiring shares of stock. GAAP requires that comprehensive income be reported in a financial statement that is displayed with the same prominence as other financial statements. Net income is one component of comprehensive income. Based on the Company's current activities, the only other components of comprehensive income consist of changes in the unrealized gains or losses on securities that are classified as available-for-sale.

The amounts of comprehensive income for the three years ended December 31, 2001, 2000, and 1999 are reported in the Consolidated Statements of Comprehensive Income. The net change in the cumulative total of the components of other comprehensive income that are included in equity are reported in the Consolidated Statements of Changes in Shareholders' Equity for the three years ended December 31, 2001, 2000, and 1999.

SEGMENT REPORTING

GAAP requires that the Company disclose certain information related to the performance of various segments of its business. Segments are defined based on the segments within a company used by

the chief operating decision maker for making operating decisions and assessing performance. Reportable segments are to be based on such factors as products and services, geography, legal structure, management structure or any manner by which a company's management distinguishes major operating units. For the purposes of this disclosure, Management has determined that the Company has seven reportable segments: Wholesale Lending, Retail Lending, Branch Activities, Tax Refund Programs, Fiduciary, Northern Region, and All Other. The basis for this determination and the required disclosure is included in Note 20.

ACCOUNTING FOR BUSINESS COMBINATIONS

The merger of SBB with the Company (Note 19) was accounted for by the pooling of interests method of accounting for a business combination. Under this method, the assets and liabilities of the two parties were combined for each year presented in the financial statements. The effect of this presentation is as if the merger had occurred as of the beginning of the earliest period presented. The assets and liabilities were combined at the amounts carried in the predecessor company records; there is no restatement to their fair market value, and consequently no goodwill was recognized.

The acquisition of LRB (Note 19) was accounted for by the purchase method of accounting for business combinations. Under this method, the assets and liabilities of the acquired company are combined with the acquirer as of the date of the acquisition at their fair market value. Any difference between the fair value of the assets and liabilities and the purchase price is recorded as goodwill. Goodwill is amortized against future earnings. The results of operations of the acquired company are included with those of the acquirer only from the transaction date forward.

In June 2001, the FASB issued Statement of Financial Accounting Standards No. 141, BUSINESS COMBINATIONS ("SFAS 141"). The Company adopted SFAS 141 immediately. Effective for transactions initiated after June 30, 2001, the statement requires all subsequent business combinations to be accounted for by the purchase method of accounting.

With the adoption of SFAS 142, goodwill recorded in connection with the acquisition of a business is no longer subject to amortization over its estimated useful life. Rather, goodwill will be subject to at least an annual assessment for impairment by applying a fair-value-based test. The Company will be required to determine the reporting units at which goodwill impairment will be assessed. (See Note 20). While the company has not yet conducted its annual assessment for impairment, we do not believe that any material impairment of goodwill has occurred. Additionally, an acquired intangible asset will be separately recognized if the benefit of the intangible asset is obtained through contractual or other legal rights, or if the intangible asset can be sold, transferred, licensed, rented, or exchanged, regardless of the acquirer's intent to do so. Such intangible assets are subject to amortization over their useful lives. As of January 1, 2002, the Company ceased amortizing the goodwill that had resulted from purchase transactions entered into prior to the adoption of SFAS 142.

OTHER RECENT ACCOUNTING PRONOUNCEMENTS

In September of 2000, the FASB issued Statement of Financial Accounting Standards No. 140, ACCOUNTING FOR TRANSFERS AND SERVICING OF FINANCIAL ASSETS AND EXTINGUISHMENTS OF LIABILITIES ("SFAS 140"). This Statement replaces Statement of Financial Accounting Standards No. 125, ACCOUNTING FOR TRANSFERS AND SERVICING OF FINANCIAL ASSETS AND EXTINGUISHMENTS OF LIABILITIES ("SFAS 125"). SFAS 140 revises the standards for accounting for securitizations and other transfers of financial assets and collateral and requires certain additional disclosures. SFAS 140 carries over most of SFAS 125's provisions without reconsideration. For the transfers and servicing of financial assets and extinguishments of liabilities, SFAS 140 requires a financial-components approach that focuses on control. Under that approach, after a transfer of financial assets, the Company will (1) recognize the financial and servicing assets it controls and the liabilities it has incurred, (2) derecognize financial assets when control has been surrendered, and (3) derecognize liabilities when extinguished.

The Company adopted SFAS 125 in 1997. SFAS 140 is effective for: transfers and servicing of financial assets and extinguishments of liabilities occurring after March 31, 2001, and recognition and reclassification of collateral and for disclosures relating to securitization transactions and collateral for fiscal years ending after December 15, 2000. The Company does have certain securitization transactions that occurred during the first quarter of 2001 that will fall under the requirements of SFAS 140. As such, the Company is required to prospectively disclose information related to such securitizations in regards to accounting policies, volume, cash flows, key assumptions made in determining fair values of retained interests, and sensitivity of those fair values for changes in key assumptions. The adoption of SFAS 140 did not have a material impact on the Company's financial position or results of operations.

In June 2001, the FASB issued Statement of Financial Accounting Standards No. 143, ACCOUNTING FOR ASSET RETIREMENT OBLIGATIONS. This statement specifies how the Company is to account for and report costs and obligations resulting from the retirement of tangible long-lived assets. The statement is intended to ensure consistency in accounting and reporting for these costs and obligations and to provide more information about the future cash outflows, leverage and liquidity of such assets. This statement will become effective for the Company on January 1, 2003 and is not expected to have a material effect on the Company's financial position or results of operation.

In August 2001, the FASB issued Statement of Financial Accounting Standards No. 144, ACCOUNTING FOR THE IMPAIRMENT OR DISPOSAL OF LONG-LIVED ASSETS ("SFAS 144"). This statement specifies how the Company is to account for and report the impairment or disposal of long-lived assets. It supercedes or amends previous pronouncements including Statement of Financial Accounting Standards No. 121, ACCOUNTING FOR THE IMPAIRMENT OF LONG-LIVED ASSETS AND FOR LONG-LIVED ASSETS TO BE DISPOSED OF, Accounting Principles Board Opinion No. 30, REPORTING THE RESULTS OF OPERATIONS-REPORTING THE EFFECTS OF DISPOSAL OF A SEGMENT OF A BUSINESS, AND EXTRAORDINARY, UNUSUAL AND INFREQUENTLY OCCURRING EVENTS AND TRANSACTIONS, and Accounting Research Bulletin No. 51, CONSOLIDATED FINANCIAL STATEMENTS. The Company adopted SFAS 144 on January 1, 2002. The adoption of this statement did not have a material effect on the Company's financial position or results of operation.

2. SECURITIES

A summary of securities owned by the Company at December 31, 2001 and 2000, is as follows:

	DECEMBER 31, 2001		
(IN THOUSANDS)	GROSS	GROSS	EST

	AMORTIZED COST	UNREALIZED GAINS	UNREALIZED LOSSES	F V
Held-to-maturity:				
Collateralized mortgage obligations	$ 5	$ -	$ -	$
State and municipal securities	71,962	7,422	-	
	71,967	7,422	-	
Available-for-sale:				
U.S. Treasury obligations	152,911	2,755	(191)	1
U.S. agency obligations	320,985	4,844	(1,919)	3
Collateralized mortgage obligations	104,251	1,559	(130)	1
Asset-backed securities	11,662	4	(6)	
State and municipal securities	100,990	3,228	(1,867)	1
	690,799	12,390	(4,113)	6
	$762,766	$19,812	$(4,113)	$7

	DECEMBER 31, 2000			
	AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	EST F V
Held-to-maturity:				
U.S. Treasury obligations	$ 12,492	$ 33	$ -	$
U.S. agency obligations	28,958	1	(304)	
Mortgage-backed securities	8,645	11	(134)	
State and municipal securities	89,199	9,589	(48)	
	139,294	9,634	(486)	1
Available-for-sale:				
U.S. Treasury obligations	157,255	1,569	(23)	1
U.S. agency obligations	246,749	2,109	(338)	2
Collateralized mortgage obligations	159,231	683	(851)	1
Asset-backed securities	13,913	3	(25)	
State and municipal securities	72,459	5,091	(230)	
	649,607	9,455	(1,467)	6
	$788,901	$19,089	$(1,953)	$8

The amortized cost and estimated fair value of debt securities at December 31, 2001 and 2000, by contractual maturity, are shown in the next table. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

(IN THOUSANDS)	DECEMBER 31, 2001 HELD-TO-MATURITY	AVAILABLE-FOR-SALE	TOTAL	DECEM HELD-TO-MATURITY	AVAI FOR
Amortized cost:					
In one year or less	$ 9,594	$167,363	$176,957	$ 31,869	$15
After one year through five years	14,717	423,763	438,480	47,624	40
After five years through ten years	12,235	14,839	27,074	18,232	2
After ten years	35,421	84,834	120,255	41,569	6
Total Securities	$ 71,967	$690,799	$762,766	$139,294	$64
Estimated market value:					
In one year or less	$ 9,686	$170,849	$180,535	$ 31,981	$15
After one year through five years	16,236	427,499	443,735	49,534	41
After five years through ten years	13,701	14,988	28,689	19,339	2
After ten years	39,766	85,740	125,506	47,588	6
Total Securities	$ 79,389	$699,076	$778,465	$148,442	$65

The proceeds received from sales orcalls of debt securities and the gross gains and losses that were recognized for the years ended December 31, 2001, 2000, and 1999 are shown in the next table.

(IN THOUSANDS)	2001			2000			
	PROCEEDS	GROSS GAINS	GROSS LOSSES	PROCEEDS	GROSS GAINS	GROSS LOSSES	PROCEEDS
Held-to-maturity:							
Sales	$ 379	$ 9	$ (4)	$ 29,995	$ -	$ (33)	$ -
Calls	$ 1,680	$ 2	$ -	$ 7,518	$ 7	$ (2)	$ 6,662
Available-for-sale:							
Sales	$28,383	$412	$(142)	$112,146	$ -	$(120)	$19,674
Calls	$45,325	$ 32	$ -	$ 11,640	$ 1	$ -	$63,340

SBB&T and FNB are members of the Federal Reserve Bank. As a condition of membership, they are required to purchase Federal Reserve Bank ("FRB") stock. The amount of stock required to be held is based on their capital accounts. Subsequently, as the banks' capital has increased, they have been required to purchase additional shares. SBB&T and FNB are members of the FHLB, and purchased stock as required of members. While technically these are considered equity securities, there is no market for the FRB and FHLB stock and the shares are considered as restricted investment securities and reported among other assets, on the Consolidated Balance Sheets. Such investments are carried at cost and periodically evaluated for impairment.

Securities with a book value of approximately $726.5 million at December 31, 2001, and $647.0 million at December 31, 2000, were pledged to secure public funds, trust deposits and other borrowings as required or permitted by law.

3. LOANS

The loan portfolio consists of the following:

(IN THOUSANDS)	DECEMBER 31 2001	2000
Real estate:		
Residential	$ 728,026	$ 586,904
Nonresidential	593,675	564,556
Construction and development	185,264	172,331
Commercial, industrial, and agricultural	874,294	775,365
Home equity lines	85,025	71,289
Consumer	187,949	205,992
Leases	126,744	129,159
Municipal tax-exempt obligations	8,043	4,102
Other	10,072	7,406
	$2,799,092	$2,517,104

The amounts above are shown net of deferred loan origination, commitment, and extension fees and origination costs of $4.9 million for 2001 and $5.8 million for 2000.

IMPAIRED LOANS

The table below discloses information about the loans classified as impaired and the valuation allowance related to them:

(IN THOUSANDS)	DECEMBER 31 2001	2000
Loans identified as impaired	$8,787	$9,256
Impaired loans for which a valuation allowance has been determined	$8,787	$9,256
Impaired loans for which no valuation allowance has been determined	$ -	$ -
Amount of valuation allowance	$2,348	$3,260

	YEAR ENDED DECEMBER 31 2001	2000
Average amount of recorded investment		

in impaired loans for the year	$10,175	$7,932
Interest recognized during the year for loans identified as impaired at year-end	$ 72	$ 571
Interest received in cash during the year for loans identified as impaired at year-end	$ 72	$ 571

As indicated in Note 1, a valuation allowance is established for an impaired loan when the fair value ofthe loan is less than the recorded investment. As shown above, a valuation allowance has been determined for all loans identified as impaired at December 31, 2001. The valuation allowance amounts disclosed above are included in the allowance for credit losses reported in the balance sheets for December 31, 2001 and 2000 and in Note 4.

REFUND ANTICIPATION LOANS

The Company offers tax refund anticipation loans ("RALs") to taxpayers desiring to receive advance proceeds based on their anticipated income tax refunds. The loans are repaid when the Internal Revenue Service later sends the refund to the Company. The funds advanced are generally repaid

within several weeks. Therefore, processing costs and provision for loan loss represent the major costs of the loans. This contrasts to other loans for which the cost of funds is the major cost to the Company. Because of their short duration, the Company cannot recover the processing costs through interest calculated over the term of the loan. Consequently, the Company has a tiered fee schedule for this service that varies by the amount of funds advanced based on the increased credit rather than the length of time that the loan is outstanding. Nonetheless, because a loan document is signed by the customer, the Company reports the fees as interest income. These fees totaled $26.4 million in 2001, $19.0 million for 2000, and $8.1 million for 1999. The loans are all made during the tax filing season of January through April of each year. Any loans for which repayment has not been received within 90 days from the expected payment date are charged off. Consequently, there were no RAL's included in the above table of outstanding loans at December 31, 2001 or 2000.

PLEDGED LOANS

At December 31, 2001 loans secured by first trust deeds on residential and commercial property with principal balances totaling $80.3 million were pledged as collateral to the Federal Reserve Bank of San Francisco. At December 31, 2001, loans secured by first deeds on residential and commercial property with principal balances of $631.6 million were pledged to the Federal Home Loan Bank of San Francisco.

4. ALLOWANCE FOR CREDIT LOSSES

The following summarizes the changes in the allowance for credit losses:

(IN THOUSANDS)	YEAR ENDED DECEMBER 31		
	2001	2000	1999
Balance, beginning of year	$ 35,125	$ 30,454	$30,499
Addition of allowance from Los Robles Bank	-	1,139	-
Tax refund anticipation loans:			
Provision for credit losses	4,420	2,726	2,816
Recoveries on loans previously charged-off	4,769	3,059	2,857
Loans charged-off	(9,189)	(6,226)	(5,518)
All other loans:			

Provision for credit losses	22,251	11,714	4,227
Recoveries on loans previously charged-off	5,616	2,506	2,518
Loans charged-off	(14,120)	(10,247)	(6,945)
Balance, end of year	$ 48,872	$ 35,125	$30,454

The ratio of losses to total loans for the RALs is higher than for other loans. For RALs, the provision for credit loss, the loans charged-off, and the loans recovered are reported separately from the corresponding amounts for all other loans.

5. CASH AND DUE FROM BANKS

All depository institutions are required by law to maintain reserves with the Federal Reserve Bank ("FRB") on transaction deposits. Amounts vary each day as the FRB permits banks to meet this requirement by maintaining the specified amount as an average balance over a two-week period. The average daily cash reserve balances required to be maintained by the Company's subsidiary banks at the FRB totaled approximately $4.0 million in 2001 and $2.6 million in 2000. In addition, the banks must maintain sufficient balances at the FRB to cover the checks written by bank customers that are clearing through the FRB because they have been deposited at other banks.

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6. PREMISES AND EQUIPMENT

Premises and equipment consist of the following:

(IN THOUSANDS)	DECEMBER 31 2001	2000
Land	$ 5,175	$ 5,175
Buildings and improvements	22,043	21,927
Leasehold improvements	25,931	25,754
Furniture and equipment	56,673	51,968
Software	9,715	-
Total cost	119,537	104,824
Accumulated depreciation and amortization	(56,434)	(51,811)
Net book value	$ 63,103	$ 53,013

Depreciation and amortization on fixed assets included in operating expenses totaled $8.3 million in 2001, $6.3 million in 2000, and $5.9 million in 1999.

7. DEPOSITS

Deposits and the related interest expense consist of the following:

(IN THOUSANDS)	BALANCE AS OF DECEMBER 31		INTEREST EXPENSE FOR TH YEAR ENDED DECEMBER 3	
	2001	2000	2001	2000

Noninterest bearing deposits	$ 718,441	$ 709,348	$ -	$ -	$
Interest bearing deposits:					
NOW accounts	386,870	372,136	1,438	2,680	
Money market deposit accounts	730,494	743,268	20,451	27,216	1
Other savings deposits	213,018	210,157	2,730	4,060	
Time certificates of $100,000 or more	827,422	571,593	31,958	38,914	1
Other time deposits	489,330	496,317	26,484	25,423	2
	$3,365,575	$3,102,819	$83,061	$98,293	$6

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8. INCOME TAXES

The provisions (benefits) for income taxes related to operations and the tax benefit related to stock options that is credited directly to shareholders' equity are as follows:

(IN THOUSANDS)	YEAR ENDED DECEMBER 31		
	2001	2000	1999
Federal:			
Current	$29,880	$24,210	$19,251
Deferred	(5,500)	(1,177)	(1,911)
	24,380	23,033	17,340
State:			
Current	11,071	9,033	8,500
Deferred	(1,775)	(141)	(270)
	9,296	8,892	8,230
Total tax provision	$33,676	$31,925	$25,570
Reduction in taxes payable associated with exercises of stock options	$(1,602)	$(1,661)	$(3,915)

The total current provision for income taxes includes a debit of $130,000 for securities gains realized in 2001 and credits of $60,000 for securities losses realized in 2000 and $113,000 for losses realized in 1999.

Although not affecting the total provision, actual income tax payments may differ from the amounts shown as current provision as a result of the final determination as to the timing of certain deductions and credits. The total tax provision differs from the Federal statutory rate of 35 percent for the reasons shown in the following table.

	YEAR ENDED DECEMBER 31		
	2001	2000	1999
Tax provision at Federal statutory rate	35.0%	35.0%	35.0%
Interest on securities exempt from Federal taxation	(3.8)	(4.3)	(5.2)
State income taxes, net of Federal income tax benefit	6.6	6.9	8.9
ESOP dividends deductibleas an expense for tax purposes	(0.5)	(0.5)	(0.7)
Goodwill amortization	1.0	0.9	0.9
Merger related costs	-	0.8	-
Other, net	(0.8)	(0.5)	(3.4)
Actual tax provision	37.5%	38.3%	35.5%

As disclosed in the following table, deferred tax assets as of December 31, 2001, and 2000, totaled $25.9 million and $16.7 million, respectively. These amounts are included within other assets on the balance sheet. The combined Federal and State deferred tax provision or tax benefit disclosed in the first table of this note is equal to the sum of the changes in the tax effects of the temporary differences. The changes in the tax effects for the principal temporary differences from December 31, 1999 to December 31, 2000 and from December 31, 2000 to December 31, 2001 are disclosed in the following table.

(IN THOUSANDS)	2001	TAX EFFECT 2001	2000	TAX EFFECT 2000	ACQUIRED COMPONENTS	1
Deferred tax assets:						
Allowance for credit losses	$20,356	$6,148	$14,208	$1,515	$ 256	$1
State taxes	3,585	528	3,057	646	139	
Loan fees	663	(97)	760	261	(10)	
Depreciation	398	(589)	987	(56)	(6)	
Postretirement benefits	500	(206)	706	(39)	-	
Other real estate owned	25	-	25	-	-	
Nonaccrual interest	1,143	854	289	(65)	-	
Accretion on securities	(202)	(202)	-	(77)	-	
Accrued salary continuation plan	1,628	(29)	1,657	(163)	-	
Change in control payments	942	(79)	1,021	(78)	-	
Deferred Compensation	3,008	3,008	-	(155)	-	
Gain on demutualization of of insurance company	(160)	(160)	-	156	-	
Accrual for BOLI	508	-	508	508	-	
Other	-	(472)	473	(318)	461	
	32,394	8,704	23,691	2,135	840	2
Deferred tax liabilities:						

Loan costs	2,283	529	1,754	248	-	
Federal effect of state tax asset	1,903	621	1,282	120	58	
Other	878	279	599	449	-	
Total deferred tax liabilities	5,064	1,429	3,635	817	58	
Net deferred tax asset before unrealized gains and losses on securities	27,330	7,275	20,056	1,318	782	1
Unrealized (gains) and losses on securities	(1,452)	-	(3,362)	-	223	
Net deferred tax asset	$25,878	$7,275	$16,694	$1,318	$1,005	$2

As mentioned in Note 1, the net unrealized gain or loss on securities that are available-for-sale is included as a component of equity. This amount is reported net of the related tax effect. The tax effect is a deferred tax asset if there is a net unrealized loss because the Company would have received a deduction for the loss had the securities been sold as of the end of the year. The tax effect would be a deferred tax liability if there is a net unrealized gain, because the Company would owe additional taxes had the securities been sold as of the end of the year. However, changes in the unrealized gains or losses are not recognized either in net income or in taxable income, and therefore they do not represent temporary differences between reported financial statement income and taxable income reported on the Company's tax return. Consequently, the change in the tax effect of the net unrealized gain or loss is not included as a component of deferred tax expense or benefit, and there is no entry in the columns labeled "Tax Effect" in the table above for the change.

The Company is permitted to recognize deferred tax assets only to the extent that they are able to be used to reduce amounts that have been paid or will be paid to tax authorities. This is reviewed each year by Management by comparing the amount of the deferred tax assets with amounts paid in the past that might be recovered by carryback provisions in the tax code and with anticipated taxable income expected to be generated from operations in the future. If it does not appear that the deferred tax assets are usable, a valuation allowance is established to acknowledge their uncertain value. Management believes a valuation allowance is not needed to reduce any deferred tax asset because there is sufficient taxable income within the carryback periods to realize all material amounts.

9. SHAREHOLDER'S EQUITY

The Company's stock option plans offer key employees and directors an opportunity to purchase shares of the Company's common stock. The Company has five stock option plans.

The first of the plans is the Directors Stock Option Plan established in 1996. Only non-qualified options may be granted under this plan. The second is the Restricted Stock Option Plan for employees established in January, 1992. Either incentive or non-qualified options may be granted under this plan. Under the original provisions of these plans, stock acquired by the exercise of options granted under the plans could not be sold for five years after the date of the grant or for two years after the date options are exercised, whichever is later. In 1998, the Board of Directors of the Company eliminated this provision.

The remaining plans were established by the former Pacific Capital Bancorp prior to its merger with the Company and by SBB and are active now only for the exercise of options held by employees and directors.

All options outstanding in these plans were granted with an option price set at 100% of the market value of the Company's common stock on the date of the grant. The grants for most of the employee options specify that they are exercisable in cumulative 20% annual installments and will expire five years from the date of grant. The Board has granted some options which are exercisable in cumulative 10% annual installments and expire ten years from the date of grant. The options granted under the directors' plan are exercisable after six months.

The option plans permit employees and directors to pay the exercise price of options they are exercising and the related tax liability with shares of Company stock they already own. The owned shares are surrendered to the Company at current market value. Shares with a current market value of $2,576,000, $2,756,000, and $6,747,000 were surrendered in the years ended December 31, 2001, 2000, and 1999, respectively. These surrendered shares are netted against the new shares issued for the exercise of stock options in the Consolidated Statements of Changes in Shareholders' Equity.

The following table presents information relating to all of the stock option plans as of December 31, 2001, 2000, and 1999 (adjusted for stock splits and stock dividends).

	OPTIONS	PER SHARE PRICE RANGES
2001		
Granted	94,817	$26.20 to $30.03
Exercised	372,999	$ 5.17 to $29.98
Cancelled and expired	6,920	$12.63 to $34.71
Outstanding at end of year	1,021,854	$ 5.17 to $34.71
Range of expiration dates	5/1/02 to 2/1/12	
Exercisable at end of year	771,622	$ 5.17 to $34.71
Shares available for future grant	1,736,964	
2000		
Granted	135,888	$25.16 to $29.44
Exercised	279,270	$ 5.17 to $26.00
Cancelled and expired	168,254	$ 6.05 to $34.71
Outstanding at end of year	1,306,956	$ 5.17 to $34.71
Exercisable at end of year	954,414	$ 5.17 to $34.71
1999		
Granted	578,906	$22.81 to $34.71
Exercised	734,414	$ 3.98 to $28.71
Cancelled and expired	4,733	$ 8.48 to $28.71
Outstanding at end of year	1,618,591	$ 5.17 to $34.71

Exercisable at end of year	797,593	$ 5.17 to $28.71

In July 2001, the Board of Directors authorized the use of up to $20 million for the repurchase of shares of the Company's stock from time to time as Management deems the price to be favorable. During the 2001, approximately $15.0 million had been spent in repurchasing 518,000 shares.

10. SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE AND FEDERAL FUNDS PURCHASED

The Company enters into certain transactions, the legal form of which is a sale of securities under an agreement to repurchase at a later date at a set price. The substance of these transactions is a secured borrowing by the Company. The Company also purchased Federal funds from correspondent banks. The following information is presented concerning these transactions:

(dollars in thousands)	REPURCHASE AGREEMENTS YEAR ENDED DECEMBER 31			FEDERAL FUNDS PUR YEAR ENDED DECEM	
	2001	2000	1999	2001	2000
Weighted average interest rate at year-end	1.29%	5.71%	5.27%	1.63%	6.59
Weighted average interest rate for the year	3.64%	5.61%	4.66%	4.31%	5.40
Average outstanding for the year	$60,250	$61,772	$29,214	$ 25,381	$14,425
Maximum outstanding at any month-end during the year	$79,919	$78,736	$61,085	$141,800	$47,200
Amount outstanding at end of year	$35,873	$79,458	$45,407	$ 9,200	$26,200
Interest expense	$ 2,194	$ 3,468	$ 1,364	$ 1,095	$ 779

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11. LONG-TERM DEBT AND OTHER BORROWINGS

As part of the Company's asset and liability management strategy, fixed rate term advances are borrowed from the FHLB. As of December 31, 2001, total outstanding balances to the FHLB were $99 million. There were $16.4 million in scheduled maturities of the advances of 1 year or less, $44.6 million in 1 to 3 years, and $38.0 million in more than 3 years.

The Company borrowed $20 million from another financial institution to partially finance the purchase of the stock of Los Robles Bancorp. The terms of the loan required quarterly payments of interest and principal with a maturity of June 30, 2001. The note was extended to permit repayment of the remaining $12.5 million from the proceeds of $40 million in senior notes issued by the Company in July 2001. These notes bear an interest rate of 7.54%, payable semi-annually and mature in July 2006. SBB&T also issued $36 million in subordinated debt in July 2001. These notes bear an interest rate of 9.22%, payable semi-annually and mature in July 2011. As subordinated notes, they are included as Tier II capital for the risk-based capital ratio computations of the Company and SBB&T as discussed in Note 17.

Also included in other borrowings at December 31, 2001, are $13.3 million of

Treasury Tax and Loan demand notes issued to the U.S. Treasury and miscellaneous other borrowings.

During the course of 2001, 2000, and 1999, the Company borrowed funds for liquidity purposes from the discount window at the Federal Reserve Bank.

12. NONINTEREST REVENUE AND OPERATING EXPENSE

Significant items included in amounts reported in the Consolidated Statements of Income for the years ended December 31, 2001, 2000, and 1999 for other service charges, commissions, and fees are listed in the table below. The refund transfer fees are earned for the electronic transmission of tax refunds to customers to facilitate earlier receipt of their refund.

	DECEMBER 31		
(IN THOUSANDS)	2001	2000	1999
Noninterest revenue			
Merchant credit card processing	$ 8,174	$8,055	$5,925
Refund transfer fees	$14,298	$7,291	$6,591

Included in other noninterest revenues is a gain of $2.9 million from the sale of the Company's merchant card processing business. There were no assets that were sold with this business, only the customer relationships. No material costs were incurred in the disposal. The employees were transferred to other areas. The Company will share in the revenue from these relationships over the next 10 years. While the sale occurred in 2001, the buyer is not anticipated to take over all of the processing until the first quarter of 2002.

The table below discloses the largest items included in operating expense. Consultants include the Company's independent accountants, attorneys, and other management consultants used for special projects.

	DECEMBER 31		
(IN THOUSANDS)	2001	2000	1999
Operating expense			
Marketing	$3,693	$3,166	$ 3,046
Consultants	5,727	7,469	10,574
Merchant credit card clearing fees	6,453	6,412	4,396
Software expense	3,756	2,551	2,549
Amortization of goodwill	2,564	2,055	1,401
Telephone and wires	4,383	3,304	2,764

The FDIC has established a reserve fund for the purpose of covering the losses of deposit customers of failed financial institutions. The FDIC may assess premiums of commercial banks based on the amount of their deposits whenever the fund is less than a specified percentage of deposits in the banking system. The FDIC has not assessed these premiums for several years, but it has indicated that it may do so in 2002 or 2003. It has suggested an annual premium rate of up to five basis points. That would result in an annual premium charge of approximately $1.5 million to the Company.

13. EMPLOYEE BENEFIT PLANS

The Company's Employee Stock Ownership Plan ("ESOP") was initiated in January 1985. In 1999, PCB's ESOP was merged with that of the Company.

As of December 31, 2001, the ESOP held 1,386,369 shares at an average cost of $9.04 per share.

The Company's profit-sharing plan, initiated in 1966, has two components. The Salary Savings Plan component is authorized under Section 401(k) of the Internal Revenue Code. An employee may defer up to 10% of pre-tax salary in the plan up to a maximum dollar amount set each year by the Internal Revenue Service. The Company matches 100% of the first 3% of the employee's compensation that the employee elects to defer and 50% of the next 3%, but not more than 4.5% of the employee's total compensation. In 2001, 2000, and 1999, the employer's matching contributions were $2.0 million, $1.7 million and $1.3 million, respectively. The other component is the Incentive & Investment Plan. It was established in 1966, and permits contributions by the Company to be invested in various mutual funds chosen by the employees.

The Company's practice has been to make total contributions to the employee benefit plans equal to the smaller of (1) 10% of pre-tax profits prior to this employer contribution, or (2) the amount deductible in the Company's current year tax return. Through the end of 2001, deductions for contributions to qualified plans are limited to 15% of eligible compensation. In each of the last three years, the deductible amount was the limiting factor for the contribution. After providing for the Company's contribution to the Retiree Health Plan discussed in Note 15 and the matching contribution to the Salary Savings Plan, the remaining contribution may be made either to the ESOP or to the Incentive & Investment Plan.

Total contributions by the Company to the above profit-sharing plans were $3,672,000 in 2001, $2,788,000 in 2000, and $2,879,000 in 1999. Aside from the employer's matching contribution to the Salary Savings Plan or 401(k) component of the profit-sharing plan, the contributions went to the Incentive & Investment Plan in 2001 and to the ESOP in 2000 and 1999.

14. DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS

GAAP requires companies to disclose the fair value of those financial instruments for which it is practicable to estimate that value and the methods and significant assumptions used to estimate those fair values. This must be done irrespective of whether or not the instruments are recognized on the balance sheets of the Company.

There are several factors which users of these financial statements should keep in mind regarding the fair values disclosed in this note. First, there are uncertainties inherent in the process of estimating the fair value of certain financial instruments. Second, the Company must exclude from its estimate of the fair value of deposit liabilities any consideration of its on-going customer relationships which provide stable sources of investable funds.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

CASH AND CASH EQUIVALENTS

The face value of cash, Federal funds sold, and securities purchased under agreements to resell are their fair value.

SECURITIES AND MONEY MARKET INSTRUMENTS

For securities, bankers' acceptances and commercial paper, fair value equals quoted market price, if available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities. As explained in Note 1, securities classified as available-for-sale are carried at fair value.

LOANS

The fair value of loans is estimated by discounting the future contractual cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. These contractual cash flows are adjusted to reflect estimates of uncollectible amounts.

DEPOSIT LIABILITIES

The fair value of demand deposits, money market accounts, and savings accounts is the amount payable on demand as of December 31 of each year. The fair value of fixed-maturity certificates of deposit is estimated using the rates currently offered for deposits of similar remaining maturities.

REPURCHASE AGREEMENTS, FEDERAL FUNDS PURCHASED, AND OTHER BORROWINGS

For short-term instruments, the carrying amount is a reasonable estimate of their fair value. For FHLB advances, the only component of debt not considered short-term, the fair value is estimated using rates currently quoted by the FHLB for advances of similar remaining maturities.

STANDBY LETTERS OF CREDIT, AND FINANCIAL GUARANTEES WRITTEN

The fair value of guarantees and letters of credit is based on fees currently charged for similar agreements. The Company does not believe that its loan commitments have a fair value within the context of this note because generally fees have not been charged, the use of the commitment is at the option of the potential borrower, and the commitments are being written at rates comparable to current market rates.

Fair values for off-balance-sheet, credit related financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. Fair values for off-balance-sheet derivative financial instruments, for other than trading purposes, are based upon quoted market prices, except in the case of certain options and swaps where pricing models are used.

The carrying amount and estimated fair values of the Company's financial instruments as of December 31, 2001 and 2000, are as follows:

	AS OF DECEMBER 31, 2001		AS OF DECEMBER 31, 2000	
	CARRYING AMOUNT	FAIR VALUE	CARRYING AMOUNT	FAIR VALUE

Cash and due from banks	$ 136,457	$ 136,457	$ 176,274	$ 176,274
Federal funds sold	94,500	94,500	19,500	19,500
Securities available-for-sale	699,076	699,076	657,595	657,595
Securities held-to-maturity	71,967	79,389	139,294	148,442
Net loans	2,750,220	2,808,640	2,481,979	2,440,099
Total financial assets	$3,752,220	$3,818,062	$3,474,642	$3,441,910
Deposits	$3,365,575	$3,376,817	$3,102,819	$3,105,378
Long-term debt, FHLB Advances	$ 175,000	$ 185,655	103,000	106,802
Repurchase agreements, Federal funds purchased, and Treasury Tax & Loan	58,404	58,407	132,316	132,286
Total financial liabilities	$3,598,979	$3,620,879	$3,338,135	$3,344,466
Unrecognized financial instruments:				
Interest rate swap contracts	$ -	$ (1,924)	$ -	$ (1,336)
Standby letters of credit	$ -	$ 40,677	$ -	$ 38,781

15. OTHER POSTRETIREMENT BENEFITS

All eligible retirees may obtain health insurance coverage through the Company's Retiree Health Plan ("the Plan"). The coverage is provided through basic coverage plan provided for current employees. The cost of this coverage is that portion of the total premium paid for the whole which relates to retirees. Based on a formula involving date of retirement, age at retirement, and years of service prior to retirement, the Plan provides that the Company will contribute a portion of the cost for the retiree, varying from 60% to 100% at the time the employee retires, with the stipulation that the cost of the portion paid by the Company shall not increase by more than 5% per year for retirees. Though the premiums for retiree health coverage is not paid until after the employee retires, the Company is required to recognize the net present value of the estimated future cost of providing health insurance benefits to retirees under the Retiree Health Plan as those benefits are earned rather than when paid. The net present value is that amount which if compounded at an assumed interest rate would equal the amount expected to be paid in the future.

THE ACCUMULATED POSTRETIREMENT BENEFIT OBLIGATION

The commitment the Company has made to provide these benefits results in an obligation that must be recognized in the financial statements. This obligation, termed the accumulated postretirement benefit obligation ("APBO"), is the actuarial net present value of the obligation for: (1) already retired employees' expected postretirement benefits; and (2) the portion of the expected postretirement benefit obligation earned to date by current employees.

This obligation must be re-measured each year because it changes with each of the following factors: (1) the number of employees working for the Company; (2) the average age of the employees working for the Company as this impacts how soon it would be expected that the Company will begin making payments; (3) increases in expected health care costs; and (4) prevailing interest rates. In addition, because the obligation is measured on a net present value basis, the passage of each year brings the eventual payment of benefits closer, and therefore, like the compounding of interest, causes the obligation to increase. The following tables disclose the reconciliation of the beginning and ending balances of the APBO; the reconciliation of beginning and ending balances of the fair value of the plan assets; and the funding status of the Plan as of December 31, 2001, 2000, and 1999.

(IN THOUSANDS)	YEAR ENDED DECEMBER 31		
	2001	2000	1999
Benefit obligation, beginning of year	$(5,326)	$(4,584)	$(4,170)
Service cost	(351)	(257)	(315)
Interest cost	(398)	(346)	(270)
Actuarial (losses) gains	(3,849)	(209)	111
Benefits paid	72	70	60
Benefit obligation, end of year	(9,852)	(5,326)	(4,584)
Fair value of Plan assets, beginning of year	6,253	6,731	4,486
Actual return on Plan assets	(1,241)	(408)	2,305
Employer contribution	-	-	-
Benefits paid	(72)	(70)	(60)
Fair value of Plan assets, end of year	4,940	6,253	6,731
Funded Status (4,912) 928 2,147			
Unrecognized net actuarial loss (gain)	3,972	(1,624)	(2,867)
Unrecognized prior service cost	-	-	1
Accrued benefit cost	$ (940)	$ (696)	$ (719)

Costs of $940,000 for December 31, 2001, and $696,000 for December 31, 2000, are included within the category for accrued interest payable and other liabilities in the consolidated balance sheets.

THE COMPONENTS OF THE NET PERIODIC POSTRETIREMENT BENEFIT

COST Each year the Company recognizes a portion of the change in the APBO. This portion is called the net periodic postretirement benefit cost (the "NPPBC"). The NPPBC, is made up of several components:

- Service cost — Each year employees earn a portion of their eventual benefit. This component is the net present value of that portion.
- Interest cost — Each year the benefit obligation for each employee is one year closer to being paid and therefore increases in amount closer to the eventual benefit payment amount. This component represents that increase resulting from the passage of another year.
- Return on assets — Income is earned on any investments that have been set aside to fund the eventual benefit payments. This component is an offset to the first two components.
- Amortization cost — Significant estimates and assumptions about interest rates, trends in health care costs, plan changes, employee turnover, and earnings on assets are used in measuring the APBO each year. Actual experience may differ from the estimates and assumptions may change. Differences will

result in what are termed experience gains and losses. These may be increases or decreases in the

APBO or in the value of plan assets. This component recognizes a portion of the experience gains and losses.

o Prior service cost — At the adoption of the Plan, the Company fully recognized the net present value of the benefits credited to employees for service provided prior to the adoption of the plan. Had the Company not recognized this amount, a portion of it would be included as a fifth component.

The following table shows the amounts for each of the components of the NPPBC. The total amount is included with the cost of other employee benefits in the Consolidated Statements of Income.

(in thousands)	YEAR ENDED DECEMBER 31		
	2001	2000	1999
Service cost	$ 351	$ 257	$ 315
Interest cost	398	346	270
Return on assets	(431)	(466)	(296)
Amortization cost	(74)	(160)	(24)
Net periodic postretirement cost	$ 244	$ (23)	$ 265

The Use of Estimates and the Amortization of Experience Gains and Losses

The following table discloses the assumed rates that have been used for the factors that may have a significant impact on the APBO.

	DECEMBER 31		
	2001	2000	1999
Discount rate	7.10%	7.61%	7.71%
Expected return on plan assets	7.00%	7.00%	7.00%
Health care inflation rate for retired participants	5.00%	5.00%	5.00%
Health care inflation rate for current employees	Graded Rates	5.00%	5.00%

The discount rate is used to compute the present value of the APBO. It is selected each year by reference to the current rates of investment grade corporate bonds. Higher discount rates result in a lower APBO at the end of the year and the NPPBC to be recognized for the following year, while lower rates raise both.

While the discount rate has fluctuated with market rates, the Company has continued to use 7% as its estimate of the long-term rate of return on plan assets. The APBO is a long-term liability of 30 years or more. The 7% rate is the assumed average earning rate over an equally long investment horizon. If the rate of return in any year is greater than this estimate, the Company will have what is an experience gain, and an experience loss if the rate of return is less.

As noted above, the Company's contribution for insurance premiums for retirees is limited to an annual increase of 5%. Should insurance premiums increase at a higher rate, the retirees are required to contribute a larger portion of the total premium cost. Therefore, 5% has been set as the assumed cost trend rate for health care. Because of this limitation, an increase of more than 5% in the actual cost of health care will have no impact on the APBO. If costs rise at a lesser rate, the Company will have an experience gain.

Because of a significant increase in health insurance premiums during 2001, the Company has changed its assumption for the health care inflation rate for current employees. The rate assumed for 2002 is 12%. The rates assumed for subsequent years gradually decrease each year to 5% in 2009 and thereafter. If costs rise at a lesser rate, the Company will have an experience gain.

Rather than recognizing the whole amount of the experience gains or losses in the year after they arise, under GAAP they are recognized through amortization over the average remaining service lives of the employees. Amortization over time is used because many of these changes may be partially or fully reversed in subsequent years as further changes in experience and/or assumptions occur. At December 31, 2001, and December 31, 2000, the Company had unamortized or unrecognized loss of $3,972,000 and gain of $1,624,000, respectively. These amounts are reported in the first table of this note.

FUNDING OF THE RETIREE HEALTH PLAN

Employers are allowed wide discretion as to whether and how they set aside funds to meet the obligation they are recognizing. Under the provisions of the current Internal Revenue Code, only a portion of this funding may be deducted by the employer. The funded status of the plan is shown in the first table as the amount by which the plan assets exceed the APBO.

The Company established a Voluntary Employees' Beneficiary Association ("VEBA") to hold the assets that will be used to pay the benefits for participants of the plan other than key executive officers. Most of the plan assets have been invested in insurance policies on the lives of various employees of the Company.

The current funding policy of the Company is to contribute assets to the VEBA at least sufficient to pay the costs of current medical premiums of retirees. In some years the Company also contributes assets to pay the costs of the life insurance premiums. In those years that the Company does not contribute assets for the payment of the life insurance premiums, assets in the VEBA are used to pay the premiums. Proceeds from the life insurance policies payoffs will fund benefits and premiums in the future. If the assets of the VEBA are more than the APBO related to employees of the Company not defined as key employees, the VEBA is overfunded.

If the assets of the VEBA are less than the APBO related to employees of the Company not defined as key employees, the VEBA is underfunded. As of December 31, 2001, the VEBA was underfunded by $3,453,000. The APBO related to the key employees of $1,459,000 is totally unfunded.

16. EARNINGS PER SHARE AND STOCK-BASED COMPENSATION

The following table presents a reconciliation of basic earnings per share and diluted earnings per share. The denominator of the diluted earnings per share ratio includes the effect of dilutive securities. The only securities outstanding that are potentially dilutive are the stock options reported in Note 9.

(amounts in thousands other than per share amounts)	Basic Earnings Per Share	Diluted Earnings Per Share
For the Year Ended December 31, 2001		
Numerator - Net Income	$56,111	$56,111
Denominator - weighted average shares outstanding	26,508	26,508
Plus: net shares issued in assumed stock option exercises		131
Diluted denominator		26,639
Earnings per share	$ 2.12	$ 2.11
For the Year Ended December 31, 2000		
Numerator - Net Income	$51,456	$51,456
Denominator - weighted average shares outstanding	26,380	26,380
Plus: net shares issued in assumed stock option exercises		229
Diluted denominator		26,609
Earnings per share	$ 1.95	$ 1.93
For the Year Ended December 31, 1999		
Numerator - Net Income	$46,533	$46,533
Denominator - weighted average shares outstanding	26,103	26,103
Plus: net shares issued in assumed stock option exercises		449
Diluted denominator		26,552
Earnings per share	$ 1.78	$ 1.75

Under the method of accounting for stock options implemented by the Company, no compensation expense is recorded if stock options are granted to employees at an exercise price equal to the fair market value of the stock at the time of the grant.

Had the Company recognized compensation expense over the expected life of the options based on their fair market value as discussed in Note 1, the Company's pro forma salary expense, net income, and earnings per share for the years ended December 31, 2001, 2000, and 1999 would have been as follows:

(in thousands except per share amounts)	YEAR ENDED DECEMBER 31 2001	2000	1999

Salary expense:			
As reported	$56,919	$54,931	$46,416
Pro forma	$58,104	$56,208	$47,789
Net Income:			
As reported	$56,111	$51,456	$46,533
Pro forma	$55,424	$50,716	$45,737
Earnings Per Share:			
As reported	$ 2.11	$ 1.93	$ 1.75
Pro forma	$ 2.08	$ 1.91	$ 1.72
Diluted average shares	26,639	26,609	26,552

17. REGULATORY CAPITAL REQUIREMENTS

The Company and its subsidiary banks are subject to various regulatory capital requirements administered by the Federal banking agencies. Failure to meet minimum capital requirements as specified by the regulatory framework for prompt corrective action could cause the regulators to initiate certain mandatory or discretionary actions that, if undertaken, could have a direct material effect on the Company's financial statements.

The table below sets forth the actual capital amounts and ratios for the Company as of December 31, 2001 and 2000. It also shows the minimum amounts and ratios that it must maintain under the regulatory requirements to meet the standard of adequately capitalized and the minimum amounts and ratios required to meet the regulatory standards of "well capitalized."

For the Company, Tier I capital consists of common stock, surplus, and retained earnings. Tier II capital includes a portion of the allowance for credit losses and the subordinated debt mentioned in Note 11. Risk-weighted assets are computed by applying a weighting factor from 0% to 100% to the carrying amount of the assets as reported in the balance sheet and to a portion of off-balance sheet items such as loan commitments and letters of credit. The definitions and weighting factors are all contained in the regulations. However, the capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

(dollars in thousands)	Pacific Capital Bancorp Actual		Minimums for Capital Adequacy Purposes		Minimums Well-Capi
	Amount	Ratio	Amount	Ratio	Amount
As of December 31, 2001					
Total Tier I & Tier II Capital (to Risk Weighted Assets)	$ 363,887	12.2%	$ 238,038	8.0%	$ 297,547
Tier I Capital (to Risk Weighted Assets)	$ 290,922	9.8%	$ 119,019	4.0%	$ 178,528

Tier I Capital (to Average Tangible Assets)	$ 290,922	7.7%	$ 151,193	4.0%	$ 188,991
Risk Weighted Assets	$2,975,471				
Average Tangible Assets	$3,779,827				
As of December 31, 2000					
Total Tier I & Tier II Capital (to Risk Weighted Assets)	$ 292,592	10.5%	$ 223,871	8.0%	$ 279,838
Tier I Capital (to Risk Weighted Assets)	$ 257,610	9.2%	$ 111,935	4.0%	$ 167,903
Tier I Capital (to Average Tangible Assets)	$ 257,610	7.2%	$ 143,956	4.0%	$ 179,945
Risk Weighted Assets	$2,798,382				
Average Tangible Assets	$3,598,896				

As of December 31, 2001, the most recent notification from the banks' examiners categorized each of the banks as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based, Tier 1 riskbased and Tier 1 leverage ratios as set forth in the above table. The following table shows the three capital ratios for each of the bank subsidiaries at December 31, 2001 and at December 31, 2000. There are no conditions or events since the notification that management believes have changed the banks' category.

As of December 31	Total Tier I and Tier II Capital to Risk Weighted Assets	Tier I Capital to Risk Weighted Assets	Tier I Capital to Average Tangible Assets
SBB&T			
2001	13.09%	9.98%	7.72%
2000	10.28%	9.06%	7.00%
FNB			
2001	10.56%	9.30%	7.97%
2000	9.30%	10.55%	7.35%

Bancorp is the parent company and sole owner of the banks. However, there are legal limitations on the amount of dividends which may be paid by the banks to Bancorp. The amounts which may be paid as dividends by banks are determined based on the banks' capital accounts and earnings in prior years. As of December 31, 2001, the subsidiary banks would have been permitted to pay up to $71.4 million to Bancorp.

18. COMMITMENTS AND CONTINGENCIES

Leases The Company leases several office locations and substantially all of the office leases contain multiple five-year renewal options and provisions for increased rentals, principally for property taxes and maintenance. As of December 31, 2001, the minimum rentals under non-cancelable leases for the next five years and thereafter are shown in the following table.

(IN THOUSANDS)	YEAR ENDED DECEMBER 31					THERE-	
	2002	2003	2004	2005	2006	after	Total
Non-cancelable lease expense	$6,946	$5,981	$5,640	$4,810	$4,343	$10,532	$38,252

Total rental expense, net of sublease income for premises included in operating expenses are $6.0 million in 2001, $5.9 million in 2000, and $5.1 million in 1999. One of the branch offices obtained through acquisition in 2000 is not currently being used. The property is leased and the Company is evaluating its potential for reuse as a branch or for sublease. If it is determined that it cannot be used for the Company's banking activities and cannot be subleased, a loss may have to be recognized by the Company for the remaining required lease payments and the unamortized cost of the leasehold improvements.

RELATED PARTIES

In the ordinary course of business, the Company has extended credit to directors and executive employees of the Company totaling $15.4 million at December 31, 2001 and $13.9 million at December 31, 2000. Such loans are subject to ratification by the Board of Directors, exclusive of the borrowing director.

Among the office space leased by the Company are two buildings leased from related parties. The first building is leased from a partnership in which a company director has an interest. In February 1999, this building was destroyed in a fire. In 2000, the Company renegotiated a lease for this property, which included sharing the costs of rebuilding and provided for adjustments to future rents to recover the funds expended by the Company in construction. The terms of this lease were negotiated with the assistance of an independent, outside commercial real estate consultant. As a result of arms length negotiations with the partnership, the consultant believed that the terms of the transaction were fair and reasonable to the Company. The terms of the lease were approved by the Company's Board of Directors.

The second building is leased from a partnership in which a director of one of the Company's subsidiary banks has an interest. The original terms of the lease were negotiated with the assistance of two independent, outside appraisers, and the lease was approved by the board of directors of the former Pacific Capital Bancorp. That company exercised its option to renew the lease in 1989. In 1994, the Company renegotiated the lease to receive other rights such as additional lease option periods and a right of first refusal to purchase the building if it is offered for sale. A nominal monthly rent increase was agreed to in order to obtain these benefits, but the actual outlay was reduced in order for the Company to be reimbursed for advancing the partnership's share of seismic improvements made to the leased property in 1994. The lease was again amended in 1999 which gave the Company five options to extend the term for 12 months each. Management believes the terms of the revised and amended lease are comparable with terms which would have been available from unaffiliated third parties at the time the negotiations occurred and the terms were approved by the subsidiary bank's board of directors.

LETTERS OF CREDIT

In order to meet the financing needs of its customers in the normal course of business, the Company is a party to financial instruments with "off-balance sheet" risk. These financial instruments consist of commitments to extend credit and standby letters of credit.

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. The Company has not usually charged fees in connection with loan commitments. Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. The Company charges a fee for these letters of credit.

The standby letters of credit involve, to varying degrees, exposure to credit risk in excess of the amounts recognized in the consolidated balance sheets. This risk arises from the possibility of the failure of the customer to perform according to the terms of a contract. In such a situation the third party might draw on the standby letter of credit to pay for completion of the contract and the Company would have to look to its customer to repay these funds to the Company with interest. To minimize the risk, the Company uses the same credit policies in making commitments and conditional obligations as it would for a loan to that customer. The decision as to whether collateral should be required is based on the circumstances of each specific commitment or conditional obligation. Because of these practices, Management does not anticipate that any significant losses will arise from such draws.

Changes in market rates of interest for those few commitments and undisbursed loans which have fixed rates of interest represent a possible cause of loss because of the contractual requirement to lend money at a rate that is no longer as great as the market rate at the time the loan is funded. To minimize this risk, if rates are quoted in a commitment, they are generally stated in relation to the Company's prime or base lending rate. These rates vary with prevailing market interest rates. Fixedrate loan commitments are not usually made for more than three months.

The maximum exposure to credit risk is represented by the contractual notional amount of those instruments. As of December 31, 2001 and 2000, the contractual notional amounts of these instruments are as follows:

(IN THOUSANDS)	DECEMBER 31	
	2001	2000
Commitments to extend credit		
Commercial	$553,390	$572,905
Consumer	$ 98,228	$ 87,582
Standby letters of credit	$ 40,677	$ 38,781

Since many of the commitments are expected to expire without being drawn upon, the amounts in the table do not necessarily represent future cash requirements.

The Company has established an allowance for credit loss on letters of credit. In accordance with GAAP, this allowance is not included as part of the allowance for credit loss reported on the consolidated balance sheets for outstanding loans. Instead, the $302,000 allowance is included in other liabilities.

LENDING ACTIVITIES

With the exception of the RAL program mentioned in Note 3, the Company has concentrated its lending activity primarily with customers in the market areas served by the branches of its subsidiary banks. Mergers and acquisitions have introduced some geographical diversity as each market area now represents only a portion of the whole Company. The business customers are in widely diversified industries, and there is a large consumer component to the portfolio. The Company monitors concentrations within four broad categories: industry, geography, product, and collateral. One -

significant concentration in the loan portfolio is represented by loans collateralized by real estate. The nature of this collateral, however, is quite varied, namely 1-4 family residential, multifamily residential, and commercial buildings of various kinds. While the economies along the Central Coast have slowed during 2001, the underlying value of real estate has remained stable. The Company has considered this concentration in evaluating the adequacy of the allowance for credit loss in the allocated component.

TRUST ACTIVITIES

The Company has a trust department that has fiduciary responsibility for the assets that it holds on behalf of its trust customers. These assets are not owned by the Company and accordingly are not reflected in the accompanying consolidated balance sheets.

LEGAL

The Company was one of a number of financial institutions named as party defendants in a patent infringement lawsuit filed in February 2000 by an unaffiliated financial institution. Generally, the lawsuit relates to the Company's tax refund program. The plaintiff contends that the program infringes on certain patents which it holds. The Company retained outside patent litigation counsel to vigorously defend it in this case. In November 2001, the plaintiff and the Company tentatively agreed to a settlement of the case. A final settlement agreement has been prepared and the Company expects that it will be fully executed in early 2002. The Company believes that the settlement is a reasonable compromise between the parties. The settlement provides for the Company to pay a license fee to the plaintiff beginning in 2002 for transactions processed in 2002 and continuing until the expiration of the patents at approximately the end of 2007.

The Company is involved in various other litigation of a routine nature which is being handled and defended in the ordinary course of the Company's business. In the opinion of Management, based in part on consultation with legal counsel, the resolution of this litigation will not have a material impact on the Company's financial position.

19. MERGERS AND ACQUISITIONS

After the close of business on June 30, 2000, the Company acquired all the outstanding stock of Los Robles Bancorp, parent company of LRB, for $32.5 million in cash. Immediately prior to the close, LRB had $159.3 million in assets and $146.4 million in liabilities.

The acquisition was accounted for under purchase accounting, with assets and liabilities recorded at their estimated fair value at the time of the acquisition. The excess of the purchase price over the net assets was recorded as goodwill. Goodwill amortized during the year ended December 31, 2001 relating to this transaction totaled approximately $1,163,000. The Company issued no stock in connection with this acquisition. The following table shows estimated fair value of the assets and liabilities of the bank, the purchase price paid, and the resulting goodwill.

(IN THOUSANDS)	FMV OF	FMV OF

	ASSETS ACQUIRED	LIABILITIES ASSUMED	PURCHASE PRICE	GOODWILL RECORDED
Los Robles Bank	$ 159,300	$146,400	$32,500	$19,600

At the time of the acquisition, LRB became a subsidiary of the Company. In 2001, LRB was merged into SBB&T. This subsequent merger does not change the accounting for the transaction for the Company. Under the provisions of purchase accounting, the results of operations of the acquired entity are included in the financial statements of the acquirer only from the date of the acquisition forward. The 2000 consolidated financial statements of the Company include the assets and liabilities acquired in the transaction and results of operations for LRB from July 1 through December 31, 2000.

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The following table presents an unaudited pro forma combined summary of operations of the Company and LRB for the two years ended December 31, 2000, as if the acquisition had been effective January 1, 1999.

(UNAUDITED) (IN THOUSANDS)	YEAR ENDED DECEMBER 31 2000	1999
Interest income	$296,392	$236,284
Interest expense	111,434	75,530
Net interest income	184,958	160,754
Provision for credit losses	14,777	7,423
Noninterest income	51,338	44,897
Noninterest expense	135,219	122,550
Income before provision for income taxes	86,300	75,678
Provision for income taxes	32,747	26,905
Net income	$ 53,553	$ 48,773
Basic earnings per share	$ 2.03	$ 1.87
Weighted average shares assumed to be outstanding	26,380	26,103
Diluted earnings per share	$ 2.01	$ 1.84
Weighted average shares assumed to be outstanding	26,609	26,552

The information in the table above combines the historical results of the Company and LRB. Adjustments have been made to exclude amortization of goodwill, to include of an estimated amount of interest that would have been earned on the cash paid to the shareholders of Los Robles Bancorp, and to exclude the interest paid on the note used to finance a portion of the purchase price. No attempt has been made to eliminate the duplicated administrative cost. There were no intercompany transactions that needed to be eliminated. The figures included in the table for pro forma combined diluted earnings per share are based on the pro forma combined net income in the table and the actual average common shares and share equivalents. Because the consideration paid to the shareholders of Los Robles Bancorp consisted entirely of cash, the average shares and share equivalents outstanding are identical to those reported in Note 16.

This unaudited combined pro forma summary of operations is intended for informational purposes only and is not necessarily representative of the future results of the Company or of the results of the Company that would have occurred had the acquisitions actually been transacted on January 1, 1999.

The amortization of goodwill relating to purchase transactions that occurred prior to 1998 amounted to approximately $1.4 million in the year ended December 31, 2001. Together with the amortization of the goodwill from the purchase of LRB, this resulted in $2.6 million in goodwill amortization expense.

On July 31, 2000, the Company issued 1,735,131 shares of common stock in exchange for all the outstanding stock of San Benito Bank. The transaction was accounted for as a pooling-of-interest, and accordingly, the accompanying consolidated financial statements have been restated to include the accounts of San Benito Bank for all periods presented. Total revenues and net income for the separate companies for the periods preceding the acquisition were as follows:

(IN THOUSANDS)	YEAR ENDED DECEMBER 31 2000	1999
Interest income plus noninterest income		
Pacific Capital Bancorp	$328,309	$253,261
San Benito Bank	11,995	15,785
Total	$340,304	$269,046
Net Income		
Pacific Capital Bancorp	$ 47,612	$ 44,274
San Benito Bank	3,844	2,259
Total	$ 51,456	$ 46,533

In December 2001, the Company signed an agreement with another financial institution to acquire certain assets and liabilities of two of its branches in Monterey and Watsonville. The deposits and loans acquired in this transaction will be combined with FNB's existing branches in those communities. The transaction is expected to close in the second quarter of 2002.

20. SEGMENT REPORTING

While the Company's products and services areall of the nature of commercial banking, the Company has seven reportable segments. There are six specific segments: Wholesale Lending, Retail Lending, Branch Activities, Fiduciary, Tax Refund Programs, and the Northern Region. The remaining activities of the Company are reported in a segment titled "All Other." A segment for Los Robles Bank was added for the Company's 2000 Annual Report, but with its merger into SBB&T in 2001, the 2000 segment information has been restated to be comparable with 2001 segment information.

FACTORS USED TO IDENTIFY REPORTABLE SEGMENTS

The Company first uses geography as a factor in distinguishing three operating segments. The discrete market areas served by SBB&T and FNB (including its affiliates SVNB and SBB) distinguish them as units for which performance must be viewed separately. The tax refund program serves customers throughout the United States, and the lack of a defined market area for this program distinguishes it from other banking activities.

SBB&T is further disaggregated into additional segments. The factors used for this disaggregation relate to products and services resulting in segments for Wholesale Lending, Retail Lending, Branch Activities (deposits), and Fiduciary (trust services). This level of disaggregation for SBB&T reflects its specific management structure in which loan and deposit products are handled by different organizational units. In contrast to this, FNB and its affiliates have organizational structures that generally place both loan and deposit products in the individual branches.

TYPES AND SERVICES FROM WHICH REVENUES ARE DERIVED

Wholesale Lending: Business units in this segment make loans to medium-sized businesses and their owners. Loans are made for the purchase of business assets, working capital lines, investment, and the development and construction of nonresidential or multi-family residential property. Letters of credit are also offered to customers both to facilitate commercial transactions and as performance bonds.

Retail Lending: Business units in this segment engage in small business lending (including Small Business Administration guaranteed loans) and leasing, consumer installment loans, home equity lines, and 1-4 family residential mortgages.

Branch Activities: The business of this segment is primarily centered on deposit products, but also includes safe deposit box rentals, foreign exchange, electronic fund transfers, and other ancillary services to businesses and individuals.

FIDUCIARY: This segment provides trust and investment services to its customers. The Trust and Investment Services Division may act as both custodian and manager of trust accounts as directed by the client. In addition to securities and other liquid assets, the division manages real estate held in trust. The division also sells third-party mutual funds and annuities to customers.

TAX REFUND PROGRAM: The loan products provided in this segment are described in Note 3. The other product, refund transfers, consists of receipt of tax refunds from the Internal Revenue Service on behalf of individual taxpayers and authorizing the local issuance of checks to the taxpayers so that they do not need a mailing address or to wait for the refund check to be mailed to them.

NORTHERN REGION: This segment derives its revenues from banking services provided by FNB and its affiliates SVNB and SBB. These include the same type of loan, deposit, and fiduciary products in the first four segments described above. This segment also derives revenues from securities in FNB's securities portfolios.

ALL OTHER: This segment consists of other business lines and support units. The administrative support units include the Company's executive administration, data processing, marketing, credit administration, human resources, legal and benefits, and finance and accounting. The primary revenues are from SBB&T's securities portfolios.

CHARGES AND CREDITS FOR FUNDS AND INCOME FROM THE INVESTMENT PORTFOLIOS

As noted above, there is a significant difference between the organizational structures FNB and the organizational structure of SBB&T. The same business units provide loans and deposits at FNB and separate business units handle them at SBB&T. This means that as a segment, the Northern Region is self-contained from a funding standpoint. That is, the one segment obtains its own funds from its depositors and lends its own funds to its borrowers. In contrast with this, SBB&T has one primary segment which provides the funds, Branch Activities, while the lending segments utilize the funds. To give a fair picture of profitability at the segment level for the SBB&T segments, it is therefore necessary to charge the lending segments for the cost of the funds they use while crediting the Branch Activities segment for the funds it provides.

The securities portfolios of each bank are used to provide liquidity to that bank and to earn income from funds received from depositors that are in excess of the amounts lent to borrowers. The interest rates applicable to securities are lower than for loans because there is little or no credit risk. Foregoing the higher rates earned by loans is, in a sense, a cost of maintaining the necessary liquidity, and an opportunity cost for being unable to generate sufficient loans to make full use of the available funds.

From the standpoint of measuring the performance of the Northern Region segment, the loans and deposits of which are organizationally integrated, it is most appropriate to include the income from the FNB securities portfolios with the operating segments. Because the Northern Region segments are self-contained from a funding standpoint, within the segments as a whole, there are no credits or charges for funds.

In the SBB&T segments, the uses of funds and the provision of funds are in separate segments. There is no one operating unit to which it is appropriate to charge the liquidity and opportunity costs related to the investment portfolios. Instead, each segment that uses funds through lending or investing is charged for its funds and the Branch Activities segment is credited for the funds it provides.

MEASURE OF PROFIT OR LOSS

In assessing the performance of each segment, the chief executive officer reviews the segment's contribution before tax. Taxes are excluded because the Company has permanent tax differences (see Note 8) which do not apply equally to all segments. In addition, if segments were measured by their

net-of-tax contribution, they would be advantaged or disadvantaged by any enacted changes in tax rates even though such changes are not reflective of the performance of a segment.

SPECIFIC SEGMENT DISCLOSURE

The following table presents information for each segment regarding assets, profit or loss, and specific items of revenue and expense that are included in that measure of segment profit or loss as reviewed by the chief executive officer.

(in thousands)	Branch Activities	Retail Lending	Wholesale Lending	Refund Programs	Fiduciary	Norther Region
Year Ended December 31, 2001						
Revenues from						

external customers	$ 13,006	$ 81,091	$ 74,199	$ 40,717	$ 12,596	$ 99,
Intersegment revenues	83,194	255	-	3,607	3,289	
Total Revenues	$ 96,200	$ 81,346	$ 74,199	$ 44,324	$ 15,885	$ 99,
Profit (Loss)	$ 21,919	$ 12,146	$ 16,175	$25,102	$ 5,162	$ 25,
Interest income	103	76,447	72,051	26,407	-	86,
Interest expense	46,173	262	7	1,080	3,298	30,
Internal charge for funds	651	49,776	35,789	3,752	-	
Depreciation	1,823	232	182	301	114	1,
Total assets	17,039	1,011,456	851,376	4,228	3,105	1,236,
Capital expenditures	26	-	-	-	-	

(in thousands)	Branch Activities	Retail Lending	Wholesale Lending	Refund Programs	Fiduciary	Norther Region
Year Ended December 31, 2000						
Revenues from external customers	$ 11,246	$ 66,521	$ 74,639	$ 26,258	$ 13,749	$ 102,
Intersegment revenues	109,791	656	-	2,198	3,920	
Total revenues	$121,037	$ 67,177	$ 74,639	$ 28,456	$ 17,669	$ 102,
Profit (Loss)	$ 32,204	$ 12,796	$ 18,228	$ 16,692	$ 7,182	$ 23,
Interest income	90	65,576	72,806	18,957	-	93,
Interest expense	64,761	662	6	-	3,621	31,
Internal charge for funds	859	42,793	41,205	3,255	-	
Depreciation	1,546	210	116	208	135	1,
Total assets	19,672	868,321	919,315	(43)	1,527	1,177,
Capital expenditures	-	-	-	-	-	1,

(in thousands)	Branch Activities	Retail Lending	Wholesale Lending	Refund Programs	Fiduciary	Norther Region
Year Ended December 31, 1999						
Revenues from external customers	$ 9,254	$ 54,483	$ 54,295	$ 14,673	$ 13,201	$ 87,
Intersegment revenues	75,656	216	-	1,988	2,420	
Total revenues	$ 84,910	$ 54,699	$ 54,295	$ 16,661	$ 15,621	$ 87,
Profit (Loss)	$ 20,761	$ 13,139	$ 18,765	$ 9,391	$ 6,538	$ 27,
Interest income	73	53,307	53,403	8,081	-	79,
Interest expense	40,002	221	5	-	2,121	24,
Internal charge for funds	866	33,076	29,536	641	-	
Depreciation	1,432	143	93	87	131	1,
Total assets	29,478	708,698	647,104	(487)	1,668	1,111,
Capital expenditures	-	-	-	-	-	2,

The following table reconciles total revenues and profit for the segments to total revenues and pre-tax income, respectively, in the consolidated financial statements.

(IN THOUSANDS)	YEAR ENDED DECEMBER 31 2001	2000	1999
Total revenues for reportable segments	$ 485,619	$ 475,411	$ 369,745
Elimination of intersegment revenues	(122,971)	(128,976)	(94,417)
Elimination of taxable equivalent adjustment	(5,814)	(6,131)	(6,282)
Total consolidated revenues	$ 356,834	$ 340,304	$ 269,046
Total profit or loss for reportable segments	$ 95,601	$ 89,512	$ 78,385
Elimination of taxable equivalent adjustment	(5,814)	(6,131)	(6,282)
Income before income taxes	$ 89,787	$ 83,381	$ 72,103

For purposes of performance measurement and therefore for the segment disclosure above, income from tax-exempt securities, loans, and leases is reported on a fully taxable equivalent basis. Under this method of disclosure, the income disclosed is increased to that amount which, if taxed, would result in the amount included in the financial statements.

With respect to the disclosure of total assets for the individual segments, fixed assets used by the Northern Region segments are included in its asset totals. Fixed assets used by the other segments are all recorded as assets of the All Other segment. Depreciation expense of these assets is charged to the segment that uses them.

The Company has no operations in foreign countries to require disclosure by geographical area. The Company has no single customer generating 10% or more of total revenues.

For the Company, the process of disaggregation is somewhat arbitrary. Many of the Company's customers do business with more than one segment. In these cases, the Company may use relationship pricing, whereby customers may be given a favorable price on one product because the other products they use are very profitable for the Company. To the extent that these products are in different segments as defined above, one segment may be sacrificing profitability to another for the sake of the overall customer relationship.

21. DIVIDENDS DECLARED

The Company declares cash dividends to its shareholders each quarter. Its policy is to declare and pay dividends of between 35% and 40% of its net income to shareholders. In 2001, the Company paid dividends of $0.22 per quarter. However, it changed the timing of the declaration of the dividend from the month prior to the quarter end to the first month of each quarter. For example, in April 2001 the Company declared a dividend of $0.22 per share payable in May 2001. In prior years, the dividend payable in May would have been declared in March. The number of dividends paid and the amount for the dividends paid to shareholders remains the same, but since only three quarterly dividends were declared in 2001, there is a smaller amount of dividends reported as declared in the Consolidated Statements of Shareholders Equity for 2001 than for the preceding years.

22. HEDGING ACTIVITIES

The Company has established policies and procedures to permit limited types and amounts of offbalance sheet hedges to help manage interest rate risk. At various times beginning in 1999, the Company has entered into several interest rate swaps to mitigate interest rate risk. Under the terms of these swaps, the Company pays a fixed rate of interest to the counterparty and receives a floating rate of interest. Such swaps have the effect of converting fixed rate financial instruments into

variable or floating rate instruments. Such swaps may be related to specific instruments or specifically specified pools of instruments-loans, securities, or deposits with similar interest rate characteristics or terms. Other types of hedges are permitted by the Company's policies, but have not been utilized.

The one swap in place at the end of 2001 is related to a specific loan and qualifies as a fair value hedge. The notional amount of this hedge at December 31, 2001 was $28.9 million with a fair value loss of approximately $1.9 million. The Company did have other specific and non-specific hedges in place during 2000 and the first nine months of 2001. A charge of $680,000 was taken in the first quarter of 2001, $320,000 of which was the cumulative effect of marking these hedges to market upon the adoption of SFAS 133 on January 1, 2001 and $360,000 of which was the market adjustment arising during the first quarter. Additional charges were taken in the second and third quarters for the market adjustment that arose during those quarters. These charges were recorded as a reduction of noninterest income. These swaps were entered into when the Company was concerned about the negative impact on its fixed rate loans from increases in interest rates. With interest rates declining and expected to stay low for at least the next several quarters, the Company elected to dispose of these swaps. The loss on disposal plus the mark to market adjustment for the third quarter was $718,000.

In addition to the interest rate swaps the Company has entered into to manage its own interest rate risk, the Company has entered into interest rate swaps with some of its customers to assist them in managing their interest rate risks. As of December 31, 2001, there were swaps with a notional amount of $16.8 million. To avoid increasing its own interest rate risk entering into these swap agreements, the Company entered into offsetting swap agreements with other larger financial institutions. The effect of the offsetting swaps to the Company is to neutralize its position. A fee is charged the Company's customer that is in excess of the fee paid by the Company to the other financial institution.

23. TRANSFERS AND SERVICING OF FINANCIAL ASSETS

The Company has entered into two securitization transactions. The disclosures related to securitizations that are required by SFAS 140 are presented below.

INDIRECT AUTO SECURITIZATION

During the first quarter of 2001, SBB&T securitized $58.2 million in automobile loans resulting in a gain on sale of approximately $566,000. Retained interest held by SBB&T upon completion of this securitization was $3.5 million. The transaction was conducted through the SBB&T Automobile Loan Securitization Corporation, a wholly owned subsidiary of SBB&T. The securities offered consisted of two classes, entitled 6.13% Asset-Backed Notes, Class A, Series 2000-A and 6.90% Asset- Backed Notes, Class B, Series 2000-A.

As of December 31, 2001, pertinent data related to this securitization is as follows:

Principal amount outstanding	$35.6 million
Retained interest	$2.8 million
Principal amount of delinquencies greater than 30 days	$675,000
Net credit losses	$233,000
Cash flows received for servicing fees	$244,000
Cash flows received on retained interests	$975,000

The figures reported above for delinquencies and net credit losses relate to the total principal amount outstanding.

Retained interests are calculated based on the present value of excess cash flows due to SBB&T over the life of the securitization. The key assumptions used in determining retained interests are outlined below. The impact of changes on these assumptions to the carrying amount of the retained interests is not material to the Company's statement of financial position or results of operations.

Discount rate	8.68%
Prepayment rate	26.85%
Weighted average life of prepayable assets	51 months
Default rate	1%

SBB&T's consumer loan services department acts as the servicer for the securitized automobile loans in compliance with the terms established in the securitization agreements. The servicer is responsible for servicing, managing and administering the receivables and enforcing and making collections on the receivables. The servicer is required to carry out its duties using the degree of skill and care that the servicer exercises in performing similar obligations. This includes payment processing, insurance follow up, loan payoffs and release of collateral. Loan servicing generally consists of collecting payments from borrowers, processing those payments, and delinquent payment collections.

Refund Anticipation Loan Securitization

SBB&T established a special purpose subsidiary corporation in November 2000 named SBB&T RAL Funding Corporation and during the first quarter of 2001 securitized RALs into a multi-seller conduit, backed by commercial paper. SBB&T acted as the servicer for all such RALs during the securitization period. As of June 30, 2001, all borrowings had been fully repaid and no securitizationrelated balances were outstanding.

Subsequent to December 31, 2001, the Company entered into agreements with two other financial institutions to make use of SBB&T RAL Funding Corporation for the 2002 RAL season.

24. PACIFIC CAPITAL BANCORP

The condensed financial statements of the Bancorp are presented on the following two pages.

PACIFIC CAPITAL BANCORP
(PARENT COMPANY ONLY)
BALANCE SHEETS
(IN THOUSANDS)

	DECEMBER 31 2001	DECEMBER 31 2000
ASSETS		
Cash	$ 1,681	$ 678
Investment in and advances to subsidiaries	328,043	296,604
Securities purchased u/a to resell	14,500	-
Loans, net	234	270
Premises and equipment, net	14,605	6,812
Other assets	24,741	19,163
Total assets	$383,804	$323,527
LIABILITIES		
Dividends payable	$ -	$ 5,826
Bank Debt	40,000	15,000
Other liabilities	17,928	6,440
Total liabilities	57,928	27,266
EQUITY		
Common stock	8,737	8,828
Surplus	106,929	115,664
Unrealized gain on securities available-for-sale	4,795	4,472
Retained earnings	205,415	167,297
Total shareholders' equity	325,876	296,261
Total liabilities and shareholders' equity	$383,804	$323,527

PACIFIC CAPITAL BANCORP
(PARENT COMPANY ONLY)
INCOME STATEMENTS
(IN THOUSANDS)

	DECEMBER 31 2001	DECEMBER 31 2000	DECEMBER 31 1999
Equity in earnings of subsidiaries:			
Undistributed	$33,512	$10,074	$28,812
Dividends	25,550	44,000	17,131
Interest income	467	28	123
Interest expense	(1,829)	(873)	-
Noninterest revenue	(225)	108	87
Operating expense	(3,231)	(3,662)	(4,715)
Income tax benefit	1,867	1,781	2,836
Net income	$56,111	$51,456	$44,274

PACIFIC CAPITAL BANCORP
(PARENT COMPANY ONLY)
STATEMENTS OF CASH FLOWS
(IN THOUSANDS)

	YEAR ENDED DECEMBER 31, 2001	2000	1999
Increase (decrease) in cash and cash equivalents:			
Cash flows from operating activities:			
Net income	$ 56,111	$ 51,456	$ 44,2
Adjustments to reconcile net income to net cash provided by (used in) operations:			
Equity in undistributed net income of subsidiaries	(59,062)	(54,074)	(45,9
Amortization of goodwill	456	654	
Depreciation expense	1,702	977	
(Increase) decrease in other assets	(3,973)	(7,122)	5
Increase (decrease) in other liabilities	11,488	3,687	(1,8
Net cash provided by (used in) operating activities	6,722	(4,422)	(3,0
Cash flows from investing activities:			
Net increase in securities purchased u/a to resell	(14,500)	-	
Net decrease in loans	36	124	2,7
Capital expenditures	(9,633)	(3,757)	(6
Purchase of capital stock of Los Robles Bank	-	(32,500)	
Distributed earnings of subsidiaries	25,550	44,000	17,1
Net cash provided by investing activities	1,453	7,867	19,2
Cash flows from financing activities:			
Proceeds from other borrowing	40,000	-	
Proceeds from short term borrowing	-	20,000	
Payments on short term borrowing	(15,000)	(5,000)	
Proceeds from issuance of common stock	6,181	1,395	2,1
Payments to retire common stock	(15,007)	-	(2,0
Dividends paid	(23,346)	(20,093)	(17,5
Net cash used in financing activities	(7,172)	(3,698)	(17,5
Net increase (decrease) in cash and cash equivalents	1,003	(253)	(1,2
Cash and cash equivalents at beginning of period	678	931	2,1
Cash and cash equivalents at end of period	$ 1,681	$ 678	$ 9

Supplemental disclosures: none

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QUARTERLY FINANCIAL DATA (UNAUDITED)

(AMOUNTS IN THOUSANDS EXCEPT PER SHARE AMOUNTS)	2001 QUARTERS 4TH	3RD	2ND	1ST	2000 QUARTERS 4TH	3RD	2ND
Interest income	$61,726	$66,689	$68,522	$94,171	$72,055	$70,032	$67,4
Interest expense	18,664	23,109	25,512	29,941	28,147	27,702	27,7
Net interest income	43,062	43,580	43,010	64,230	43,908	42,330	39,7
Provision for credit losses	7,007	4,438	3,358	11,868	1,295	5,219	2,2
Noninterest income	14,313	12,969	14,213	24,231	11,137	11,044	10,9
Noninterest expense	33,643	35,909	35,548	38,050	35,433	36,108	29,3
Income before income taxes	16,725	16,202	18,317	38,543	18,317	12,047	19,1
Income taxes	6,305	4,923	6,819	15,629	5,994	5,284	7,1
Net Income	$10,420	$11,279	$11,498	$22,914	$12,323	$ 6,763	$12,0
Net earnings per share:							
Basic	$ 0.41	$ 0.42	$ 0.43	$ 0.86	$ 0.47	$ 0.25	$ 0.
Diluted	$ 0.40	$ 0.42	$ 0.43	$ 0.86	$ 0.46	$ 0.25	$ 0.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

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PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The information required by Item 10 is incorporated herein by reference to the sections titled "The Board of Directors" and "Executive Officers" in the Company's definitive Proxy Statement for the annual meeting to be held April 23, 2002 ("Proxy Statement").

ITEM 11. EXECUTIVE COMPENSATION

The information required by Item 11 is incorporated herein by reference to the section titled "Executive Compensation" in the Company's Proxy Statement.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The information required by Item 12 is incorporated herein by reference to the section titled "Beneficial Ownership Chart" in the Company's Proxy Statement.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information required by Item 13 is incorporated herein by reference to the section titled "Other Information" in the Company's Proxy Statement.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENTS, AND REPORTS ON FORM 8-K

(a)1. FINANCIAL STATEMENTS

The listing of financial statements required by this item is set forth in the index for Item 8 of this report.

(a)2. FINANCIAL STATEMENTS SCHEDULES

The listing of supplementary financial statement schedules required by this item is set forth in the index for Item 8 of this report.

(a)3. EXHIBITS

The listing of exhibits required by this item is set forth in the Exhibit Index beginning on page 103 of this report. Each management contract or compensatory plan or arrangement required to be filed as an exhibit to this report is listed under Item 10.1 "Compensation Plans and Agreements," in the Exhibit Index.

(b) REPORTS ON FORM 8-K

No reports on Form 8-K were filed during the fourth quarter of the fiscal year ended December 31, 2001.

(c) EXHIBITS

See exhibits listed in "Exhibit Index" on page 103 of this report.

(d) FINANCIAL STATEMENT SCHEDULES

There are no financial statement schedules required by Regulation S-X that have been excluded from the annual report to shareholders.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Company has duly caused this report to be signed by the undersigned, thereunto duly authorized.

Pacific Capital Bancorp

By /s/ William S. Thomas. Jr William S. Thomas, Jr. President Director	March 15, 2002 Date

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Company and in the capacities and on the dates indicated.

/s/ David W. Spainhour David W. Spainhour Chairman of the Board	March 15, 2002 Date	/s/ William S. Thomas, Jr. William S. Thomas, Jr. President Chief Executive Officer	March 15, 20 Date
/s/ Edward E. Birch Edward E. Birch Director	March 15, 2002 Date	/s/ Richard M. Davis Richard M. Davis Director	March 15, 20 Date
/s/ Richard S. Hambleton, Jr. Richard S. Hambleton, Jr. Director	March 15, 2002 Date	/s/ Dale E. Hanst Dale E. Hanst Director	March 15, 20 Date
/s/ D. Vernon Horton D. Vernon Horton Vice Chairman Director	March 15, 2002 Date	/s/ Roger C. Knopf Roger C. Knopf	March 15, 20 Date
/s/ Donald Lafler Donald Lafler Executive Vice President Chief Financial Officer	March 15, 2002 Date	/s/ Clayton C. Larson Clayton C. Larson Vice Chairman	March 15, 20 Date
/s/ Gerald T. McCullough Gerald T. McCullough Director Director	March 15, 2002 Date	/s/ Richard A. Nightingale Richard A. Nightingale	March 15, 20 Date
/s/ Kathy J. Odell Kathy J. Odell Director	March 15, 2002 Date		

EXHIBIT INDEX TO PACIFIC CAPITAL BANCORP FORM 10-K FOR
THE FISCAL YEAR ENDED DECEMBER 31, 2001

Exhibit

Number	Description *
3.	Articles of Incorporation and Bylaws:

3.1 Certificate of Restatement of Articles of Incorporation of Pacific Capital Bancorp dated January 27, 1999. (1)

3.2 Certificate of Determination for the Series A Preferred Stock of Pacific Capital Bancorp (incorporated by reference to Exhibit 3(b) to Pacific Capital Bancorp's Registration Statement on Form S-4 (Registration No. 333-36298) filed May 4, 2000).

3.3 Amended and Restated Bylaws of Pacific Capital Bancorp effective April 25, 2000. (7)

4. Instruments Defining the Rights of Security Holders, including indentures

4.1 Stockholders Rights Agreements, dated as of December 14, between Pacific Capital Bancorp and Norwest Bank Minnesota, N.A., as Rights Agent (incorporated by reference to Exhibit 1 to Pacific Capital Bancorp's Registration Statement on Form 8-A dated December 14, 1999).

Note: No long-term debt instruments issued by the Company or any of its consolidated subsidiaries exceeds 10% of the consolidated total assets of the Company and its subsidiaries. In accordance with paragraph 4(iii) of Item 601 of Regulation S-K, the Company will furnish to the Commission upon request copies of long-term debt instruments and related agreements.

10. Material contracts:

10.1 Compensation Plans and Agreements:

10.1.1 Pacific Capital Bancorp Amended and Restated Restricted Stock Plan as amended effective April 25, 2000. (3)

10.1.1.1 Pacific Capital Bancorp Restricted Stock Option Agreement (Incentive Stock Option). (2)

10.1.1.2 Pacific Capital Bancorp Restricted Stock Option Agreement (Nonstatutory Stock Option - 5 Year). (2)

10.1.1.3 Pacific Capital Bancorp Restricted Stock Option Agreement (Nonstatutory Stock Option - 10 Year). (2)

10.1.1.4 Pacific Capital Bancorp Restricted Stock Option Agreement (Incentive Reload Option). (2)

10.1.1.5 Pacific Capital Bancorp Restricted Stock Option Agreement (Non-statutory Reload Option). (2)

10.1.2 Pacific Capital Bancorp Directors Stock Option Plan (incorporated by reference to Exhibit 4.2 to Post-Effective Amendment No. One to Santa Barbara Bancorp's Registration Statement on Form S-8 (Registration No. 33-48724), filed on June 13, 1995).

10.1.3 Pacific Capital Bancorp Incentive & Investment and Salary Savings Plan, as amended and restated effective January 1, 1998. (6)

10.1.4 Pacific Capital Bancorp Employee Stock Ownership Plan and Trust, as amended and restated effective January 1, 1998. (6)

10.1.5 Santa Barbara Bank & Trust Key Employee Retiree Health Plan incorporated by reference to Exhibit 10.1.8 to Santa Barbara Bancorp's Annual Report on Form 10-K (File No. 0-11113) for fiscal year ended December 31, 1993).

10.1.5.1 First Amendment to Santa Barbara Bank & Trust Key Employee Retiree Health Plan. (4)

10.1.5.2 Second Amendment to Santa Barbara Bank & Trust Key Employee Retiree Health Plan. (4)

10.1.6 Santa Barbara Bank & Trust Retiree Health Plan (Non-Key Employees) (incorporated by reference to Exhibit 10.1.9 to Santa Barbara Bancorp's Annual Report on Form 10-K (File No. 0-11113) for the fiscal year ended December 31, 1993).

10.1.6.1 First Amendment to Santa Barbara Bank & Trust Retiree Health Plan (Non-Key Employees). (4)

10.1.6.2 Second Amendment to Santa Barbara Bank & Trust Retiree Health Plan (Non-Key Employees). (4)

10.1.7 Trust Agreement of Santa Barbara Bank & Trust Voluntary Beneficiary Association. (4)

10.1.7.1 First Amendment to Trust Agreement of Santa Barbara Bank & Trust Voluntary Beneficiary Association. (3)

10.1.8 Pacific Capital Bancorp, Amended and Restated, 1996 Directors Stock Plan, as amended April 25,2000. (8)

10.1.8.1 Pacific Capital Bancorp 1996 Directors Stock Option Agreement. (2)

10.1.8.2 Pacific Capital Bancorp 1996 Directors Stock Option Agreement (Reload Option). (2)

10.1.9 Pacific Capital Bancorp Directors' Stock Option Plan and Form of Stock Option Agreement (incorporated by reference to Exhibit 10.25 to Pacific Capital Bancorp's Annual Report on Form 10-K (File No. 0-13528) for the fiscal year ended December 31, 1991).

10.1.10 Pacific Capital Bancorp 1984 Stock Option Plan and Forms of Agreements as amended to date (incorporated by reference to Exhibit 10.27 to Pacific Capital Bancorp's Annual Report on Form 10-K (File No. 0-13528) for the fiscal year ended December 31, 1991).

10.1.11 Pacific Capital Bancorp 1994 Stock Option Plan, as amended, and Forms of Incentive and Non-Qualified Stock Option Agreements (incorporated by reference to Exhibit 4 to Pacific Capital Bancorp's Amendment No. 1 to Registration Statement on Form S-8 (Registration No. 33-83848) filed on November 15, 1994).

10.1.12 Pacific Capital Bancorp Management Retention Plan as amended through January 11, 1999. (6)

10.1.13 Pacific Capital Bancorp Deferred Compensation Plan dated December 15, 1999. (9)

10.1.13.1 Trust Agreement under Pacific Capital Bancorp Deferred Compensation Plan dated December 15, 1999. (9)

10.2 Consolidated Agreement dated December17, 1991 by and between First National Bank of Central California and Unisys with Equipment Sale Agreement, Software License Agreement and Product License Agreement by and between First National Bank of Central California and Information Technology, Inc. (5)

21. Subsidiaries of the registrant **

23. Consents of Experts and Counsel

23.1 Consent of Arthur Andersen LLP with respect to financial statements of the Registrant **

23.2 Consent of Deloitte & Touche LLP with respect to financial statements of San Benito Bank - statements not presented separately **

Shareholders may obtain a copy of any exhibit by writing to:

Carol Kelleher, Corporate Services Administrator
Pacific Capital Bancorp
P.O. Box 60839
Santa Barbara, CA 93160

* Effective December 30, 1998, Santa Barbara Bancorp and Pacific Capital Bancorp merged and, contemporaneously with effectiveness of the merger, Santa Barbara Bancorp, the surviving entity, changed its corporate name to Pacific Capital Bancorp. Documents identified as filed by Santa Barbara Bancorp prior to December 30, 1998 were filed by Santa Barbara Bancorp (File 0-11113). Documents identified as filed by Pacific Capital Bancorp prior to December 30, 1998 were filed by Pacific Capital Bancorp as it existed prior to the merger (File No. 0-13528).

** Filed herewith.

The Exhibits listed below are incorporated by reference to the specified filing.

(1) Filed as Exhibits 4.1 and 4.2 to the Registration Statement on Form S-8 of Pacific Capital Bancorp (Registration No. 333-74831) filed March 18,

1999.

(2) Filed as Exhibits 10.1.1 through 10.1.1.5 and 10.1.10 through 10.1.10.2 to Annual Report on Form 10-K of Santa Barbara Bancorp (File No.0-11113) for fiscal year ended December 31, 1996.

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(3) Filed as an Exhibit to Annual Report on Form 10-K of Santa Barbara Bancorp (File No.0-11113) for fiscal year ended December 31, 1995.

(4) Filed as an Exhibit to Annual Report on Form 10-K of Santa Barbara Bancorp (File No.0-11113) for the fiscal year ended December 31, 1997.

(5) Filed as Exhibits 10.23 through 10.34 to the Annual Report of Pacific Capital Bancorp on Form 10-K (File No. 0-13528) for the fiscal year ended December 31, 1991.

(6) Filed as an Exhibit to the Annual Report on Form 10-K of Pacific Capital Bancorp (File No. 0-11113) for the fiscal year ended December 31, 1998.

(7) Filed as Exhibit 3.2 to the Quarterly Report on Form 10-Q of Pacific Capital Bancorp (File No. 0-11113) for the fiscal quarter ended June 30, 2000.

(8) Filed as Exhibit 10.1.9 to the Quarterly Report on Form 10-Q of Pacific Capital Bancorp (File No. 0-11113) for the fiscal quarter ended June 30, 2000.

(9) Filed as Exhibits 10.1.13 and 10.1.13.1 to the Annual Report on Form 10-K of Pacific Capital Bancorp (File No. 0-01113) for the fiscal quarter ended December 31, 2001.

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