PACIFIC CAPITAL BANCORP /CA/
Form 10-Q
May 10, 2012
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended March 31, 2012

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from ______ to ______

COMMISSION FILE NUMBER NO: 001-35026

(Exact Name of Registrant as Specified in its Charter)

Delaware	**95-3673456**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
1021 Anacapa St.	**93101**
Santa Barbara, California	
(Address of principal executive offices)	**(Zip Code)**

(805) 564-6405

(Registrant s telephone number, including area code)

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 whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer , accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

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

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

Number of shares of common stock of the registrant outstanding as of April 30, 2012: 32,940,093

Table of Contents

TABLE OF CONTENTS

Table of Contents

PART I - Financial Information

Forward-Looking Statements

This Quarterly Report on Form 10-Q (Form 10-Q) contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Pacific Capital Bancorp (the Company or PCBC) intends such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements in these provisions. All statements, other than statements of historical fact, are forward-looking statements for purposes of federal and state securities laws, including, but not limited to, statements about anticipated future operating and financial performance, financial position and liquidity, business prospects, strategic alternatives, business strategies, regulatory and competitive outlook, investment and expenditure plans, capital and financing needs and availability, acquisition and divestiture opportunities, plans and objectives of management for future operations, and other similar forecasts and statements of expectation and statements of assumptions underlying any of the foregoing. Words such as will likely result, aims, anticipates, believes, could, estimates, expects, hopes, intends, may, plans, projects, seeks, should, will, and variations of these words and similar expressions are intended to identify these forward-looking statements.

Forward-looking statements are based on the Company s current expectations and assumptions regarding its business, the regulatory environment, the economy and other future conditions. Because forward-looking statements relate to the future, they are subject to inherent uncertainties, risks and changes in circumstances that are difficult to predict. The Company s actual results may differ materially from those contemplated by the forward-looking statements. The Company cautions the reader of these statements therefore against relying on any of these forward-looking statements. They are neither statements of historical fact nor guarantees or assurances of future performance. Important factors that could cause actual results to differ materially from those in the forward-looking statements include, but are not limited to, the following:

- *Inability to continuously satisfy the requirements of the Operating Agreement dated September 2, 2010, by and between Santa Barbara Bank & Trust, N.A. (the Bank) and the Office of the Comptroller of the Currency;*
- *Inability to continuously satisfy the requirements of the Written Agreement dated May 11, 2010, by and between the Company and the Federal Reserve Bank of San Francisco, and any further regulatory actions;*
- *Inability to close the proposed merger with UnionBanCal Corporation (UNBC) when expected or at all because required regulatory or other approvals and other conditions to closing are not received or satisfied on a timely basis or at all;*
- *Reputational risks and the reaction of the Company s customers and employees to the proposed merger;*
- *Diversion of the Company s resources and Management s time and focus on merger-related issues;*
- *Inability to generate assets on acceptable terms or at all;*
- *Management s ability to effectively execute the Company s business plan;*
- *Inability to raise additional capital, if and when necessary, on acceptable terms or at all;*

- *Inability to receive dividends from the Bank;*

- *Costs and effects of legal and regulatory developments, including the resolution of legal proceedings or regulatory or other governmental inquiries, and the results of regulatory examinations or reviews;*

- *Changes in capital classification;*

- *The impact of current economic conditions and the Company s results of operations on its ability to borrow additional funds to meet its liquidity needs;*

3

Table of Contents

- *Local, regional, national and international economic conditions and events and the impact they may have on the Company and its clients;*
- *Changes in the economy affecting real estate values;*
- *Inability to attract and retain deposits;*
- *Changes in the level of non-performing assets and charge-offs;*
- *Changes in estimates of future reserve requirements based upon the periodic review thereof under relevant regulatory and accounting requirements;*
- *Changes in the financial performance and/or condition of the Bank s borrowers;*
- *Effect of additional provision for loan losses;*
- *Long term negative trends in the Company s market capitalization;*
- *Effects of any changes in trade and monetary and fiscal policies and laws, including the interest rate policies of the Board of Governors of the Federal Reserve System;*
- *Inflation, interest rate, cost of funds, securities market and monetary fluctuations;*
- *Political instability;*
- *Acts of war or terrorism, natural disasters such as earthquakes or fires, or the effects of pandemic flu;*
- *The timely development and acceptance of new products and services and perceived overall value of these products and services by users;*
- *Changes in consumer spending, borrowings and savings habits;*
- *Technological changes, including the implementation of new systems;*
- *Changes in the Company s organization, management, compensation and benefit plans;*

- *Competitive pressures from other financial institutions;*
- *Continued consolidation in the financial services industry;*
- *Inability to maintain or increase market share and control expenses;*
- *Impact of reputational risk on such matters as business generation and retention, funding and liquidity;*
- *Rating agency downgrades;*
- *Continued volatility in the credit and equity markets and its effect on the general economy;*
- *Effect of changes in laws and regulations (including the implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010) and other changes in laws concerning banking, taxes and securities with which the Company and its subsidiaries must comply;*

Table of Contents

- *Effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board and other accounting standard setters;*

- *Other factors that are described under the heading Risk Factors in the Company s Annual Report on Form 10-K for the year ended December 31, 2011 (the 2011 Form 10-K); and*

- *The Company s success at managing the risks involved in the foregoing items.*

Forward-looking statements speak only as of the date they are made, and the Company does not undertake to update forward-looking statements to reflect circumstances or events that occur after the date the forward-looking statements are made, whether as a result of new information, future developments or otherwise, except as may be required by law.

Definition of Terms

Specific accounting and banking industry terms and acronyms used throughout this document are defined in the glossary on pages 93 through 95.

Table of Contents

ITEM 1. FINANCIAL STATEMENTS

Pacific Capital Bancorp and Subsidiaries

CONSOLIDATED BALANCE SHEETS (unaudited)

(dollars and shares in thousands, except per share amounts)

	000000000000 March 31, 2012	*000000000000 December 31, 2011*
ASSETS		
Cash and due from banks	$ 45,189	$ 49,324
Interest bearing demand deposits in other financial institutions	147,774	173,408
Cash and cash equivalents	192,963	222,732
Investment securities available for sale	1,441,033	1,503,425
Loans held for sale	3,996	3,072
Loans held for investment	3,746,469	3,660,961
Allowance for loan and lease losses	(6,272)	(5,528)
Net loans held for investment	3,740,197	3,655,433
Premises and equipment, net	82,796	75,749
FHLB stock and other investments	73,757	76,356
Goodwill and other intangible assets	87,456	89,255
Other assets	223,376	224,000
TOTAL ASSETS	$ 5,845,574	$ 5,850,022
LIABILITIES		
Deposits		
Noninterest bearing	$ 1,120,826	$ 1,175,532
Interest bearing	3,467,574	3,441,508
Total deposits	4,588,400	4,617,040
Securities sold under agreements to repurchase	315,099	315,919
Other borrowings	71,744	66,524
Other liabilities	82,775	88,569
TOTAL LIABILITIES	5,058,018	5,088,052
SHAREHOLDERS EQUITY		
Common stock ($0.001 par value; 50,000 authorized; 32,905 and 32,905 shares issued and outstanding at March 31, 2012, and December 31, 2011, respectively)	33	33
Paid in capital	651,524	651,066
Retained earnings	112,904	96,266
Accumulated other comprehensive income	23,095	14,605
TOTAL SHAREHOLDERS EQUITY	787,556	761,970
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$ 5,845,574	$ 5,850,022

The accompanying notes are an integral part of these Consolidated Financial Statements.

Table of Contents

Pacific Capital Bancorp and Subsidiaries

CONSOLIDATED STATEMENTS OF OPERATONS (unaudited)

(dollars and shares in thousands, except per share amounts)

	Three Months Ended March 31, 2012	Three Months Ended March 31, 2011
Interest income		
Loans	$ 58,170	$ 59,763
Investment securities	7,722	6,096
Other	491	622
TOTAL INTEREST INCOME	66,383	66,481
Interest expense		
Deposits	5,418	7,106
Securities sold under agreements to repurchase	2,463	2,102
Other borrowings	834	2,976
TOTAL INTEREST EXPENSE	8,715	12,184
NET INTEREST INCOME	57,668	54,297
Provision for loan losses	835	1,667
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	56,833	52,630
Noninterest income		
Service charges and fees	5,636	5,751
Trust and investment advisory fees	5,311	5,335
Loss on securities, net	(13)	(4)
Other	3,001	1,783
TOTAL NONINTEREST INCOME	13,935	12,865
Noninterest expense		
Salaries and employee benefits	24,810	22,947
Net occupancy expense	6,258	5,676
Other	22,068	19,640
TOTAL NONINTEREST EXPENSE	53,136	48,263
INCOME BEFORE INCOME TAX EXPENSE	17,632	17,232
Income tax expense	994	472
NET INCOME	$ 16,638	$ 16,760
Earnings per share:		
Basic	$ 0.51	$ 0.51
Diluted	$ 0.50	$ 0.51
Weighted average number of common shares outstanding:		
Basic	32,905	32,903
Diluted	32,948	32,909

The accompanying notes are an integral part of these Consolidated Financial Statements.

Table of Contents

Pacific Capital Bancorp and Subsidiaries

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (unaudited)

(dollars in thousands)

	Three Months Ended March 31,	
	2012	*2011*
NET INCOME	$ 16,638	$ 16,760
Unrealized gain on investment securities - AFS	8,477	279
Realized loss on sale of investment securities - AFS included in net income	13	4
Total other comprehensive income	8,490	283
TOTAL COMPREHENSIVE INCOME	$ 25,128	$ 17,043

The accompanying notes are an integral part of these Consolidated Financial Statements.

Table of Contents

Pacific Capital Bancorp and Subsidiaries

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY (unaudited)

(dollars and shares in thousands)

	Common Stock			Accumulated Other		Total
	Shares	*Amount*	*Paid in Capital*	*Comprehensive (Loss)/Income*	*Retained Earnings*	*Shareholders Equity*
Balance, December 31, 2010	32,901	$ 33	$ 650,010	$ (33,104)	$ 25,744	$ 642,683
Net income					16,760	16,760
Unrealized gain on AFS securities				279		279
Realized loss on sales and calls of AFS securities included in earnings				4		4
Restricted stock activity (1)	2		(8)			(8)
Balance, March 31, 2011	32,903	$ 33	$ 650,002	$ (32,821)	$ 42,504	$ 659,718
Balance, December 31, 2011	32,905	$ 33	$ 651,066	$ 14,605	$ 96,266	$ 761,970
Net income					16,638	16,638
Unrealized gain on AFS securities				8,477		8,477
Realized loss on calls of AFSsecurities included in earnings				13		13
Stock option compensation			91			91
Restricted stock activity (1)			367			367
Balance, March 31, 2012	32,905	$ 33	$ 651,524	$ 23,095	$ 112,904	$ 787,556

(1) The amount recognized as compensation expense related to restricted stock awards for the three months ended March 31, 2012, and 2011, was $367,000, and $0, respectively.

The accompanying notes are an integral part of these Consolidated Financial Statements.

Table of Contents

Pacific Capital Bancorp and Subsidiaries

CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

(dollars in thousands)

	Three Months Ended March 31,	
	2012	*2011*
OPERATING ACTIVITIES:		
Net income	$ 16,638	$ 16,760
Adjustments to reconcile net income to net cash (used in)/provided by operating activities:		
Provision for loan losses	835	1,667
Depreciation, amortization and accretion	2,818	2,899
Accretion of PCI Term Pools	(43,412)	(51,617)
Stock-based compensation	458	
Net amortization of discounts and premiums for investment securities - AFS	864	1,725
Gains on sale of assets	(1,950)	(2,498)
Loans originated for sale, net of principal collections	(502)	15,162
Collection of taxes receivable	1,757	50,050
Changes in:		
Other assets	2,287	2,715
Other liabilities	(521)	(2,866)
NET CASH (USED IN)/ PROVIDED BY OPERATING ACTIVITIES	(20,728)	33,997
INVESTING ACTIVITIES:		
Proceeds from loan sales		3,298
Loans originated for investment, net of principal collections	35,169	165,579
Purchase of loans held for investment	(89,886)	(178,932)
Proceeds from sale of investment securities - AFS		2,386
Principal pay downs, calls and maturities of investment securities - AFS	70,005	50,217
Purchase of investment securities - AFS		(96,452)
Proceeds from sale of low income housing tax credit partnerships, net	3,777	
Purchase of premises and equipment, net	(9,517)	(2,120)
Proceeds from redemption of FHLB stock	2,596	2,571
Proceeds from sale of OREO, net	6,240	12,107
NET CASH PROVIDED BY/(USED IN) INVESTING ACTIVITIES	18,384	(41,346)

(continued on next page)

Table of Contents

Pacific Capital Bancorp and Subsidiaries

CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

(dollars in thousands)

(continued)

	Three Months Ended March 31,	
	2012	***2011***
FINANCING ACTIVITIES:		
Decrease in deposits, net	(27,425)	(151,882)
Decrease in short term borrowings, net		(2,295)
Repayment of long term debt and other borrowings		(790)
Other, net		(8)
NET CASH USED IN FINANCING ACTIVITIES	(27,425)	(154,975)
DECREASE IN CASH AND CASH EQUIVALENTS	(29,769)	(162,324)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	222,732	495,864
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 192,963	$ 333,540
SUPPLEMENTAL DISCLOSURE OF CASH FLOWS INFORMATION:		
Cash paid during the period for		
Interest	$ 8,903	$ 12,250
Income taxes	3,025	2,266
Non-cash investing activity:		
Net transfers from loans held for investment to loans held for sale		2,811
Transfers to OREO	12,816	10,973

The accompanying notes are an integral part of these Consolidated Financial Statements.

Table of Contents

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

Pacific Capital Bancorp is a bank holding company organized under the laws of the state of Delaware. The Company provides a full range of commercial and consumer banking services to households, professionals, and businesses through its wholly-owned subsidiary Santa Barbara Bank & Trust, National Association (SBB&T). These banking services include depository, lending and wealth management services. The Bank s lending products include commercial and industrial (commercial), consumer, commercial and residential real estate loans and Small Business Administration (SBA) loans. Depository services include checking, interest bearing checking (NOW), money market demand accounts (MMDA), savings, and certificate of deposit (CD) accounts, as well as safe deposit boxes, travelers checks, money orders, foreign exchange services, and cashier s checks. The Bank also offers a wide range of wealth management services through a full service trust operation and two registered investment advisors that are wholly-owned subsidiaries, Morton Capital Management (MCM) and R.E. Wacker Associates (REWA). The Bank conducts its banking in the counties of Santa Barbara, Ventura, Los Angeles, Monterey, San Luis Obispo, Santa Clara, Santa Cruz, and San Benito.

Basis of Presentation

The accompanying Consolidated Financial Statements of PCBC are unaudited and, in the opinion of Management, include all adjustments necessary for a fair statement of the Company s financial position and results of operations for the periods presented. All inter-company balances and transactions are eliminated in consolidation.

The Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and footnotes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2011, also referred to as the 2011 Form 10-K. The accompanying unaudited Consolidated Financial Statements and related footnotes have been prepared in accordance with generally accepted accounting principles in the United States (GAAP) for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X and conform to practices within the financial services industry. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. The results of operations, for the three months ended March 31, 2012, are not necessarily indicative of the results to be expected for the fiscal year ending December 31, 2012. The Consolidated Financial Statements refer to Management within the disclosures. The Company s definition of Management is the executive management team of the Company and its subsidiaries.

The preparation of financial statements in conformity with GAAP requires Management to make estimates and assumptions that affect the amount of assets and liabilities as well as disclosures of contingent assets and liabilities at the date of the financial statements. Although Management believes these estimates to be reasonably accurate, actual amounts may differ. In the opinion of Management, all adjustments considered necessary have been reflected in the financial statements during their preparation. Certain amounts in the 2011 Consolidated Financial Statements have been reclassified to be comparable with classifications used in the 2012 Consolidated Financial Statements.

Recent Developments

On March 12, 2012, the Company announced that it had entered into a Merger Agreement with UnionBanCal Corporation (the Merger Agreement). Pursuant to the Merger Agreement, each outstanding share of the Company s common stock will be converted into the right to receive cash in the amount of $46.00 per share upon consummation of the Merger. The acquisition requires approval from banking regulators and is subject to other customary closing conditions, and is expected to be completed in the fourth quarter of 2012.

Table of Contents

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES CONTINUED

Recapitalization through the Investment Transaction and Purchase Accounting

On August 31, 2010, pursuant to the terms of an Investment Agreement (the Investment Agreement), dated as of April 29, 2010, by and among the Company, the Bank and SB Acquisition Company LLC, a wholly-owned subsidiary of Ford Financial Fund, L.P. (the Investor), the Company issued common and preferred stock to the Investor for the aggregate consideration paid to the Company by the Investor of $500 million in cash, herein referred to as the Investment Transaction.

As a result of the Investment Transaction, pursuant to which the Investor acquired and controlled 98.1% of the voting securities of the Company, the Company followed the acquisition or purchase method of accounting as required by the Business Combinations Topic of the Accounting Standard Codification (ASC) Topic 805*, Business Combinations* (ASC 805). Under the rules of the Securities Exchange Commission (SEC) Staff Accounting Bulletin T. 5J, *New Basis of Accounting Required in Certain Circumstances* (SEC SAB T. 5J) or ASC 805-50-S99, the application of push down accounting is required.

Purchase accounting requires that the assets purchased, the liabilities assumed, and noncontrolling interests all be reported in the acquirer s financial statements at their fair value, with any excess of purchase consideration over the net assets being reported as goodwill. Although the $500 million in cash from the Investor was received on August 31, 2010, the purchase accounting adjustments are reflected in the Consolidated Financial Statements after the close of business on August 31, 2010, and herein is referred to as the Transaction Date.

In addition to the new accounting basis established for assets, liabilities and noncontrolling interests, purchase accounting requires the reclassification of any retained earnings from periods prior to the acquisition to be recognized as common share equity and the elimination of any accumulated other comprehensive income (AOCI) or loss and paid in capital within the Company s Shareholders Equity section of the Company s Consolidated Financial Statements. For information regarding the authorized shares and stock issuances related to the Investment Transaction refer to Note 2, Business Combinations Investment Transaction of the Consolidated Financial Statements in the Company s 2011 Form 10-K.

Consolidation of Subsidiaries and Variable Interest Entities

The Company has five wholly-owned subsidiaries: SBB&T, a banking subsidiary, and four unconsolidated subsidiaries used as business trusts in connection with issuance of trust preferred securities as described in Note 15, Segments of these Consolidated Financial Statements.

SBB&T has three wholly-owned consolidated subsidiaries:

¡ MCM and REWA, registered investment advisors that provide investment advisory services to individuals, foundations, retirement plans and select institutional clients; and

¡ PCB Service Corporation, utilized as a trustee of deeds of trust in which SBB&T is the beneficiary.

SBB&T also retains ownership in several low income housing tax credit partnerships (LIHTCP) that generate tax credits. These partnerships are not consolidated into these Consolidated Financial Statements. These investments play a role in meeting SBB&T s Community Reinvestment Act (CRA) requirements as well as providing tax credits to reduce the Company s taxable income. The Company does not have any other entities that should be considered for consolidation.

13

Table of Contents

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES CONTINUED

Recent Accounting Pronouncements

No new accounting pronouncements applicable to the Company were issued during the three months ended March 31, 2012, and the adopted accounting pronouncements during the three months ended March 31, 2012, did not have a material impact to the Consolidated Financial Statements.

Cash Reserve Requirement

All depository institutions are required by law to maintain reserves against their transaction deposits. The Bank s reserves must be held in cash or with the Federal Reserve Bank of San Francisco (Reserve Bank). The amount of the reserve may vary each day as banks are permitted to meet this requirement by maintaining the specified amount as an average balance over a two-week period. In addition, the Bank must maintain sufficient balances to cover the checks written by the Bank s clients that are clearing through the Reserve Bank because they have been deposited at other banks.

Investment Securities

All investment securities are debt securities and are classified as available for sale (AFS). The appropriate classification is determined at the time of purchase. Securities classified as AFS are reported as an asset on the Consolidated Balance Sheets at their estimated fair value. As the fair value of AFS securities changes, the changes are reported (net of income taxes, if applicable) as an element of other comprehensive income (OCI). When AFS securities, specifically identified, are sold, the unrealized gain or loss is reclassified from OCI to noninterest income.

When the estimated fair value of a security is lower than the book value, a security is considered to be temporarily impaired. On a quarterly basis, Management evaluates any securities in a loss position to determine whether the impairment is other-than-temporary. If there is intent to sell the security or if the Company will be required to sell the security or if the Company believes it will not recover the entire cost basis of the security, the security is other-than-temporarily impaired (OTTI) and impairment is recognized. The amount of impairment resulting from credit loss is recognized in earnings and impairment related to all other factors, such as general market conditions, is recognized in OCI.

Management considers a number of factors in its analysis of whether a decline in a security s estimated fair value is an OTTI. Certain factors considered include, but are not limited to: (a) the length of time and the extent to which the security has been in an unrealized loss position, (b) changes in the financial condition of the issuer, (c) the payment structure of debt securities, (d) adverse changes in ratings issued by rating agencies, (e) and the intent and ability of the Company to hold the security for a period of time sufficient to allow for any anticipated recovery in fair value. Interest income is recognized based on the coupon rate, and is increased by the accretion of discounts earned or decreased by the amortization of premiums paid over the contractual life of the security using the effective interest method.

The Bank is a member of both the Reserve Bank and the Federal Home Loan Bank of San Francisco (FHLB), and as a condition of membership in both organizations, it is required to purchase stock. In the case of the Reserve Bank, the amount of stock that is required to be held is based on the Bank s capital. The required ownership of FHLB stock is based on the borrowing capacity used by the Bank. These investments are considered equity securities with no actively traded market. Therefore, the shares are considered restricted investment securities and reported in FHLB stock and other investments in the Consolidated Balance Sheets. Such investments are carried at cost, which is equal to the value at which they may be redeemed. The dividend income received from the stock is reported in interest income.

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS   CONTINUED

NOTE 1.   SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES   CONTINUED

Loans Held for Sale

Periodically, the Company originates or identifies loans it expects to sell prior to maturity. When loans are originated or identified to be sold, they are recorded as held for sale and reported at the lower of cost or fair value with any adjustment for net unrealized losses reported in noninterest income. Generally, the fair value of loans held for sale is based on what secondary markets are currently offering for loans with similar characteristics or based on an agreed upon sales price. A loan s cost basis includes unearned deferred fees and costs, and premiums and discounts. These loans are generally held between 30 to 90 days from their origination date. Due to the short period of time loans are held for sale, deferred fees or expenses are not amortized. Any subsequent decreases in fair value are recognized in noninterest income, and increases in fair value are not recognized until the loans are sold. If a loan has been reported as held for sale and is then determined that it is unlikely to be sold, the loan is reclassified to loans held for investment at the lower of cost or fair value. The majority of loans held for sale by the Company are residential real estate loans. Loans classified as held for sale are disclosed in Note 4, Loans of these Consolidated Financial Statements.

Loans Held for Investment

Loans held for investment, except for Purchased Credit Impaired (PCI) Loan Pools described below, are reported at their outstanding principal balances net of any unearned income, cumulative charge-offs, unamortized deferred fees and costs on originated loans and unamortized premiums or discounts on purchased loans.

Loans originated or purchased since the Transaction Date are included in Loans Held for Investment within these Consolidated Financial Statements and are referred to within these Consolidated Financial Statements as Loans originated or purchased since the Transaction Date. At March 31, 2012, a majority of the loans reported as Loans Held for Investment are in PCI Loan Pools. The accounting for PCI Loan Pools is significantly different from the accounting for loans originated or purchased since the Transaction Date. The accounting policies for the loans originated or purchased since the Transaction Date is covered within this section, while the accounting for PCI Loan Pools is described in the section below called Accounting for PCI Loan Pools.

Interest income on loans originated or purchased since the Transaction Date is accrued daily, except for loans in a nonaccrual status. Loan fees collected for the origination of loans less direct loan origination costs (net deferred loan fees) are amortized over the contractual life of the loan through interest income. If a loan has scheduled payments, the amortization of the net deferred loan fee is calculated using the effective interest method over the contractual life of the loan. If the loan does not have scheduled payments, such as a line of credit, the net deferred loan fee is recognized as interest income on a straight line basis over the contractual life of the loan commitment. Loan fees received for loan commitments are recognized as interest income over the term of the commitment. Premiums and discounts recorded in connection with the purchase of loans are accounted for in a similar manner as net deferred loan fees. Any premium or discount from a loan purchase is recognized in interest income over the life of the contractual life of the loan through interest income. When loans are repaid, any remaining unamortized balances of unearned fees, deferred fees and costs, premiums, and discounts are recognized in interest income.

Unfunded Loan Commitments and Letters of Credit

Letters and lines of credit are commitments to extend credit and standby letters of credit to the Bank s clients. These commitments meet the financing needs of the Bank s clients in the normal course of business and are commitments with off-balance sheet risk since the Bank has committed to issuing funds to or on behalf of clients, but there is no current loan outstanding. Included in unfunded loan commitments are secured and unsecured lines of credit.

Table of Contents

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES CONTINUED

Lines of credit are obligations to lend money to a borrower. Credit risk arises when the borrowers current financial condition may indicate less ability to pay than when the commitment was originally made. Standby letters of credit and financial guarantees are conditional commitments issued by the Company to guarantee the performance of a client to a third party in borrowing arrangements. In the case of standby letters of credit, the risk arises from the possibility of the failure of the client 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 client to repay these funds to the Company with interest. The Company uses the same credit policies in making commitments and conditional obligations as it would for a loan to that client.

The Company has exposure to losses from unfunded loan commitments and letters of credit. Since the funds have not been disbursed on these commitments, they are not reported as loans outstanding. Losses related to these commitments are not included in the Allowance for Loan and Lease Losses (ALLL) reported in Note 6, Allowance for Loan and Lease Losses and Credit Quality of these Consolidated Financial Statements. Instead, they are accounted for as a separate loss contingency or reserve within other liabilities on the Company s Consolidated Balance Sheets. This reserve is discussed within Note 1, Summary of Significant Accounting Policies in a section called Reserve for Off-Balance Sheet Commitments.

Prior to the funding of a loan, the Company may provide an interest rate lock commitment for mortgage loans that will be originated with the intent to sell. The Company may also enter into mandatory delivery contracts, which are loan sale agreements in which the Company has committed to deliver a certain principal amount of mortgage loans to a third party investor at a specified price on or before a specified date. These interest rate lock commitments and mandatory delivery contracts qualify as derivatives under GAAP. The fair value of the interest rate lock commitments is based on the change in interest rates between the date the interest rate lock commitment is executed and the date the loan is funded. The fair value of the mandatory delivery contracts is calculated by comparing the price on the contract accepted date to the price on the actual sale date. The fair value of these derivatives is reported as other assets or other liabilities and changes in the fair values are reflected through noninterest income in the Company s Consolidated Financial Statements.

Accounting for PCI Loan Pools

Loans acquired in a transfer, including business combinations, where there is evidence of credit deterioration since origination and it is probable at the date of acquisition that the acquirer will not collect all contractually required principal and interest payments, are accounted for using the guidance for PCI Loan Pools, which is contained in the ASC 310-30, *Receivables, Loans and Debt Securities Acquired with Deteriorated Credit Quality* (ASC 310-30). In addition, the American Institute of Certified Public Accountants (AICPA) reached an understanding with the SEC that permits an acquirer to elect to account for acquired loans that are not impaired by means of expected cash flows rather than contractual cash flows. This understanding was documented in a letter from the AICPA to the SEC dated December 18, 2009. The Company has elected an accounting policy to apply expected cash flows accounting guidance to all loans subject to the business combination, and push-down accounting requirements for loan portfolios acquired in a business combination, and will herein be referred to as PCI Term Pools.

Some loans that otherwise meet the definition of credit impaired, such as revolving lines of credit, are specifically excluded from the scope of the accounting guidance in ASC 310-30 and are accounted for using ASC 310-20, *Receivables, Nonrefundable Fees and Other Costs* (ASC 310-20). However, Management considers these revolving lines of credit to also be credit impaired and has pooled these revolving lines of credit purchased through the Investment Transaction and herein will refer to these loans as PCI Revolving Pools.

Table of Contents

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES CONTINUED

PCI Term Pools

PCI Term Pools are initially recorded at fair value, and any related ALLL from before the acquisition was reversed. Fair value is determined by estimating the principal and interest cash flows expected to be collected after discounting at the prevailing market rate of interest. The difference between contractual cash flows and expected cash flows, on an undiscounted basis, represents the nonaccretable difference. The difference between undiscounted expected cash flows and discounted expected cash flows represents the accretable yield. The Company s estimate for expected cash flows on PCI Loan Pools takes into consideration estimated prepayments based on the characteristics of the loans contained in each loan pool, and expected charge-offs and recoveries of the PCI Loan Pools. The accretable yield is recognized in interest income over the remaining life of the pool of loans using the effective interest method or cost recovery method if the cash flows are not estimable.

Management elected to aggregate PCI term loans into several pools based on common risk characteristics as allowed under ASC 310-30. Each pool is accounted for as a single asset with a single composite discount rate and an aggregate expectation of cash flows. Both the accretion of interest income and the comparison of actual cash flows to expected cash flows are completed at the pool level rather than on individual loans. PCI term loans may not be removed from a pool, added to a pool, or moved from one pool to another. All activity such as payments, charge-offs, recoveries, and prepayments received are applied to the loan pool in which the loan was placed. Payments in excess of expectations in one pool may not be applied to other pools to avoid the recognition of impairment for deficient payments within another pool. Only the payoff or prepayment by the borrower, foreclosure of the collateral, or charge-off, or disposal of a loan, as a result of sales of loans to third parties, will result in the removal of a loan from a loan pool. When a loan is removed from a pool, it is removed at its carrying amount.

Quarterly, the Company compares actual cash flows to expected cash flows for PCI Term Pools to determine whether actual cash flows are substantially the same as was expected at the time the loans expected cash flows were last estimated. Differences in actual cash flows from that previously expected may result in a revision to the Company s estimate for expected cash flows. If upon reevaluation of expected cash flows the Company determines that as a result of credit deterioration there will be less expected cash flows than previously estimated, an ALLL is established through a charge to the provision for loan losses and an impairment amount is recorded. Other changes in cash flows due to changes in interest rates, certain refinancing activities or prepayments are accounted for prospectively as an adjustment to the discount rate on the pool. If reevaluation of expected cash flows indicates there is a significant and probable increase over that previously expected, the Company would decrease any previously established ALLL, and record an adjustment to interest income through the change in the discount rate used to calculate the accretable yield.

The classification and disclosures are at pool levels regardless of the underlying individual loan performance because at acquisition PCI Term Pools were written down to an amount estimated to be collectible and aggregated into pool levels. PCI Term Pools are not reported as nonaccrual, impaired or troubled debt restructurings (TDRs) even though some of the underlying loans may be contractually past due, on nonaccrual, impaired or TDRs, as the pool is evaluated as a single unit of account. If the Company determines it can no longer reasonably estimate future cash flows for a PCI Term Pool, the Company would cease accretion on such pools.

PCI Revolving Pools

As mentioned above, acquired loans with revolving features are excluded from ASC 310-30. The accounting for purchase discounts on pooled revolving lines of credit is determined in accordance with ASC 310-20. PCI Revolving Pools were recorded at fair value at the Transaction Date, similar to PCI Term Pools, based on expected cash flows, which included estimated losses inherent in those pools at the Transaction Date. A new carrying amount was established for PCI Revolving Pools based on their fair value, which represents its net realizable value. The difference between the carrying value and the net realizable value is the purchase discount.

Table of Contents

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES CONTINUED

Cash flows associated with the PCI Revolving Pools determine the amount of purchase discount that is to be accreted based on when the net realizable value exceeds the net carrying amount. Therefore, the Company only records interest income on these pools based at the contractual rate of the underlying loans, to the extent considered collectible. Management periodically reassesses the net realizable value of each PCI Revolving Pool and records interest income relating to the purchase discount in accordance with ASC 310-20. Such amounts are recognized in income using the effective interest method over the period the revolving line of credit is active, assuming that borrowings are outstanding for the maximum term provided in the loan contract. In the event that credit losses inherent in the portfolio are higher than expectations, the Company records an ALLL to the extent that the carrying value exceeds the amounts expected to be collected.

Unlike PCI Term Pools, accounting guidance requires that disclosures be made on the underlying loans in PCI Revolving Pools even though such loans were recorded at fair value on the Transaction Date. As a result, the underlying loans in PCI Revolving Pools are reported as contractually delinquent, nonaccrual, impaired, or TDRs to the extent applicable.

Allowance for Loan and Lease Losses

Credit risk is inherent in the business of extending loans and leases to borrowers and this risk is addressed through a valuation allowance. The ALLL represents a creditor s estimate of loan losses inherent within the loan portfolio at each balance sheet date and is netted against the outstanding loan balance. The ALLL reduces the carrying amount to the creditor s estimate of what will be collected from borrowers. The ALLL is established through charges to current period earnings by recording a provision for loan losses. When losses become specifically identifiable and quantifiable, the loan balance is reduced through recording a charge-off against the ALLL. Should payments be received on charged-off loans, the payment is credited to the ALLL as a recovery.

Loan charge-offs are generally processed by policy and regulatory guidance. Secured consumer loans, including residential real estate loans, that are 120 days past due are written down to the fair value of the collateral. Unsecured consumer loans are charged-off once the loan is 120 days past due. Decisions on when to charge-off commercial loans and loans secured by commercial real estate are made on an individual basis rather than length of delinquency, though it is a factor in the decision. The financial resources of the borrower and/or guarantor and the nature and value of any collateral are other factors considered such as if the loan is for business purposes or to a consumer.

The purchase accounting guidance for business combinations significantly impacted the Company s ALLL as of the Transaction Date. The revaluation of assets required by this accounting guidance resulted in all loans being reported at their fair value as of the Transaction Date. The fair value is presumed to take into account the contractual payments on loans that are not expected to be received, and consequently no ALLL was carried over for the Company s loans as of the Transaction Date. In accordance with purchase accounting guidance, charge-offs and recoveries related to loans within PCI Term Pools and PCI Revolving Pools are not to be recorded through the ALLL. Instead, charge-offs and recoveries related to PCI Loan Pools are recorded against the purchase accounting adjustment for loans in the PCI Term Pools, and against the purchase discount for loans within PCI Revolving Pools. ALLL is comprised of the Company s estimate of losses inherent in loans originated or purchased since the Transaction Date; the differential between current expected cash flows and prior expected cash flows for PCI Term Pools when current expected cash flows are less than prior expected cash flows as a result of credit deterioration; and the amount of credit losses inherent in PCI Revolving Pools in excess of the net realizable value.

Table of Contents

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS   CONTINUED

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES   CONTINUED

Credit risk grades are assigned to all loans for the overall monitoring of credit risk within the loan portfolio. For PCI Loan Pools, the individual loans within each pool are assigned a credit grade but, then are aggregated to review the total credit risk of each pool which then monitored by Management for each loan pool and monitoring of expected cash flows. For loans originated or purchased since the Transaction Date, credit risk grades are monitored by Management on a loan by loan basis.

Portfolio Segments

When the Company s credit administration department reviews and updates credit risk rating for loans, there are two main groups or portfolio segments; Commercial Loans and Consumer Loans. The risk characteristics and approaches to reviewing credit risk for each portfolio segment are described in the following paragraphs.

Commercial Loans

Commercial loans consist of multifamily loans, commercial real estate loans, construction loans, and commercial lines of credit. Such loans are made primarily to borrowers to provide financing for the acquisition of or development of commercial properties, including the construction of single family, multifamily, and multi-unit commercial properties. Commercial loans are subject to underwriting standards and processes specific to the risks related to each credit, including but not limited to: geographic location of the project, and/or operations of the borrower, financial condition of the borrower and/or guarantor(s), debt service coverage analyses, and knowledge of local economic conditions. Risks associated with commercial loans are largely related to general economic conditions, changes in, and sustainability of cash flows for the underlying business servicing the obligation, declines in collateral values for collateral dependent loans, and in the case of certain construction loans, the ability of the borrower to obtain longer-term financing. The Company mitigates and monitors risk associated with such loans through its internal review and risk grading process, making loans to in-market borrowers, controlling loan structure, and monitoring the financial conditions of the underlying businesses/borrowers.

Credit risk grades for large problem loans in the commercial loan portfolio are reviewed quarterly, at a minimum. A credit risk grade for a commercial loan is assessed and will generally require a credit risk grade change when the following events occur:

- New credit requests;
- Loan renewals;
- Review of borrower financial statements or non-receipt of borrower financial statements when requested;
- Appearance on delinquency reports;
- Outside credit inquires;
- Identified facts demonstrate change in risk of nonpayment;

- Historical payment experience;
- Current economic trends;
- Emerging industry problems; and/or
- Contact with borrower provides new credit information.

Table of Contents

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES CONTINUED

Consumer Loans

Consumer loans consist largely of residential and revolving 1 to 4 family loans, and consumer installment loans. The majority of the consumer portfolio is comprised of financing for single family dwellings, which are predominately owner-occupied. Such loans are typically made based on the borrower s financial condition, credit scores, debt-to-income ratios, and the type, location, and value of the underlying collateral. Risks associated with such loans are primarily related to general economic conditions, including the level of unemployment, and declines in the value of the underlying collateral. Consumer loans made for purposes other than for the financing of residential real estate are typically secured and unsecured shorter term loans made to borrowers for various purposes, including automobile and recreational vehicle purchases, and personal liquidity needs. Risks associated with such loans are primarily dependent on general economic conditions, which influence the financial condition of the borrower and their ability to repay the loan, or a shortfall in the collateral value in the event of default by the borrower. The Company primarily makes such loans to in-market borrowers, and bases lending decisions on factors related to the financial condition of the borrower. Risks associated with these loans are mitigated in part by the smaller amount of the individual loans spread across many borrowers.

A credit risk grade in the consumer loan portfolio is assessed and will generally require a grade change when the following events occur:

- New credit requests;
- Deterioration of credit score;
- Loan renewals;
- Appearance on delinquency reports;
- Identified facts demonstrate change risk of nonpayment;
- Historical payment experience; and/or
- Contact with borrower provides new credit information.

The change in a borrower s credit risk grade is not limited to this list. Quarterly, the Company s credit administration department obtains a credit score refreshment report which assesses consumer loan borrowers credit scores to identify borrowers who could have a deterioration of credit score which would trigger a credit risk grade change. Once a credit risk grade is assessed for a loan, its classification is determined based on the expectation of repayment. Nonclassified loans generally include those loans that are expected to be repaid in accordance with contractual loan terms. Classified loans are those loans that are classified as substandard or doubtful consistent with regulatory guidelines as described below.

Table of Contents

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES CONTINUED

Loans Classified as Substandard

A substandard loan is a loan which is inadequately protected by a current sound worth and paying capacity of the borrower or the collateral pledged, if any. The extension of credit has a well-defined weakness and/or the Company identifies a distinct possibility that a loss will be incurred if the deficiency identified is not corrected. When a loan is classified as substandard it does not necessarily imply there is a loss exposure in a specific loan, but a loss potential does exist.

Loans Classified as Doubtful

Loans classified as doubtful have all of the weaknesses inherent in a loan classified as substandard with an added characteristic that the weaknesses make the collection or liquidation, in full, highly questionable and improbable, on the basis of currently existing facts, conditions, and values. After reviewing the credit risk ratings in the loan portfolio, the second step is to develop an estimate of the loss inherent in individual loans or groups of similar loans. The estimation of probable losses takes into consideration the loan credit risk ratings and other factors such as:

- Loan balances;
- Loan pool segmentation;
- Historical loss analysis;
- Identification, review, and valuation of impaired loans;
- Changes in the economy impacting lending activities;
- Changes in the concentrations of various loan types;
- Changes in the growth rate or volume of lending activities;
- Changes in the trends for delinquent and problem loans;
- Changes in the control environment or procedures;

- Changes in the management and staffing effectiveness;
- Changes in the loan review effectiveness;
- Changes in the underlying collateral values of loans;
- Changes in the competition/regulatory/legal issues;
- Unanticipated events; and
- Changes and additional valuation for structured financing and syndicated national credits.

The amount of the allowance recorded at the end of the prior reporting period is then compared with the new estimate of inherent loss. If additional allowance is required to cover the revised estimate, the additional amount is provided through a charge to provision for loan losses. If the recorded allowance is higher than the revised estimate, the allowance is reduced by a negative provision for loan losses.

Table of Contents

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES CONTINUED

When reviewing cash flows for PCI Loan Pools, Management makes a determination whether the estimate of expected cash flows from these loans needs revision. This determination is based on actual cash flows received, general market conditions, and any information available about borrowers and their financial condition that would lead Management to conclude that expected cash flows will be substantially different from what was previously estimated. Of the factors noted above for PCI Loan Pools, those that relate specifically to the borrower, to the economy, and to credit deterioration seen for similar borrowers or similar businesses or industries will be most relevant.

As is indicated in the section above for PCI Loan Pools, the Company aggregated all of these loans into pools with similar risk characteristics that became the individual units of accounting. The estimates of expected cash flows are therefore calculated at the pool level. An unfavorable change in the estimate of expected cash flows due to credit may require the recognition of impairment by establishing an ALLL on a pool by pool basis. A favorable change in the estimate of expected cash flows would result in reversing any allowance previously established allowance due to an unfavorable change, but no negative allowance is recorded if the favorable change exceeds any previously recorded allowance. The excess expected cash flows are accreted into income over the remaining estimated terms of the loans in the pool. Additional information on the ALLL is provided in Note 6, Allowance for Loan and Lease Losses and Credit Quality of these Consolidated Financial Statements.

ALLL Model Methodology

The Company considers both quantitative and qualitative factors when determining the level of estimated ALLL. Quantitative factors are based primarily on historical credit losses for each portfolio of similar loans over a time horizon or look-back period. The Company generally uses historical credit losses over the past six quarters as a basis for its quantitative factors. The look-back period has been the past six quarters since the second quarter of 2009, when Management shortened the timeframe to better capture current risk conditions. The shorter time frame, coupled with less reliance on qualitative factors, was determined to be more responsive to the increasing risk seen in economic conditions and rapidly deteriorating real estate collateral values over the last few years.

Qualitative factors are generally used to adjust historical loss rates based on the Company s estimate of the losses inherent in the outstanding balance of the loan portfolio that are not fully captured by the quantitative factors alone. Qualitative factors taken into consideration in calculations of the ALLL include: concentrations of types of loans, loan growth, control environment, delinquency and classified loan trends, Management and staffing experience and turnover, economic conditions, results of independent loan review, underlying collateral values, competition, regulatory, legal issues, structured finance and syndicated national credits, and other factors. These qualitative factors are applied as adjustments to the historical loss rates when Management believes they are necessary to better reflect current conditions.

Nonaccrual Loans, Impaired Loans, and Restructures of Troubled Debt

As discussed above in the PCI Loan Pools section, the accounting for PCI loans has implications for classification and reporting disclosures of loans classified as nonaccrual, impaired, or TDRs. Because the Company s loans were written down to fair value and pooled as of the Transaction Date, the carrying amount of these loans in the Company s Consolidated Financial Statements is based upon amounts estimated to be collected. PCI Term Pools are not classified as nonaccrual, impaired or TDRs even though some of the underlying loans may be contractually past due, nonperforming, or restructured as TDRs. PCI Term Pools are accounted for and reported as a single unit of account, based on expectations for future cash flows, in accordance with ASC 310-30, and therefore the performance of the underlying loans within PCI Term Pools are not reported in the Company s Consolidated Financial Statements.

Table of Contents

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES CONTINUED

The reporting for PCI Revolving Pools differs from that of PCI Term Pools, because the accounting and reporting for such loans is not within the scope of ASC 310-30, and therefore the underlying loans are required to be reported and accounted for as delinquent, nonaccrual, impaired or TDR. Quarterly, PCI Loan Pools are assessed for the overall collectability of the expected cash flows on a pool by pool basis.

For all loans originated or purchased since the Transaction Date, when an individual borrower discontinues making payments as contractually required by the note, the Company must determine whether it is appropriate to continue to accrue interest. Generally, the Company places loans in a nonaccrual status and ceases recognizing interest income when the loan has become delinquent by 90 days or more and/or when Management determines that the repayment of principal and collection of interest is unlikely. The Company may decide that it is appropriate to continue to accrue interest on certain loans 90 days or more delinquent if they are well secured by collateral and collection is in process.

When a loan is placed on nonaccrual status, any accrued but uncollected interest for the loan is reversed out of interest income in the period in which the status is changed. Subsequent payments received from the client are applied to principal and no further interest income is recognized until the principal has been paid in full or until circumstances have changed such that payments are again consistently received as contractually required. In the case of commercial clients, the pattern of payment must also be accompanied by a positive change in the financial condition of the borrower.

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. However, there are some loans that are termed impaired because of doubt regarding collectability of interest and principal according to the contractual terms, which are both fully secured by collateral and are current in their interest and principal payments. Once a loan is identified as impaired, the amount of any impairment is determined based on the extent to which the Company s recorded investment in the loan exceeds the loan s estimated fair value. The Company determines an impaired loan s fair value based on either the present value of the expected future cash flows discounted at the loan s effective interest rate, or the fair value of the collateral securing the loan. When using the fair value of the collateral securing an impaired loan as the basis for measuring impairment, the Company takes into consideration estimated costs to sell the collateral when determining the loan s fair value. A valuation allowance is established for an impaired loan through a charge to earnings when the fair value of the loan is less than the Company s recorded investment in the loan. An impaired loan may be placed back on accrual if the loan is no longer considered to be impaired. For additional information in obtaining the fair value of a loan, refer to Note 2, Fair Value of Financial Instruments of these Consolidated Financial Statements.

A loan may be restructured when the Company determines that a borrower s financial condition has deteriorated, but still has the ability to repay at least some portion of the loan. A loan is considered to be a TDR when the borrower is experiencing financial difficulty, and the original terms have been modified in favor of the borrower such that either principal or interest has been forgiven, contractual payments are deferred, or the interest rate is reduced (i.e. a concession in accordance with ASU 2011-02). A loan may also be considered a TDR when the loan of a financially troubled borrower is renewed with the same terms as were offered when the borrower was not troubled, because it is normally expected that interest rates will be higher to cover the increased credit risk from a troubled borrower. Generally, when a loan is identified as a TDR, the loan is also disclosed as an impaired loan.

Additional information regarding loans classified nonaccrual, impaired, and TDR is disclosed in Note 6, Allowance for Loan and Lease Losses and Credit Quality of these Consolidated Financial Statements.

Table of Contents

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES CONTINUED

Premises and Equipment

Premises and equipment are reported at cost less accumulated depreciation. Depreciation is expensed over the estimated useful lives of the assets. The Company depreciates assets utilizing straight line depreciation. The estimated useful lives of premises and equipment are as follows:

Buildings	40 years
Building improvements	3 40 years
Furniture and equipment	5 7 years
Electronic equipment and software	3 10 years

Leasehold improvements are amortized over the terms of the leases or the estimated useful lives of the improvements, whichever is shorter. Management annually reviews premises and equipment in order to determine if facts and circumstances suggest that the value of an asset is not recoverable.

Leases

The Company leases a majority of its branches and support offices. Most of these leases are operating leases for which a monthly rental expense is recognized. However, when the terms of the lease are such that the Company is leasing the building for most of its useful economic life or the present value of the sum of lease payments represents most of the fair value of the building, the transaction is accounted for as a capital lease. In a capital lease, the building is recognized as an asset of the Company and the net present value of the contracted lease payments is recognized as a long term liability. The long term liability recognized as part of a capital lease is accounted for using the interest method, and is included in other borrowings of the Company s Consolidated Financial Statements. The Company s capital leases were recorded at fair value in conjunction with the Investment Transaction. The amortization charge relating to assets recorded under capital leases is included with depreciation expense.

Some of the Company s leases have cost-of-living adjustments based on the consumer price index. Some of the leases have fixed increases provided for in the terms or increases based on the index but have a minimum increase irrespective of the change in index. In these cases, the total fixed or minimum lease expense is recognized on a straight line basis over the term of the lease. As part of the purchase accounting due to the Investment Transaction, the Company evaluated all of its leases. A liability was recorded as of the Transaction Date because the contractual operating lease payments were above the current market rates for several leased properties in aggregate. The contractual obligations for operating and capital leases are disclosed in Note 11, Commitments and Contingencies of these Consolidated Financial Statements.

Goodwill and Intangible Assets

Intangible assets are generally acquired through an acquisition with exception of mortgage serving rights. 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, the acquired intangible asset will be a separately recognized asset. Such intangible assets are subject to amortization over their useful lives unless they have an indefinite life. Among these identifiable intangible assets are core deposit intangibles (CDI), customer relationship intangibles (CRI), and trade name intangibles. The Company amortizes CDI and CRI over their estimated useful lives.

Table of Contents

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES CONTINUED

Any excess of the purchase price over the estimated fair value of the assets received and liabilities assumed is an unidentifiable intangible asset and is recorded as goodwill. Goodwill must be reviewed for impairment when there is evidence to suggest that the estimated fair value of the net assets is lower than the carrying value, or at a minimum of once a year. This evidence may be in the form of a triggering event or a series of events or developments.

Testing goodwill for impairment consists of a two-part test to determine the fair value of goodwill. In Step 1, the fair value of the reporting unit is determined and compared to its carrying value including goodwill. If the fair value of the reporting unit is more than its carrying value, goodwill is not impaired. If the fair value of the reporting unit is less than its carrying value, the company must proceed with Step 2. In Step 2, the implied fair value of goodwill is estimated. The implied fair value of goodwill is the excess of fair value of the reporting unit over the fair values of the assets and liabilities of the reporting unit as they would be determined in an acquisition. If the carrying amount of the goodwill is more than its implied fair value, it is impaired and an impairment charge must be recognized.

All of the goodwill recognized in the Company s Consolidated Financial Statements, as of March 31, 2012, is the result of the purchase accounting for the Investment Transaction. Additional information regarding goodwill and the computation of goodwill at March 31, 2012, is disclosed in Note 7, Goodwill and Intangible Assets of these Consolidated Financial Statements.

Included in goodwill and other intangible assets are mortgage and other loan servicing rights associated with the sale of loans for which the servicing of the loan is retained. The Company receives a fee for servicing these loans. The right to receive this fee for performing servicing is of value to the Company and could be sold should the Company choose to do so. Companies engaged in selling loans and retaining servicing rights for a fee are required to recognize servicing rights as an asset or liability. The rights are recorded at the net present value of the fees that will be collected, less estimated servicing costs, which approximates the fair value. Loan servicing rights are amortized into noninterest income in proportion to, and over the period of, estimated future net servicing income. Estimates of the lives of the loans are based on several industry standard sources and take into consideration prepayment rates expected in the current market interest rate environment.

Each quarter Management evaluates servicing rights for impairment. Impairment occurs when the fair value of loan servicing rights is less than amortized cost. The rates at which consumers prepay their loans are impacted by changes in interest rates prepayments generally increase as interest rates fall, and generally decrease as interest rates rise so the value of the servicing right changes with changes in interest rates. When prepayments increase, the Company will collect less servicing fees, and the value of the servicing rights declines. A valuation of the servicing assets is performed at each reporting period and reductions to the servicing assets carrying values are made when the carrying balance is higher than the fair value of the servicing asset, utilizing the lower of cost or fair value valuation methodology.

Bank Owned Life Insurance

Bank owned life insurance (BOLI) involves the purchase of life insurance by the Company on a chosen group of employees. The Company is the owner and beneficiary of the policies. This life insurance investment is carried as an asset at the cash surrender value of the underlying policies. In cases where the Company is a joint beneficiary of the policies, the Company has recorded a liability for the portion of the cash surrender value owned by the other party. Income from the increase in cash surrender value of the policies is reflected in noninterest income. The cash surrender value approximates fair value.

Table of Contents

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES CONTINUED

Other Real Estate Owned

Real estate acquired through foreclosure on a loan or by the surrender of real estate in lieu of foreclosure is referred to as other real estate owned (OREO). When real estate is foreclosed on, the collateral is transferred to OREO at estimated fair value less costs to sell. If the outstanding balance of the loan is greater than the fair value of the OREO at the time of foreclosure, the excess of the loan balance over the fair value is charged-off against the ALLL or PCI Loan Pool s valuation adjustment before recording the asset as an OREO. OREO is maintained in the Company s Consolidated Financial Statements at the lower of its carrying value or fair value of the OREO, less estimated costs to sell. OREO is recorded as other assets within the Consolidated Financial Statements.

Once the collateral is foreclosed on and the property becomes an OREO, Management periodically obtains appraisals to determine if further valuation adjustments are required. Valuation adjustments are also required when the listing price to sell an OREO has had to be reduced below the current carrying value. If there is a decrease in the fair value of the property from the last valuation, the decrease in value is charged against noninterest income. During the time the property is held, all related operating and maintenance costs are expensed as incurred. Increases in the values of properties are not recognized until sale. All income produced from OREO, such as from renting the property, is included in noninterest income.

Securities Sold Under Agreement to Repurchase

The Company enters into repurchase agreements whereby it sells securities or loans to another institution and agrees to repurchase them at a later date for an amount in excess of the sale price. While in form these are agreements to sell and repurchase, in substance they are secured borrowings in which the excess of the repurchase price over the sale price represents interest expense. This expense is accrued over the term of the borrowing. For security or collateral, the Company must pledge assets with a higher fair value than the amount borrowed. Information about the amounts held and the interest rates may be found in Note 14, Securities Sold Under Agreements to Repurchase and Federal Funds Purchased of the 2011 Form 10-K s Consolidated Financial Statements. There was a purchase accounting premium recorded as a result of the Investment Transaction for the repurchase agreements based on current market rates for similar instruments.

Other Borrowings

Management utilizes a variety of sources to raise borrowed funds at competitive rates, including FHLB borrowings and subordinated debt. FHLB borrowings typically carry rates approximating the London Inter-Bank Offered Rate (LIBOR) for the equivalent term because they are secured with investments or high quality loans. Interest is accrued on a monthly basis, based on the outstanding borrowing s interest rate, and is included in interest expense.

In past periods, a majority of the long term and short term debt of the Company were advances with the FHLB. Long term funding through the FHLB is collateralized by pledging qualifying loans and/or securities. Virtually all of the FHLB advances were repaid by the Company in early September 2010 from the proceeds received in the Investment Transaction and deposits maintained at the Reserve Bank. Purchase accounting adjustments were made based on current market rates for similar instruments. Refer to Note 10, Other Borrowings of these Consolidated Financial Statements for the current period activity within other borrowings.

Reserve for Off-Balance Sheet Commitments

The Company has exposure to losses from unfunded loan commitments and letters of credit. Since the funds have not been disbursed on these commitments, they are not reported as loans outstanding. Estimated losses related to these commitments are not included in the ALLL reported in Note 6, Allowance for Loan and Lease Losses and Credit Quality of these Consolidated Financial Statements.

26

Table of Contents

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES CONTINUED

Instead, they are accounted for as a separate loss contingency or reserve as a liability within other liabilities on the Company s Consolidated Balance Sheets also referred to as a Reserve for Off-Balance Sheet Commitments. Losses are experienced when the Company is contractually obligated to make a payment under these instruments and must seek repayment from a party that may not be as financially sound in the current period as it was when the commitment was originally made.

The reserve for off-balance sheet commitments originated after the Transaction Date applies the same historical loss rates and qualitative factors used in the calculation for ALLL to the off-balance sheet obligations in determining an estimate of losses inherent in these contractual obligations. For off-balance sheet commitments made prior to the Investment Transaction, a different model is utilized. This model assesses the unfunded commitments for the same group of loans at the Transaction Date at the end of each quarter and applies an estimated funding factor and probability of default for the remaining unfunded commitments to estimate the required reserve. To the extent that the credit exposure has increased, additional reserve for off-balance sheet commitments will increase and to the extent the credit exposure has decreased, the off-balance sheet reserve will decrease.

The estimate of reserves for off-balance sheet commitments is included as a contingent liability under the provisions of ASC 450, *Loss Contingencies* and is reported within other liabilities and is adjusted for changes in the estimated reserve requirement by an adjustment to noninterest expense. Additional disclosure regarding the Company s reserve for off-balance sheet commitments is located in Note 4, Loans of these Consolidated Financial Statements.

Derivative Financial Instruments

GAAP requires that all derivatives be recorded at their fair value on the balance sheet. Certain derivative transactions that meet specified criteria qualify for hedge accounting under GAAP. The Company does not hold any derivatives that meet the criteria for hedge accounting. Gains or losses associated with changes in fair value of derivative instruments are immediately recognized in noninterest income.

Trust Assets and Investment and Advisory Fees

The Company has a trust department and two registered investment advisory subsidiaries, MCM and REWA, each of which have fiduciary responsibility for the assets that they manage on behalf of clients. These assets are not owned by the Company and are not reflected in the Consolidated Balance Sheets. Fees for most trust services are based on the market value of client assets, and the fees are accrued monthly. All of the activity for the trust department and investment and advisory services are reported in the Wealth Management segment.

Stock-Based Compensation

The Company grants nonqualified stock options, restricted stock, performance stock options and performance restricted stock to directors and employees as a form of compensation. All stock-based compensation is accounted for in accordance with GAAP which requires compensation expense for the issuance of stock-based compensation be recognized over the vesting period of the share-based award or when it is probable that the performance stock grants performance measures will be met.

The amount of compensation expense to be recognized for options is based on the fair value of the stock options, utilizing the Black-Scholes-Merton technique, at the date of the grant. The Black-Scholes-Merton technique is used to value the stock options since this model provides the most appropriate stock option valuation in the opinion of management. The fair value for the options is estimated based on the length of their term, the volatility of the stock price in past periods, and other factors. The expected term is calculated using the simplified method. The simplified method is used because historical stock option exercise data does not provide a reasonable basis upon which to estimate the expected term. Expected volatility is based on historical volatility of the Company s stock price.

27

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES CONTINUED

Details regarding the accounting for stock-based compensation expense are disclosed in Note 18, Shareholders Equity of the Company s 2011 Form 10-K s Consolidated Financial Statements.

A valuation model is not used for pricing restricted stock because the value is based on the closing price of the Company s stock on the grant date. The total value of the restricted stock is the number of shares granted multiplied by the stock price.

The amount of compensation expense to be recognized for performance stock grants is based on the probability of meeting specific performance goals. These estimates are reassessed at each reporting period, and if the probability has changed, the amount of expense is adjusted based on the most recent assessment of probability.

Income Taxes

The Company uses the asset and liability method, which recognizes a liability or asset representing the tax effects of future deductible or taxable amounts attributable to events that have been recognized in these Consolidated Financial Statements. Due to tax regulations, several items of income and expense are recognized in different periods for tax return purposes than for financial reporting purposes. These items represent temporary differences. The Company is required to provide in its Consolidated Financial Statements for the eventual liability or deduction in its tax return for these temporary differences until the item of income or expense has been recognized for both financial reporting and for taxes. The provision is recorded in the form of deferred tax expense or benefit as the temporary differences arise, with the accumulated amount recognized as a deferred tax liability or asset. Deferred tax assets represent future deductions in the Company s income tax return, while deferred tax liabilities represent future payments to tax authorities. In August 2011, in connection with the Investment Transaction, the Company recorded a deferred tax liability of $5.2 million related to an indefinite life trade name intangible. This related deferred tax liability will remain on the Company s Consolidated Financial Statements as long as the SBB&T trade name intangible exists.

When realization of the benefit of a deferred tax asset is uncertain, the Company is required to recognize a valuation allowance. A full valuation allowance was recorded by the Company in 2009. Management assesses the realizability of its deferred tax asset each quarter. The realization of the Company s deferred tax asset is subject to considerable judgment and could occur as a single event or over a period of time, depending upon the level of forecasted taxable income, the degree of risk related to realizing the forecasted taxable income, and the estimated risk related to credit quality.

Earnings Per Share

The computation of basic earnings per share for all periods presented in the Consolidated Statements of Income is based on the weighted average number of shares outstanding during each period retroactively adjusted for the reverse stock split effective December 28, 2010. Diluted earnings per share include the effect of common stock equivalents for the Company, which consist of shares issuable on the exercise of outstanding options and restricted stock awards and common stock warrants.

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 at the average market price for the period and that the proceeds from the assumed exercise have been used for market repurchases of shares at the average market price. Normally, the Company would receive a tax benefit for the difference between the market price and the exercise price of nonqualified options when options are exercised. The treasury stock method also assumes that the tax benefit from the assumed exercise of options

Table of Contents

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES CONTINUED

is used to retire shares thereby lowering the number of shares assumed to be exercised. Options that have an exercise price higher than the average market price are excluded from the computation because they are anti-dilutive. When the Company s net income available to common shareholders is in a loss position, the diluted earnings per share calculation utilizes only the average shares outstanding, because assuming the exercise of stock options or warrants would lower the loss per share. Once stock options are exercised, restricted stock vests, or once a performance measurement has been met, the shares are included in the actual weighted average shares outstanding rather than as common stock equivalents.

Statement of Cash Flows

For purposes of reporting cash flows, cash and cash equivalents includes 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.

Segments

GAAP requires that the Company disclose certain information related to the performance of various segments of its business. Segments are defined based on how the chief operating decision maker of the Company views the Company s operations. Management has determined that the Company has two reportable operating segments: (1) Commercial & Community Banking and (2) Wealth Management. The All Other segment is not considered an operating segment, but includes all corporate administrative support departments such as human resources, legal, finance and accounting, treasury, information technology, internal audit, risk management, facilities management, marketing, and the Bank s holding company. The factors used in determining these reportable segments are explained in Note 15, Segments of these Consolidated Financial Statements.

NOTE 2. FAIR VALUE OF FINANCIAL INSTRUMENTS

The accounting guidance for fair value establishes a framework for measuring fair value and establishes a three-level valuation hierarchy for disclosure of fair value measurement. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

Level 1: Observable quoted prices in active markets for identical assets and liabilities.

Level 2: Observable quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

Level 3: Model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques.

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The assets and liabilities which are fair valued on a recurring basis are described below and contained in the following tables. In addition, the Company may be required to record other assets and liabilities at fair value on a nonrecurring basis. These nonrecurring fair value adjustments involve the lower of carrying value or fair value accounting and write downs resulting from impairment of assets. The following methods and assumptions were used to estimate the fair value of each class

29

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

NOTE 2. FAIR VALUE OF FINANCIAL INSTRUMENTS CONTINUED

of financial instruments that are recorded in the Company s Consolidated Financial Statements at fair value on a recurring and nonrecurring basis.

Investment Securities - AFS

Investment securities are recorded at fair value on a recurring basis. Where quoted prices are available in an active market for identical assets, securities are classified within Level 1 of the valuation hierarchy such as United States Department of the Treasury (U.S. Treasury) securities. All of the Company s securities are reported as Level 2 of the fair value hierarchy. Investment securities are fair valued by an independent third party that obtains observable market prices for similar assets or by obtaining quoted market prices that are not in an active market or in pricing models which have inputs that are observable in the market to obtain the fair value. When observable market information is not available for securities or there is limited activity or less transparency around inputs, such securities would be classified within Level 3 of the valuation hierarchy. The Company does not have any securities within the Level 1 or Level 3 hierarchy.

Derivatives

The Company s swap derivatives are not listed on an exchange and are instead executed over the counter (OTC). As no quoted market prices exist for such instruments, the Company values these OTC derivatives primarily based on third party broker pricing indications and valuation techniques that use readily observable market parameters. As a result, the swap values are classified within Level 2 of the fair value hierarchy.

As discussed in Note 1, Summary of Significant Accounting Policies, of these Consolidated Financial Statements, prior to the funding of a mortgage loan, the Company may provide an interest rate lock commitment and mandatory delivery contracts for mortgage loans originated for sale that qualify as derivatives under GAAP. The value of the interest rate lock commitments is based on the change in interest rates between the date the interest rate lock commitment is executed and the date the loan is funded. The interest rates used to fair value these derivatives are from similar assets in observable markets. The value of the mandatory delivery contract is calculated by comparing the price on the contract accepted date to the price on the actual sale date on similar assets that are currently being sold. As a result, these derivatives are classified within Level 2 of the fair value hierarchy.

Foreclosed Collateral

Foreclosed collateral is carried at value or fair value less estimated cost to sell. Fair value is determined by the lower of suggested market prices obtained from independent certified appraisers, the current listing price, or the net present value of expected cash flows of the asset received. When the fair value of the collateral is based on a current appraised value or the appraised value, the asset is classified as nonrecurring Level 2. When a net present value technique using the cash flows of the asset received is used, the asset is classified as nonrecurring Level 3.

Mortgage and Other Loan Servicing Rights

Servicing rights are carried at the lower of aggregate cost or estimated fair value. Servicing rights are subject to quarterly impairment testing. When the fair value of the servicing rights is lower than their carrying value, impairment is recorded by establishing or increasing the amount of a valuation allowance so that the net carrying amount is equal to the fair value. The Company uses independent third parties to value the servicing rights. The valuation model takes into consideration discounted cash flows using current interest rates and prepayment speeds for each type of the underlying asset being serviced. The Company uses discounted cash flows to obtain the fair value for servicing rights and therefore servicing rights are classified as nonrecurring Level 3. Significant

Table of Contents

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

NOTE 2. FAIR VALUE OF FINANCIAL INSTRUMENTS CONTINUED

changes in any of the assumption inputs within the valuation model such as prepayment speeds, internal rates of return, and estimated inflation rates could result in a significantly different fair value measurement. Generally, as interest rates decrease, prepayment speeds increase resulting in a lower fair value. Contrarily, as interest rates increase, prepayment speeds decrease resulting in a higher fair value.

Financial Assets and Liabilities Measured at Fair Value on a Recurring Basis

Assets and liabilities measured at fair value on a recurring basis at March 31, 2012, and December 31, 2011, are summarized in the following tables:

		Recurring Fair Value Measurements at Reporting		
	As of March 31, 2012	*Quoted prices in active markets for identical assets (Level 1)*	*Active markets for similar assets (Level 2)*	*Unobservable inputs (Level 3)*
		(dollars in thousands)		
Assets:				
Available for Sale:				
U.S. Agency securities	$ 114,300	$	$ 114,300	$
Collateralized mortgage obligations	887,216		887,216	
Mortgage-backed securities (1)	225,168		225,168	
State and municipal securities	214,349		214,349	
Total available for sale securities	1,441,033		1,441,033	
Fair value swap asset	8,272		8,272	
Fair value of derivative loan contracts	170		170	
Total assets at fair value	$ 1,449,475	$	$ 1,449,475	$
Liabilities:				
Fair value swap liability	$ 8,312	$	$ 8,312	$
Fair value of derivative loan contracts	17		17	
Total liabilities at fair value	$ 8,329	$	$ 8,329	$

(1) The mortgage-backed securities (MBS) included in the tables above are residential MBS.

Table of Contents

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

NOTE 2. FAIR VALUE OF FINANCIAL INSTRUMENTS CONTINUED

		Recurring Fair Value Measurements at Reporting		
	As of December 31, 2011	*Quoted prices in active markets for identical assets (Level 1)*	*Active markets for similar assets (Level 2)*	*Unobservable inputs (Level 3)*
		(dollars in thousands)		
Assets:				
Available for Sale:				
U.S. Agency securities	$ 114,906	$	$ 114,906	$
Collateralized mortgage obligations	938,964		938,964	
Mortgage-backed securities (1)	237,044		237,044	
State and municipal securities	212,511		212,511	
Total available for sale securities	1,503,425		1,503,425	
Fair value swap asset	9,200		9,200	
Fair value of derivative loan contracts	8		8	
Total assets at fair value	$ 1,512,633	$	$ 1,512,633	$
Liabilities:				
Fair value swap liability	$ 9,242	$	$ 9,242	$
Fair value of derivative loan contracts	2		2	
Total liabilities at fair value	$ 9,244	$	$ 9,244	$

(1) The MBS included in the tables above are residential MBS.

Table of Contents

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

NOTE 2. FAIR VALUE OF FINANCIAL INSTRUMENTS CONTINUED

Financial Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

The Company is required to periodically measure certain financial assets at fair value on a nonrecurring basis. The financial assets identified in the table below are fair value measurements that resulted from the application of lower of cost or fair value accounting and were written-down to the fair value during the three months ended March 31, 2012, and March 31, 2011. A summary of the assets measured at fair value on a nonrecurring basis are summarized in the tables below:

	Quoted prices in	Quoted prices in	Quoted prices in	Quoted prices in	Quoted prices in	
		Nonrecurring Fair Value Measurements at Reporting				
	As of March 31, 2012	***Quoted prices in active markets for identical assets (Level 1)***	***Active markets for similar assets (Level 2)***	***Unobservable inputs (Level 3)***	***Losses for the Three Months Ended March 31, 2012***	
			(dollars in thousands)			
Foreclosed collateral	$ 9,598	$	$ 9,598	$	$ 776	(1)
Servicing rights	382			382	38	(2)
Total assets at fair value	$ 9,980	$	$ 9,598	$ 382	$ 814	

		Nonrecurring Fair Value Measurements at Reporting				
	As of March 31, 2011	***Quoted prices in active markets for identical assets (Level 1)***	***Active markets for similar assets (Level 2)***	***Unobservable inputs (Level 3)***	***Losses for the Three Months Ended March 31, 2011***	
			(dollars in thousands)			
Foreclosed collateral	$ 7,447	$	$ 7,447	$	$ 1,740	(1)
Servicing rights	75			75	5	(2)
Total assets at fair value	$ 7,522	$	$ 7,447	$ 75	$ 1,745	

(1) Losses were recognized due to the decline in real estate values.

(2) Losses were recognized due to the decline in interest rates, which may result in higher than previously estimated prepayments.

There were no liabilities measured at fair value on a nonrecurring basis for the periods presented within this note of these Consolidated Financial Statements. There were no transfers in or out of the Company s Level 3 financial assets during the periods presented within this note of these Consolidated Financial Statements by reason of a change in the methodology for establishing the fair value.

Table of Contents

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS   CONTINUED

NOTE 2.   FAIR VALUE OF FINANCIAL INSTRUMENTS   CONTINUED

Disclosure of the Fair Value of Financial Instruments

The disclosure below provides the carrying value and fair value of the financial instruments which are not carried on the Company s Consolidated Financial Statements at fair value or are carried at the lower of cost or fair value and not disclosed in the recurring or nonrecurring fair value measurements in the tables above.

	March 31, 2012		*December 31, 2011*	
	Carrying Amount	*Fair Value*	*Carrying Amount*	*Fair Value*
		(dollars in thousands)		
Assets:				
Cash and due from banks	$ 45,189	$ 45,189	$ 49,324	$ 49,324
Interest bearing demand deposits in other financial institutions	147,774	147,774	173,408	173,408
Loans held for investment, net	3,740,197	3,793,319	3,655,433	3,704,493
Liabilities:				
Deposits (excluding CDs)	3,110,522	3,110,522	3,058,078	3,058,078
CDs	1,477,878	1,496,838	1,558,962	1,578,189
Other borrowings	71,744	77,584	66,524	70,735
Securities sold under agreements to repurchase	315,099	320,210	315,919	318,370

A summary of the valuation methodology used to disclose the fair value of the financial instruments in the table above is as follows:

Cash and Due from Banks and Interest Bearing Demand Deposits in Other Financial Institutions

The carrying values of cash and interest bearing demand deposits in other financial institutions represent the fair value. The Company classifies cash and interest bearing demand deposits in other financial institutions within Level 1 of the fair value hierarchy.

Loans Held for Investment, net

The carrying value of the loans held for investment at March 31, 2012, and December 31, 2011, was significantly impacted by the write down to fair value at the Transaction Date due to the application of purchase accounting related to the Investment Transaction. At the Transaction Date, the loans purchased were at fair value based on the contractual cash flows expected to be collected. The fair value presented above is calculated based on the present value of expected principal and interest cash flows. The carrying value of the loans is net of the ALLL which represents Management s evaluation of expected credit losses inherent in those loan portfolios. These methods are based on the entrance price concept versus the exit price concept described in ASC 820*, Fair Value Measurements*.

The methods used to estimate the fair value of loans are sensitive to the assumptions and estimates used. While Management has attempted to use assumptions and estimates that best reflect the Company s loan portfolio and current market conditions, a greater degree of subjectivity is inherent in these values than in those determined in active markets. Accordingly, readers are cautioned in using this information for purposes of evaluating the financial condition and/or value of the Company in and of itself or in comparison with any other company and amounts presented may not be realized in a current sale between willing buyers and willing sellers. The Company classifies these loans within Level 3 of the fair value hierarchy.

Table of Contents

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

NOTE 2. FAIR VALUE OF FINANCIAL INSTRUMENTS CONTINUED

Deposits (excluding Certificates of Deposit)

The fair value of demand deposits, money market accounts, and savings accounts is the amount payable on demand at March 31, 2012, and December 31, 2011. The Company classifies these deposits in Level 1 of the fair value hierarchy.

Certificates of Deposit

The fair value of fixed-maturity CDs is estimated by discounting the interest and principal payments using the rates currently offered for deposits of similar remaining maturities. The Company classifies these deposits in Level 3 of the fair value hierarchy.

Other Borrowings

The fair value of trust preferred securities is estimated by using discounted cash flow model which uses the interest and principal payments using current market rates for comparable debt. Accordingly, other borrowings are classified in Level 2 of the fair value hierarchy.

Securities Sold Under Agreements to Repurchase

The fair value of repurchase agreements is determined by reference to rates in the wholesale repurchase market. The rates paid to the Company s clients are slightly lower than rates in the wholesale market and, consequently, the fair value will generally be less than the carrying amount. The fair value of the long term repurchase agreements is determined in the same manner as other borrowings above. Therefore, repurchase agreements are classified in Level 2 of the fair value hierarchy.

Disclosed Fair Value of Financial Instruments is not Equivalent to Franchise Value

The financial instruments disclosed in this note include such items as securities, loans, deposits, debt, and other instruments. Disclosure of fair values is not required for certain assets and liabilities that are not financial instruments such as premises and equipment, prepaid expenses, and income tax assets and liabilities. Accordingly, the aggregate fair value of amounts presented in this note does not purport to represent, and should not be considered representative of, the underlying market or franchise value of the Company. Further, due to a variety of alternative valuation techniques and approaches permitted by the fair value measurement accounting standards as well as the significant assumptions that are required to be made in the process of valuation, the determinations or estimations of fair value for many of the financial instruments disclosed in this note could and do differ between various market participants. A direct comparison of the Company s fair value information with that of other financial institutions may not be appropriate.

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

NOTE 3. INVESTMENT SECURITIES

A summary of investment securities held by the Company at March 31, 2012, and December 31, 2011, is as follows:

	March 31, 2012			
	Amortized Cost	*Gross Unrealized Gains*	*Gross Unrealized Losses*	*Fair Value*
	(dollars in thousands)			
Available for sale:				
U.S. Agency securities (1)	$ 113,699	$ 601	$	$ 114,300
Mortgage-backed securities (2)	220,238	4,990	(60)	225,168
Collateralized mortgage obligations (3)	876,687	11,635	(1,106)	887,216
State and municipal securities	207,314	7,932	(897)	214,349
Total securities	$ 1,417,938	$ 25,158	$ (2,063)	$ 1,441,033

	December 31, 2011			
	Amortized Cost	*Gross Unrealized Gains*	*Gross Unrealized Losses*	*Fair Value*
	(dollars in thousands)			
Available for sale:				
U.S. Agency securities (1)	$ 114,278	$ 628	$	$ 114,906
Mortgage-backed securities (2)	232,737	4,378	(71)	237,044
Collateralized mortgage obligations (3)	931,875	9,471	(2,382)	938,964
State and municipal securities	209,930	4,583	(2,002)	212,511
Total securities	$ 1,488,820	$ 19,060	$ (4,455)	$ 1,503,425

(1) U.S. Agency securities are general obligations that are not backed by the full faith and credit of the United States government and consist of Government Sponsored Enterprises issued by the Federal Farm Credit, Federal Home Loan Mortgage Corporation (FHLMC), Federal National Mortgage Association (FNMA), Federal Home Loan Bank and Tennessee Valley Authority.

(2) Mortgage-backed securities are securitized mortgage loans that are not backed by the full faith and credit of the United States Government and consist of Government Sponsored Enterprises which guarantee the collection of principal and interest payments. The securities primarily consist of securities issued by FHLMC and FNMA.

(3) Collateralized mortgage obligations (CMOs) are securities which pool together mortgages and separate them into short, medium, or long term positions called tranches. The CMOs in the table above primarily consist of securities issued by Government National Mortgage Association (GNMA), FNMA, FHLMC, and private label.

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

NOTE 3. INVESTMENT SECURITIES CONTINUED

Available for Sale Securities

At March 31, 2012, and December 31, 2011, the Company held $1.44 billion and $1.50 billion, respectively, of securities in its AFS portfolio. Unrealized gains or losses relating to AFS securities are accounted for by adjusting the carrying amount of the securities. An offsetting entry after the adjustment for taxes at the Company s corporate effective tax rate, when applicable, is recognized in OCI.

Fair values are obtained from independent sources based on current market prices for the specific security held by the Company or for a security with similar characteristics. If a security is in an unrealized loss position, Management is required to determine whether or not the security is temporarily or permanently impaired.

The following tables show all AFS securities that are in an unrealized loss position, and temporarily impaired, as of March 31, 2012, and December 31, 2011:

	March 31, 2012					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
	(dollars in thousands)					
Municipal bonds	$ 5,962	$ (45)	$ 21,688	$ (852)	$ 27,650	$ (897)
Mortgage-backed securities	1,094	(28)	2,904	(32)	3,998	(60)
Collateralized mortgage obligations	116,408	(811)	1,469	(295)	117,877	(1,106)
Total	$ 123,464	$ (884)	$ 26,061	$ (1,179)	$ 149,525	$ (2,063)

	December 31, 2011					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
	(dollars in thousands)					
Municipal bonds	$ 6,359	$ (21)	$ 45,230	$ (1,981)	$ 51,589	$ (2,002)
Mortgage-backed securities	2,784	(36)	2,910	(35)	5,694	(71)
Collateralized mortgage obligations	184,141	(1,978)	1,450	(404)	185,591	(2,382)
Total	$ 193,284	$ (2,035)	$ 49,590	$ (2,420)	$ 242,874	$ (4,455)

As of March 31, 2012, and December 31, 2011, 89 and 142 AFS securities were in a loss position, respectively. The $2.1 million and $4.5 million of unrealized losses for the AFS portfolio as of March 31, 2012, and December 31, 2011, respectively, are primarily a result of changes in market interest rates. The fair value is based on current market prices obtained from independent sources for each security held. At March 31, 2012, the issuers of these securities have not, to the Company s knowledge, established any cause for default on these securities and the most recent credit ratings on all securities have an investment grade rating, except for one security. The one security which has a credit rating below investment grade is a municipal bond which is current on all interest payments and is a General Obligation Municipal Bond. At March 31, 2012, Management does not intend to sell any of the securities in a loss position nor are there any conditions present at March 31, 2012, that would require Management to sell them. As such, Management does not believe that there are any securities that are OTTI as of March 31, 2012.

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

NOTE 3. INVESTMENT SECURITIES CONTINUED

Contractual Maturities for Securities Portfolio

The amortized cost and estimated fair value of debt securities at March 31, 2012, and December 31, 2011, by weighted average contractual maturity, are shown in the table below:

	March 31, 2012		December 31, 2011	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
	(dollars in thousands)			
Available for sale securities:				
In one year or less	$ 84,568	$ 84,870	$ 83,611	$ 83,892
After one year through five years	1,016,773	1,029,564	1,063,218	1,072,379
After five years through ten years	153,625	157,625	190,895	194,750
After ten years	162,972	168,974	151,096	152,404
Total securities	$ 1,417,938	$ 1,441,033	$ 1,488,820	$ 1,503,425

Expected maturities will differ from contractual maturities because borrowers or issuers have the right to call or prepay investment securities. Changes in interest rates may also impact borrowers or issuers of investment securities and cause them to prepay investment securities earlier than the contractual term.

Interest Income

The following table summarizes interest income from investment securities:

	Three Months Ended March 31,	
	2012	2011
	(dollars in thousands)	
Interest income for AFS securities:		
Taxable:		
U.S. Agency securities	$ 247	$ 415
Asset-backed securities		61
CMO s and MBS	5,321	3,460
Nontaxable:		
State and municipal securities	2,154	2,160
Total interest income for AFS securities	$ 7,722	$ 6,096

Pledged Securities

Securities with a carrying value of approximately $666.8 million and $688.3 million at March 31, 2012, and December 31, 2011, respectively, were pledged to secure public funds, trust deposits, repurchase agreements and other borrowings as required or permitted by law.

Table of Contents

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

NOTE 3. INVESTMENT SECURITIES CONTINUED

Investment in FHLB and Reserve Bank Stock

The Company s investment in stock of the FHLB was $51.7 million and $54.3 million at March 31, 2012, and December 31, 2011, respectively. As with other investment securities, the investment in FHLB stock is periodically evaluated for impairment based on, among other things, the capital adequacy of the FHLB and its overall financial condition. Based on the current capital adequacy, liquidity position and recent credit ratings of the FHLB of San Francisco, Management believes there is no impairment in the Company s investment at March 31, 2012, and that the cost of the investment approximates fair value. The Company s investment in stock of the Reserve Bank was $18.8 million at March 31, 2012, and December 31, 2011. The investments of FHLB and Reserve Bank stock are included in FHLB stock and other investments on the Company s Consolidated Balance Sheets.

NOTE 4. LOANS

Loans Held for Sale

As of March 31, 2012, and December 31, 2011, the Company had a carrying value of $4.0 million, and $3.1 million, respectively, and represents residential 1 to 4 family unit loans.

Loans Held for Investment

The composition of the Company s loans held for investment portfolio at carrying value is as follows:

	March 31, 2012	***December 31, 2011***
	(dollars in thousands)	
Real estate:		
Residential - 1 to 4 family	$ 1,103,650	$ 1,040,126
Multifamily	425,910	344,643
Commercial	1,586,687	1,588,852
Construction	156,531	185,400
Revolving - 1 to 4 family	239,657	249,857
Commercial loans	173,489	189,226
Consumer loans	47,438	49,977
Other loans	13,107	12,880
Total loans	$ 3,746,469	$ 3,660,961

The table above includes PCI Term Pools and PCI Revolving Pools, which were recorded at fair value at the Transaction Date. The loan balances above are net of deferred loan origination fees, commitment extension fees and origination costs of $1.6 million and $1.1 million at March 31, 2012, and December 31, 2011, respectively. The unamortized net deferred costs at March 31, 2012, and December 31, 2011, relate only to loans originated after the Transaction Date. Unamortized net deferred fees were eliminated in the purchase accounting at the Transaction Date.

39

Table of Contents

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

NOTE 4. LOANS CONTINUED

A summary of the carrying balances of loans originated or purchased since the Transaction Date are as follows, and excludes loans held for sale:

	March 31, 2012	December 31, 2011
	(dollars in thousands)	
Real estate:		
Residential - 1 to 4 family	$ 394,159	$ 296,257
Multifamily	243,306	151,417
Commercial	137,625	114,307
Construction	4,327	1,793
Revolving - 1 to 4 family	5,042	3,890
Commercial loans	17,189	11,622
Consumer loans	5,492	6,404
Other loans	4,008	2,335
Total	$ 811,148	$ 588,025

Loan Purchases

The following table summarizes loans the Company purchased during each period:

	Three Months Ended March 31, 2012	2011
	(dollars in thousands)	
Real estate:		
Residential - 1 to 4 family	$ 49,222	$
Multifamily	44,268	97,791
Commercial		90,559
Net, purchase discount	(3,604)	(9,417)
Total loans purchased	$ 89,886	$ 178,933

During the three months ended March 31, 2012, and 2011, the Company purchased $89.9 million, and $178.9 million of loans at net discounts of $3.6 million, and $9.4 million, respectively. Residential real estate 1 to 4 family loans were purchased at a premium, while commercial real estate and multifamily loans were purchased at a discount. Loans purchased during the three months ended March 31, 2012, and 2011, were performing loans at the time of purchase, and are not considered credit impaired.

Table of Contents

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

NOTE 4. LOANS CONTINUED

The determination to not classify loans purchased at a discount as purchased credit impaired was based on due diligence performed prior to their purchase. When reviewing and selecting loans for purchase, the Company required that the loans have no delinquencies during the previous 36 months, i.e., all contractual payments had been made on time. In addition, a majority of the loans purchased were seasoned loans which were originated prior to 2005. All these loans were initially assigned an internal credit risk grade of Pass.

Loan Sales and Transactions

A summary of the loan sale activities by loan portfolio, excluding SBA loans, is below:

	Three Months Ended March 31, 2012	2011
	(dollars in thousands)	
Loans sold:		
Residential real estate loans	$ 22,690	$ 29,632
Commercial real estate and construction loans		2,500
Total loans sold, net carrying value	$ 22,690	$ 32,132
Net gain on loans sold:		
Net gain on residential real estate loans	$ 422	$ 430
Total net gain on loans sold	$ 422	$ 430
Loans sold with servicing released:		
Residential real estate loans	$ 901	$ 22,326
Commercial real estate and construction loans		2,500
Total loans sold with servicing released, net carrying value	$ 901	$ 24,826
Loans sold with servicing retained:		
Residential real estate loans	$ 21,789	$ 7,306
Total loans sold with servicing retained, net carrying value	$ 21,789	$ 7,306
Servicing rights recorded on loans sold:	$ 216	$ 80
Residential real estate loans sold:		
Loans sold that were originated for sale	$ 22,690	$ 29,321
Loans sold from held for investment portfolio	$	$ 311

Pledged Loans

At March 31, 2012, and December 31, 2011, loans secured by residential and commercial real estate with principal balances totaling $57.7 million, and $45.9 million, respectively, were pledged to the FHLB as collateral for borrowings. The amounts pledged do not represent the amount of outstanding borrowings that are required to be supported by collateral. The Company maintains an excess of collateral at these institutions so that it may borrow without having to first transfer collateral to them.

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

NOTE 4. LOANS CONTINUED

Unfunded Loan Commitments and Letters of Credit

As of March 31, 2012, and December 31, 2011, the contractual commitments for unfunded commitments and letters of credit are as follows:

	March 31, 2012				
	Total	Less than one year	One to three years	Three to five years	More than five years
	(dollars in thousands)				
Unfunded commitments	$ 483,838	$ 151,651	$ 56,267	$ 80,801	$ 195,119
Standby letters of credit and financial guarantees	66,024	13,018	21,471	21,543	9,992
Total	$ 549,862	$ 164,669	$ 77,738	$ 102,344	$ 205,111

	December 31, 2011				
	Total	Less than one year	One to three years	Three to five years	More than five years
	(dollars in thousands)				
Unfunded commitments	$ 488,611	$ 145,827	$ 60,156	$ 81,248	$ 201,380
Standby letters of credit and financial guarantees	69,426	40,553	13,417	3,119	12,337
Total	$ 558,037	$ 186,380	$ 73,573	$ 84,367	$ 213,717

Included in unfunded loan commitments are secured and unsecured lines and letters of credit and loans which have approved applications, but they have not been funded. Letters and lines of credit are commitments to extend credit and standby letters of credit for the Bank s clients. These commitments meet the financing needs of the Bank s clients in the normal course of business and are commitments with off-balance sheet risk since the Bank has committed to issuing funds to or on behalf of clients, but there is no current loan outstanding.

Standby letters of credit and financial guarantees are conditional commitments issued by the Company to guarantee the performance of a client to a third party in borrowing arrangements. At March 31, 2012, the maximum undiscounted future payments that the Company could be required to make were $549.9 million. Approximately 29.9% of these arrangements mature within one year. The Company generally has recourse to recover from the client any amounts paid under these guarantees. Most of the guarantees are fully collateralized by the same types of assets used as loan collateral, however several are unsecured.

The Company anticipates that a majority of the above commitments will not be fully drawn on by clients. Consumers do not tend to borrow the maximum amounts available under their home equity lines and businesses typically arrange for credit lines in excess of their expected needs to handle contingencies. A majority of the lines of credit are adjustable rate commitments that are tied to prime or a base-lending rate. If a rate is fixed on a line of credit, the commitments are not usually for more than three months.

Table of Contents

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

NOTE 4. LOANS CONTINUED

The Company has exposure to loan losses from unfunded loan commitments and letters of credit. Since the funds have not been disbursed on these commitments, they are not reported as loans outstanding. Loan losses related to these commitments are not included in the ALLL reported in Note 6, Allowance for Loan and Lease Losses and Credit Quality of these Consolidated Financial Statements; instead, they are accounted for as a separate loss contingency or reserve, and reported as a liability within other liabilities on the Company s Balance Sheets. The reserve for the unfunded loan commitments and letters of credit was $15.7 million and $16.2 million at March 31, 2012, and December 31, 2011, respectively. The reserve for unfunded loan commitments declined $506,000 during the three months ended March 31, 2012, primarily due to the expiration of commitments.

The table below summarizes the reserve for unfunded loan commitments:

	Three Months Ended March 31,	
	2012	*2011*
	(dollars in thousands)	
Beginning balance	$ 16,184	$ 19,032
Additions/(reductions), net	(506)	15
Balance	$ 15,678	$ 19,047

Related Parties

In the ordinary course of business, the Company has extended credit to directors and executive officers of the Company. These related party loans totaled $1.9 million at March 31, 2012, and December 31, 2011. At March 31, 2012, the maturities of the related party loans were approximately 30 years, and were made to senior officers of the Company. Such loans are subject to ratification by the Board of Directors, exclusive of the borrowing director or officer. Federal banking regulations require that any such extensions of credit not be offered on terms more favorable than would be offered to non-related party borrowers of similar credit worthiness.

Table of Contents

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

NOTE 5. PURCHASED CREDIT IMPAIRED POOLS

As discussed in Note 1, Summary of Significant Accounting Policies of these Consolidated Financial Statements, the Company has classified all of the loans acquired on the Transaction Date as PCI loans, and pooled the purchased loans into pools of loans which have similar risk characteristics. PCI loans which have revolving lines of credit are referred to as PCI Revolving Pools, while the remainder of the loans purchased are referred to as PCI Term Pools.

The following table summarizes the balance of PCI Term Pools:

	March 31, 2012	*December 31, 2011*
	(dollars in thousands)	
Real estate:		
Residential - 1 to 4 family	$ 648,131	$ 679,282
Multifamily loans	181,237	191,850
Commercial	1,433,193	1,454,837
Construction	142,029	179,646
Revolving - 1 to 4 family	2,384	5,949
Commercial loans	46,967	56,806
Consumer loans	21,501	22,342
Other loans	5,583	5,838
Total PCI term pools - carrying balance	$ 2,481,025	$ 2,596,550
Total PCI term pools - unpaid principal balance	$ 2,718,384	$ 2,841,625

The following table summarizes the balance of the PCI Revolving Pools:

	March 31, 2012	*December 31, 2011*
	(dollars in thousands)	
Real estate:		
Residential - 1 to 4 family	$ 61,360	$ 64,587
Multifamily loans	1,367	1,376
Commercial	15,869	19,708
Construction	10,175	3,961
Revolving - 1 to 4 family	232,231	240,018
Commercial loans	109,333	120,798

Consumer loans	20,445	21,231
Other loans	3,516	4,707
Total PCI revolving pools - carrying balance	$ 454,296	$ 476,386
Total PCI revolving pools - unpaid principal balance	$ 529,930	$ 557,023

44

Table of Contents

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

NOTE 5. PURCHASED CREDIT IMPAIRED POOLS CONTINUED

The following table summarizes the accretable yield or income expected to be collected for PCI Term Pools purchased:

	Three Months Ended March 31,	
	2012	2011
	(dollars in thousands)	
Balance at beginning of period	$ 577,105	$ 785,001
Accretion of income (1)	(43,412)	(51,617)
Reclassification from nonaccretable difference related to improvement in credit loss expectations (2)	34,671	4,230
Reclassification to nonaccretable difference related to changes in prepayment expectations and other factors (3)	9,136	
Balance at end of period	$ 577,500	$ 737,614

(1) Accretion of income represents the recognition of the discount rate used to present value the expected cash flows.
(2) Relates to changes in credit loss expectations.
(3) Relates primarily to changes in prepayment expectations, and also relates to changes in spot rates for variable rate loans.

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

NOTE 6. ALLOWANCE FOR LOAN AND LEASE LOSSES AND CREDIT QUALITY

The following tables summarize the activity within the ALLL for the three months ended March 31, 2012, and 2011:

	Three Months Ended March 31, 2012				
	Beginning Balance at December 31, 2011	*Charge-offs*	*Recoveries*	*Provision for loan and lease losses*	*Ending Balance at March 31, 2012*
			(dollars in thousands)		
Real estate:					
Residential - 1 to 4 family	$ 1,952	$	$	$ (34)	$ 1,918
Multifamily	783			525	1,308
Commercial	722			117	839
Construction	20			31	51
Revolving - 1 to 4 family	71			34	105
Commercial loans	437			221	658
Consumer loans	327	(76)	22	(97)	176
Other loans	349	(51)	14	41	353
Purchased credit impaired loans	867			(3)	864
Total	$ 5,528	$ (127)	$ 36	$ 835	$ 6,272

	Three Months Ended March 31, 2011				
	Beginning Balance at December 31, 2010	*Charge-offs*	*Recoveries*	*Provision for loan and lease losses*	*Ending Balance at March 31, 2011*
			(dollars in thousands)		
Real estate:					
Residential - 1 to 4 family	$ 120	$	$	$ 462	$ 582
Multifamily				508	508
Commercial				492	492
Revolving - 1 to 4 family	28			25	53
Commercial loans	206			12	218
Consumer loans	69	(8)		86	147
Other loans	97	(64)	16	82	131
Total	$ 520	$ (72)	$ 16	$ 1,667	$ 2,131

The ALLL relates to the Company s estimate of credit losses inherent in loans originated or purchased since the Transaction Date, as well as estimates for losses in PCI Loan Pools to the extent that estimates for cash flows from those pools are below Management s prior expectations. At March 31, 2012, December 31, 2011, and at March 31, 2011, the majority of the ALLL relates to loans the Company originated or purchased since the Transaction Date. At March 31, 2012, and December 31, 2011, the portion of the ALLL that related to PCI Loan Pools was $864,000, and $867,000, respectively, and can be attributed to one PCI Term Pool. As of March 31, 2012, cash flows from the PCI Loan Pools were within Management s expectations, and no additional ALLL was required to be recognized during the three months ended March 31, 2012.

46

Table of Contents

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS   CONTINUED

NOTE 6.   ALLOWANCE FOR LOAN AND LEASE LOSSES AND CREDIT QUALITY   CONTINUED

For the three months ended March 31, 2012, and 2011, charge-offs and recoveries related to overdrafts, as well as smaller consumer loans. Provisions for loan and lease losses for the three months ended March 31, 2012, and 2011, relate to an increase in the balance of loans originated and purchased since the Transaction Date.

The following tables disaggregate the ALLL and the recorded investment in loans by impairment methodology at March 31, 2012, and December 31, 2011:

	Allowance for Loan and Lease Losses March 31, 2012		
	Commercial	*Consumer*	*Total*
	(dollars in thousands)		
Individually evaluated for impairment (1)	$	$	$
Collectively evaluated for impairment (2)	3,209	2,199	5,408
Acquired with deteriorated credit quality - Term (3)	656	208	864
Acquired with deteriorated credit quality - Revolving (4)			
	$ 3,865	$ 2,407	$ 6,272

	Recorded Investment in Loans March 31, 2012		
	Commercial	*Consumer*	*Total*
	(dollars in thousands)		
Individually evaluated for impairment (1)	$ 5,567	$	$ 5,567
Collectively evaluated for impairment (2)	400,888	404,693	805,581
Acquired with deteriorated credit quality - Term (3)	1,809,009	672,016	2,481,025
Acquired with deteriorated credit quality - Revolving (4)	140,260	314,036	454,296
	$ 2,355,724	$ 1,390,745	$ 3,746,469

(1) Represents loans individually evaluated for impairment in accordance with ASC 310-10, Receivables (formerly FAS 114), and pursuant to amendments by ASU 2010-20 regarding allowance for impaired loans originated or purchased since the Transaction Date.
(2) Represents loans collectively evaluated for impairment in accordance with ASC 450-20, Loss Contingencies (formerly FAS 5), and pursuant to amendments by ASU 2010-20 regarding allowance for unimpaired loans.
(3) Represents the related loan carrying value determined in accordance with ASC 310-30, Receivables   Loans and Debt Securities Acquired with Deteriorated Credit Quality (formerly SOP 03-3) and pursuant to amendments by ASU 2010-20 regarding allowance for PCI Term Loan Pools in accordance with ASC 450-20.
(4) Represents the related loan carrying value for revolving loan pools accounted for in accordance with ASC 310-20, Receivables, Nonrefundable Fees and Other Costs and pursuant to amendments by ASU 2010-20 regarding allowance for PCI Revolving Loan Pools. Included in this amount are $1.7 million of TDRs, of which $1.2 million were from the consumer loan portfolio, and $519,000 were from

the commercial loan portfolio.

Table of Contents

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS   CONTINUED

NOTE 6.   Allowance for Loan and Lease Losses and Credit Quality   Continued

	Allowance for Loan and Lease Losses December 31, 2011		
	Commercial	*Consumer*	*Total*
		(dollars in thousands)	
Individually evaluated for impairment (1)	$	$	$
Collectively evaluated for impairment (2)	2,311	2,350	4,661
Acquired with deteriorated credit quality - Term (3)	148	719	867
Acquired with deteriorated credit quality - Revolving (4)			
	$ 2,459	$ 3,069	$ 5,528

	Recorded Investment in Loans December 31, 2011		
	Commercial	*Consumer*	*Total*
		(dollars in thousands)	
Individually evaluated for impairment (1)	$	$	$
Collectively evaluated for impairment (2)	279,139	308,886	588,025
Acquired with deteriorated credit quality - Term (3)	1,888,977	707,573	2,596,550
Acquired with deteriorated credit quality - Revolving (4)	150,550	325,836	476,386
	$ 2,318,666	$ 1,342,295	$ 3,660,961

(1) Represents loans individually evaluated for impairment in accordance with ASC 310-10, Receivables (formerly FAS 114), and pursuant to amendments by ASU 2010-20 regarding allowance for impaired loans originated or purchased since the Transaction Date.

(2) Represents loans collectively evaluated for impairment in accordance with ASC 450-20, Loss Contingencies (formerly FAS 5) and pursuant to amendments by ASU 2010-20 regarding allowance for unimpaired loans.

(3) Represents the related loan carrying value determined in accordance with ASC 310-30, Receivables   Loans and Debt Securities Acquired with Deteriorated Credit Quality (formerly SOP 03-3) and pursuant to amendments by ASU 2010-20 regarding allowance for PCI Term Loan Pools in accordance with ASC 450-20.

(4) Represents the related loan carrying value for revolving loan pools accounted for in accordance with ASC 310-20, Receivables, Nonrefundable Fees and Other Costs and pursuant to amendments by ASU 2010-20 regarding allowance for PCI Revolving Loan Pools. Included in this amount are $1.0 million of TDRs, of which $732,000 was from the consumer loan portfolio, and $305,000 was from the commercial loan portfolio.

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

NOTE 6. ALLOWANCE FOR LOAN AND LEASE LOSSES AND CREDIT QUALITY CONTINUED

Nonperforming Loans

Nonperforming loans include nonaccrual loans, loans past due 90 days which are accruing interest, and TDRs. The reporting for nonperforming loans was significantly impacted by the Investment Transaction as described in Note 1, Summary of Significant Accounting Policies and Note 5, Purchased Credit Impaired Pools of these Consolidated Financial Statements, because all loans were recorded at their fair value at the Transaction Date, and the majority of the Company s loans as of the Transaction Date are accounted for as PCI loans under ASC 310-30.

The table below summarizes loans classified as nonperforming:

	December 31,M ***March 31, 2012***	December 31,M ***December 31, 2011***
	(dollars in thousands)	
Nonaccrual loans:		
Real estate:		
Residential - 1 to 4 family	$ 2,968	$ 2,896
Commercial	5,930	426
Construction		320
Revolving - 1 to 4 family	6,646	6,842
Commercial loans	4,893	5,275
Consumer loans	141	155
Other loans	519	481
Total nonaccrual loans (1)	21,097	16,395
Loans past due 90 days or more on accrual status:		
Other loans	294	
Total loans past due 90 days or more on accrual status	294	
Troubled debt restructured loans:		
Real estate:		
Residential - 1 to 4 family	885	732
Revolving - 1 to 4 family	198	
Commercial loans	519	305
Consumer loans	101	
Total troubled debt restructured loans	1,703	1,037
Total nonperforming loans	$ 23,094	$ 17,432

(1) Nonaccrual loans do not include TDRs that have been placed in on nonaccruing status.

Table of Contents

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

NOTE 6. ALLOWANCE FOR LOAN AND LEASE LOSSES AND CREDIT QUALITY CONTINUED

The table below summarizes troubled debt restructurings:

	March 31, 2012	*December 31, 2011*
	(dollars in thousands)	
Troubled debt restructurings:		
Nonaccrual status	$ 1,607	$ 1,037
Accrual status	96	
Total troubled debt restructured loans	$ 1,703	$ 1,037

50

Table of Contents

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

NOTE 6. ALLOWANCE FOR LOAN AND LEASE LOSSES AND CREDIT QUALITY CONTINUED

Classified and Nonclassified Loans

The following table summarizes classified and nonclassified loans as defined in Note 1, Summary of Significant Accounting Policies of these Consolidated Financial Statements. The amounts are reported at the net carrying amounts at March 31, 2012, and December 31, 2011:

	March 31, 2012		
	Non-Classified	*Classified* (dollars in thousands)	*Total*
Loans Originated or Purchased Since Transaction Date:			
Real estate:			
Residential - 1 to 4 family	$ 394,159	$	$ 394,159
Multifamily loans	243,306		243,306
Commercial	132,058	5,567	137,625
Construction	4,327		4,327
Revolving - 1 to 4 family	5,042		5,042
Commercial loans	17,189		17,189
Consumer loans	5,492		5,492
Other loans (1)	3,654	354	4,008
	805,227	5,921	811,148
PCI Revolving Pools:			
Real estate:			
Residential - 1 to 4 family	55,725	5,635	61,360
Multifamily loans	1,367		1,367
Commercial	15,117	752	15,869
Construction	8,807	1,368	10,175
Revolving - 1 to 4 family	222,008	10,223	232,231
Commercial loans	98,562	10,771	109,333
Consumer loans	19,823	622	20,445
Other loans	2,840	676	3,516
	424,249	30,047	454,296
PCI Term Pools:			
Real estate:			
Residential - 1 to 4 family	571,743	76,388	648,131
Multifamily loans	168,554	12,683	181,237
Commercial	1,172,750	260,443	1,433,193
Construction	42,145	99,884	142,029
Revolving - 1 to 4 family		2,384	2,384
Commercial loans	32,592	14,375	46,967
Consumer loans	21,025	476	21,501
Other loans	5,280	303	5,583
	2,014,089	466,936	2,481,025

Total	$ 3,243,565	$ 502,904	$ 3,746,469

(1) Classified loans represent overdrafts subsequent to the Investment Transaction.

Table of Contents

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

NOTE 6. ALLOWANCE FOR LOAN AND LEASE LOSSES AND CREDIT QUALITY CONTINUED

	December 31, 2011		
	Non-Classified	*Classified*	*Total*
		(dollars in thousands)	
Loans Originated or Purchased Since Transaction Date:			
Real estate:			
Residential - 1 to 4 family	$ 296,257	$	$ 296,257
Multifamily loans	151,417		151,417
Commercial	114,307		114,307
Construction	1,793		1,793
Revolving - 1 to 4 family	3,890		3,890
Commercial loans	11,622		11,622
Consumer loans	6,404		6,404
Other loans (1)	2,222	113	2,335
	587,912	113	588,025
PCI Revolving Pools:			
Real estate:			
Residential - 1 to 4 family	59,505	5,082	64,587
Multifamily loans	1,376		1,376
Commercial	18,923	785	19,708
Construction	3,641	320	3,961
Revolving - 1 to 4 family	227,889	12,129	240,018
Commercial loans	107,268	13,530	120,798
Consumer loans	20,542	689	21,231
Other loans	4,054	653	4,707
	443,198	33,188	476,386
PCI Term Pools:			
Real estate:			
Residential - 1 to 4 family	595,104	84,178	679,282
Multifamily loans	180,971	10,879	191,850
Commercial	1,158,546	296,291	1,454,837
Construction	69,318	110,328	179,646
Revolving - 1 to 4 family	2,086	3,863	5,949
Commercial loans	34,937	21,869	56,806
Consumer loans	21,563	779	22,342
Other loans	4,662	1,176	5,838
	2,067,187	529,363	2,596,550
Total	$ 3,098,297	$ 562,664	$ 3,660,961

(1) Classified loans represent overdrafts subsequent to the Investment Transaction.

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

NOTE 6. ALLOWANCE FOR LOAN AND LEASE LOSSES AND CREDIT QUALITY CONTINUED

The Company closely monitors and assesses credit quality and credit risk in the loan portfolio on an ongoing basis. Loan credit risk grades and classifications of loans are reviewed and updated periodically. The credit risk grades for large classified loans are reviewed at a minimum on a quarterly basis as disclosed in Note 1, Summary of Significant Accounting Policies of these Consolidated Financial Statements.

The Company uses internally assigned credit risk grades in monitoring the credit quality of the loan portfolio. Changes in credit risk grades serve as indications of potential problem loans, and improvement or worsening of existing problem loans, which assist the Company with the process of determining the ultimate collectability of the loan portfolio for loans originated or purchased since the Transaction Date, and assists with determining future cash flows for the PCI Loan Pools. Changes in balances of classified and nonclassified loans are factors that impact the required level of the ALLL for new and purchased loans since the Transaction Date under the Company s periodic evaluation of the adequacy of the ALLL. Changes in classified and nonclassified loans are also considered by the Company in its periodic evaluation of cash flows from PCI Loan Pools, but do not necessarily indicate impairment or the need for an ALLL or a reversal of a previously established ALLL for PCI Loan Pools, as such loans are accounted based on expected cash flows, as more fully described in Note 1, Summary of Significant Accounting Policies, of these Consolidated Financial Statements. Changes in credit risk grades for PCI Loan Pools serve primarily as a basis for the Company to manage the underlying credit quality and collection efforts of loans within PCI Loan Pools, and for the establishment of assumptions used by the Company in estimating cash flows expected to be collected from these pools in future periods.

Aging of Past Due Loans

A majority of the loans held by the Company have been pooled into PCI Term Pools and none of the pools were considered to be past due at March 31, 2012, and December 31, 2011, when reporting on a pooled basis in accordance with ASC 310-30. The following tables provide the aging of past due loans on an individual loan basis at the net carrying amount at March 31, 2012, and December 31, 2011.

Table of Contents

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

NOTE 6. ALLOWANCE FOR LOAN AND LEASE LOSSES AND CREDIT QUALITY CONTINUED

	March 31, 2012				
	Current	*30-89 Days Past Due*	*90+ Days Past Due - Still Accruing*	*Nonaccrual (1)*	*Total*
			(dollars in thousands)		
Loans Originated or Purchased Since Transaction Date:					
Real estate:					
Residential - 1 to 4 family	$ 394,159	$	$	$	$ 394,159
Multifamily loans	243,240	66			243,306
Commercial	128,249	3,809		5,567	137,625
Construction	4,327				4,327
Revolving - 1 to 4 family	5,042				5,042
Commercial loans	17,108	81			17,189
Consumer loans	5,461	31			5,492
Other loans	3,690	24	294		4,008
	801,276	4,011	294	5,567	811,148
PCI Revolving Pools:					
Real estate:					
Residential - 1 to 4 family	56,476	1,031		3,853	61,360
Multifamily loans	1,367				1,367
Commercial	15,506			363	15,869
Construction	8,552	1,623			10,175
Revolving - 1 to 4 family	223,759	1,628		6,844	232,231
Commercial loans	103,198	820		5,315	109,333
Consumer loans	20,074	129		242	20,445
Other loans	2,997			519	3,516
	431,929	5,231		17,136	454,296
PCI Term Pools:					
Real estate:					
Residential - 1 to 4 family	611,093	17,919	19,119		648,131
Multifamily loans	176,740	3,330	1,167		181,237
Commercial	1,390,812	15,129	27,252		1,433,193
Construction	71,843	5,752	64,434		142,029
Revolving - 1 to 4 family			2,384		2,384
Commercial loans	38,241	1,000	7,726		46,967
Consumer loans	21,261	240			21,501
Other loans	5,583				5,583
	2,315,573	43,370	122,082		2,481,025
Total	$ 3,548,778	$ 52,612	$ 122,376	$ 22,703	$ 3,746,469

(1) At March 31, 2012, $9.0 million of nonaccruing loans were current, and $7.6 million of nonaccruing loans were 30-89 days past due. Nonaccruing loans originated or purchased since Transaction Date relate to two commercial real estate loans.

Table of Contents

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

NOTE 6. ALLOWANCE FOR LOAN AND LEASE LOSSES AND CREDIT QUALITY CONTINUED

	December 31, 2011				
	Current	*30-89 Days Past Due*	*90+ Days Past Due - Still Accruing*	*Nonaccrual (1)*	*Total*
			(dollars in thousands)		
Loans Originated or Purchased Since Transaction Date:					
Real estate:					
Residential - 1 to 4 family	$ 296,257	$	$	$	$ 296,257
Multifamily loans	151,314	103			151,417
Commercial	114,306	1			114,307
Construction	1,793				1,793
Revolving - 1 to 4 family	3,890				3,890
Commercial loans	11,321	301			11,622
Consumer loans	6,335	69			6,404
Other loans	2,306	29			2,335
	587,522	503			588,025
PCI Revolving Pools:					
Real estate:					
Residential - 1 to 4 family	58,973	1,986		3,628	64,587
Multifamily loans	1,376				1,376
Commercial	19,206	76		426	19,708
Construction	3,641			320	3,961
Revolving - 1 to 4 family	231,777	1,399		6,842	240,018
Commercial loans	106,642	8,576		5,580	120,798
Consumer loans	20,941	135		155	21,231
Other loans	4,179	47		481	4,707
	446,735	12,219		17,432	476,386
PCI Term Pools:					
Real estate:					
Residential - 1 to 4 family	630,441	30,553	18,288		679,282
Multifamily loans	186,190	3,741	1,919		191,850
Commercial	1,407,344	22,593	24,900		1,454,837
Construction	111,171	1,917	66,558		179,646
Revolving - 1 to 4 family	2,304		3,645		5,949
Commercial loans	47,105	907	8,794		56,806
Consumer loans	22,088	227	27		22,342
Other loans	4,999	37	802		5,838
	2,411,642	59,975	124,933		2,596,550
Total	$ 3,445,899	$ 72,697	$ 124,933	$ 17,432	$ 3,660,961

(1) At December 31, 2011 $10.2 million of nonaccruing loans were current, and $1.7 million of nonaccruing loans were 30-89 days past due.

Table of Contents

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

NOTE 6. ALLOWANCE FOR LOAN AND LEASE LOSSES AND CREDIT QUALITY CONTINUED

Impaired Loans

PCI Loan Pools are measured for impairment at the pool level, based on estimates for aggregate cash flows expected to be collected from the pool. At March 31, 2012, and December 31, 2011, all PCI Term Pools were considered performing. Impaired loans as of March 31, 2012, represent TDRs within the PCI Revolving Pools, as well as one nonaccruing commercial real estate loan in the newly originated or purchased loans portfolio. At December 31, 2011, all impaired loans represented TDRs within the PCI Revolving Pools.

The table below summarizes the average balance of impaired loans:

	Three Months Ended March 31,	
	2012	2011
	(dollars in thousands)	
Average investment in impaired loans for the period	$ 1,728	$ 8

Interest income recognized on impaired loans during the periods for which the average recorded investment in impaired loans is presented in the table above was not material.

Troubled Debt Restructurings

The following tables provide a summary of loans modified as TDRs during the three months ended March 31, 2012, and 2011:

	Three Months Ended March 31, 2012			
	PCI Revolving Loans		New and Purchased Loans	
	Amount	Number	Amount	Number
	(dollars in thousands)			
Residential - 1 to 4 family	$ 193	1	$	
Commercial loans	375	4		
Revolving - 1 to 4 family	39	1		
Total TDRs during the period	$ 607	6	$	

	Three Months Ended March 31, 2011			
	PCI Revolving Loans		New and Purchased Loans	
	Amount	Number	Amount	Number
	(dollars in thousands)			
Commercial loans	$ 139	2	$	
Total TDRs during the period	$ 139	2	$	

Table of Contents

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

NOTE 6. ALLOWANCE FOR LOAN AND LEASE LOSSES AND CREDIT QUALITY CONTINUED

Modifications made during the three months ended March 31, 2012, and 2011 that are considered TDRs involve reductions in interest rates, extension of terms, and reductions in periodic contractual payments for a specified period of time. As discussed in Note 1, Summary of Significant Accounting Policies of these Consolidated Financial Statements, the aggregation of loans into pools at the Transaction Date, along with the application of ASC 310-30, eliminated the requirement for the PCI Term Pools to be evaluated on the underlying individual loan performance and classification as TDRs.

NOTE 7. GOODWILL AND INTANGIBLE ASSETS

Goodwill and intangible assets reported on the Consolidated Balance Sheet for March 31, 2012, and December 31, 2011, is comprised of the following:

	March 31, 2012	*December 31, 2011*
	(dollars in thousands)	
Goodwill	$ 26,550	$ 26,550
Core deposit intangible	29,685	31,040
Customer relationship intangible	16,306	16,724
Trade name intangible	12,471	12,471
Mortgage and other loan servicing rights	2,366	2,378
Other	78	92
Total	$ 87,456	$ 89,255

The table below presents the allocation of goodwill by segment:

	March 31, 2012	*December 31, 2011*
	(dollars in thousands)	
Segment:		
Commercial & Community Banking	$ 21,627	$ 21,627
Wealth Management	4,923	4,923
Total	$ 26,550	$ 26,550

The Company performs an annual goodwill impairment assessment at the third quarter end of each year. As of March 31, 2012, there was no evidence of any triggering events or developments which would require the goodwill to be reassessed for impairment.

Table of Contents

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS   CONTINUED

NOTE 7.   GOODWILL AND INTANGIBLE ASSETS   CONTINUED

Other Intangible Assets

The Company has five types of identifiable intangible assets: core deposit intangibles, customer relationship intangibles, trade name intangibles, non-compete intangibles, and mortgage and other loan servicing rights. All intangible assets are amortized over their estimated lives, where applicable. The core deposit, the customer relationship, the trade name, and the non-compete intangibles are created when a company acquires another company. The loan servicing rights are created when loans are sold but the right to service the loans is retained by the seller. The recognition of any new intangibles due to new loan servicing rights appears as Additions, in the following tables which summarize the changes in the other intangible assets by class.

A summary of the activity for other intangible assets, by asset class, is as follows:

	Core Deposit Intangible	*Customer Relationship Intangible*	*Trade Name Intangible*	*Mortgage Servicing Rights*
	(dollars in thousands)			
Balance, December 31, 2011	$ 31,040	$ 16,724	$ 12,471	$ 2,378
Amortization	(1,355)	(418)		(189)
Additions				216
Valuation adjustment				(39)
Balance, March 31, 2012	$ 29,685	$ 16,306	$ 12,471	$ 2,366

	Core Deposit Intangible	*Customer Relationship Intangible*	*Trade Name Intangible*	*Mortgage Servicing Rights*
	(dollars in thousands)			
Balance, December 31, 2010	$ 37,469	$ 18,684	$ 12,669	$ 3,065
Amortization	(1,733)	(425)	(27)	(253)
Additions				90
Valuation adjustment				(5)
Balance, March 31, 2011	$ 35,736	$ 18,259	$ 12,642	$ 2,897

Table of Contents

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

NOTE 8. OTHER REAL ESTATE OWNED

A summary of the OREO by loan type is as follows:

	March 31, 2012	*December 31, 2011*
	(dollars in thousands)	
OREO:		
Real estate:		
Residential - 1 to 4 family	$ 17,653	$ 12,941
Multifamily loans	2,493	1,440
Commercial	10,095	8,582
Construction	28,545	29,339
Total OREO	$ 58,786	$ 52,302

Below is a summary of the OREO valuation allowance activity for the three months ended March 31, 2012, and March 31, 2011:

	Three Months Ended March 31, 2012	*2011*
	(dollars in thousands)	
Beginning balance	$ 2,874	$ 134
Additions	776	1,740
Sales	(1,458)	(821)
Ending balance	$ 2,192	$ 1,053

NOTE 9. DEFERRED TAX ASSETS AND TAX PROVISION

Deferred Tax Assets

The Company recognizes deferred tax assets and liabilities for the future tax consequences related to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, for tax credit carryforwards, and for other tax attributes. Without regard to a deferred tax liability of $5.2 million for an indefinite lived intangible, the deferred tax asset net of valuation allowance was $2.2 million at March 31, 2012, and $1.5 million at December 31, 2011. In determining these amounts, the gross deferred tax assets were reduced by deferred tax liabilities with the exception of a deferred tax liability of $5.2 million that was recorded in connection with an indefinite lived trade name intangible. The deferred tax liabilities other than that associated with the indefinite lived trade name intangible are expected to reverse in a manner that produces future taxable income appropriate to support the recognition of a corresponding amount of deferred tax assets. Any amounts of deferred tax asset that are not able to be recognized on this basis have been reduced by a valuation allowance.

At June 30, 2009, Management concluded that it was more likely than not that the Company would not generate sufficient future taxable income in the foreseeable future to realize all of the Company s deferred tax assets. Management evaluates the Company s deferred tax assets for recoverability using a consistent approach which considers the relative impact of negative and positive evidence, including the Company s historical profitability and projections of future taxable income.

59

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

NOTE 9. DEFERRED TAX ASSETS AND TAX PROVISION CONTINUED

For the three year period ended March 31, 2012, the Company is in a cumulative pretax loss position. For purposes of maintaining a deferred tax valuation allowance, this cumulative pretax loss position is considered significant, objective evidence that the Company may not be able to realize some portion of the deferred tax assets in the future. In addition, as a result of the Investment Transaction on August 31, 2010, the Company incurred an ownership change under Section 382 of the Internal Revenue Code. The ownership change will limit the utilization, for tax purposes, of certain items of the net deferred tax asset including net operating losses, recognized built-in-losses and credit carryforwards.

During the first three months ended March 31, 2012, and during 2011, the Company released a portion of the state deferred tax valuation allowance due to an assessment of the realizability of the deferred tax asset based on existing California State tax law. In addition, an adjustment to the state deferred tax asset and valuation allowance was posted as the Company utilized a portion of its state net operating loss carryforwards to offset the current period s estimated state taxable income.

Income Tax Provision

Estimates of the annual effective tax rate at the end of interim periods to be utilized in determining the provision for income tax expense are, of necessity, based on evaluations of possible future events and transactions which are subject to subsequent refinement or revision. Since the Company believes a reliable estimate of the annual effective tax rate cannot be made, the actual effective tax rate for the year to date has been used as the best estimate of the annual effective tax rate.

For the three months ended March 31, 2012, a $994,000 income tax provision was recognized. The tax provision for the three months ended March 31, 2012, is primarily attributable to a state alternative minimum tax (AMT) offset by a favorable settlement of $204,000 with the California Franchise Tax Board s examination of the Company s 2002-2006 claim for refund. Although the state AMT liability generated an AMT credit carryforward, the Company did not recognize a benefit for this AMT credit carryforward, since it has a valuation allowance offsetting its deferred tax assets.

At March 31, 2012, and December 31, 2011, Management concluded that there were no significant uncertain tax positions requiring recognition or disclosure in the Company s Consolidated Financial Statements as required under ASC 740-10, *Income Taxes* regarding accounting for uncertainty in income taxes. The Company may from time to time be assessed interest or penalties by major tax jurisdictions, although any such assessments historically have been minimal and immaterial to financial results. In the event the Company has an assessment from a taxing authority, any resulting interest and penalties are recognized as a component of income tax expense.

Table of Contents

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS   CONTINUED

NOTE 10.   OTHER BORROWINGS

The following table summarizes long term debt and other borrowings:

	March 31, 2012	December 31, 2011
	(dollars in thousands)	
Other borrowings:		
Subordinated notes payable (1)	$ 51,768	$ 51,664
Obligation under capital lease	19,976	14,860
Total other borrowings	$ 71,744	$ 66,524

(1) Includes the Bancorp s subordinated notes payable to unconsolidated trusts issuing trust preferred securities. Also referred to as trust preferred securities within these Consolidated Financial Statements.

The subordinated notes payable balances above are net of discounts of $17.7 million and $17.8 million as of March 31, 2012, and December 31, 2011, respectively.

Other Short Term Borrowings

Other short term borrowings consist of TT&L deposits collected from clients held by the Bank until the funds are requested by the Reserve Bank.

The following table summarizes additional information for other short term borrowings:

	Three Months Ended March 31, 2012	Three Months Ended March 31, 2011 (1)
	(dollars in thousands)	
Weighted average interest rate at end of period	0.00%	0.00%
Weighted average interest rate for the period	0.00%	0.00%
Average outstanding balance	$	$ 3,377
Total balance at end of period	$	$ 3,074
Maximum outstanding at any month-end	$	$ 3,330

(1) Included in the balances are TT&L funds from clients on behalf of the U.S. Treasury. The funds received and held for TT&Ls do not incur interest expense, therefore no interest expense or rates are disclosed for these borrowings in the table above. The U.S. Treasury discontinued its TT&L program during 2011.

Federal Home Loan Bank Advances

As a member of FHLB the Company has established a credit line. The borrowing capacity is determined based on asset size among other factors. The Company is required to pledge assets to securitize its borrowings line. As of March 31, 2012, and December 31, 2011, there were no FHLB advances outstanding. As of March 31, 2012, the Company had a line of credit with the FHLB of $1.30 billion, with investment securities and loans pledged as collateral with an estimated market value of $1.64 billion for the line.

Table of Contents

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

NOTE 11. COMMITMENTS AND CONTINGENCIES

Contractual Lease Obligations

The following table shows the contractual lease obligations of the Company at March 31, 2012:

	March 31, 2012					
	Less than one year	*One to three years*	*Three to five years*	*More than five years*	*Total*	*December 31, 2011*
	(dollars in thousands)					
Non-cancelable leases	$ 12,352	$ 21,510	$ 14,031	$ 42,853	$ 90,746	$ 90,125
Capital leases	1,847	3,992	4,132	25,722	35,693	30,625
Total lease obligations	$ 14,199	$ 25,502	$ 18,163	$ 68,575	$ 126,439	$ 120,750

The Company leases most of its office locations and substantially all of these office leases contain multiple five-year renewal options and provisions for increased rentals, principally for property taxes and maintenance. At March 31, 2012, the minimum commitments under non-cancelable leases for the next five years and thereafter are shown in the table above. The amounts in the table for minimum rentals are not reported net of the contractual obligations of sub-tenants. Sub-tenants leasing space from the Company under these operating and capital leases are contractually obligated to the Company for approximately $1.4 million at March 31, 2012. Approximately 95% of these payments are due to the Company over the next three years.

Contractual Commitments for Unfunded Loans and Letter of Credits

For a summary and more information on the contractual commitments for unfunded loan commitments and letters of credit as of March 31, 2012, refer to Note 4, Loans of these Consolidated Financial Statements.

Legal Matters

The plaintiffs, the Company, and the other defendants entered into an agreement to settle all claims in the previously disclosed consolidated shareholder derivative and direct complaints of Monty and Clem. Following a hearing on January 19, 2012, the trial court approved the settlement and entered judgment dismissing the lawsuit with prejudice. The settlement did not have any material effect on the Company s financial position, results of operations, or cash flows.

The Company and the individual members of its Board of Directors have been named as defendants in a number of purported shareholder class action lawsuits arising out of the proposed merger between the Company and UnionBanCal Corporation, which merger was announced on March 12, 2012. Five lawsuits were filed in Superior Court in Santa Barbara County, California, and two lawsuits were filed in Delaware Chancery Court. The California and Delaware lawsuits have been consolidated in their respective jurisdictions (consolidated California case is captioned *Monty v. Ford, et al.*, and consolidated Delaware case is captioned *In re Pacific Capital Bancorp Shareholder Litigation*). The consolidated lawsuits in both jurisdictions allege claims for breach of fiduciary duty by the individual directors, and claims against the Company and UnionBanCal Corporation for aiding and abetting that breach of fiduciary duty. Both actions seek to enjoin the proposed merger. Preliminary injunction hearings have been scheduled for May 29, 2012, and June 7, 2012, in the California and Delaware actions, respectively. The defendants believe the claims are without merit and intend to vigorously defend these actions.

The Company is involved in various other lawsuits of a routine nature that are being handled and defended in the ordinary course of the Company s business. Expenses are being incurred in connection with defending the Company, but in the opinion of Management, based in part on consultation with legal counsel, the resolution of these lawsuits will not have a material impact on the Company s financial position, results of operations, or cash flows.

Table of Contents

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS   CONTINUED

NOTE 12. EARNINGS PER SHARE

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 securities outstanding that are potentially dilutive are employee stock options, restricted stock and common stock warrants.

	Three Months Ended March 31, 2012	2011
	(dollars and shares in thousands, except per share amounts)	
Net income	$ 16,638	$ 16,760
Basic weighted average shares outstanding	32,905	32,903
Dilutive effect of stock grants	37	1
Dilutive effect of common stock warrants	6	5
Diluted weighted average shares outstanding	32,948	32,909
Anti-dilutive common stock equivalents excluded from computation of diluted weighted average shares outstanding:		
Stock options	49	9
Common stock warrants		
Earnings per share:		
Basic	$ 0.51	$ 0.51
Diluted (1)	$ 0.50	$ 0.51

(1) Common stock equivalents are not included in the computation of the diluted weighted average shares outstanding when they are anti-dilutive.

Table of Contents

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

NOTE 13. NONINTEREST INCOME

The table below discloses the largest items included in other noninterest income:

	Three Months Ended March 31,	
	2012	*2011*
	(dollars in thousands)	
Other Income:		
Net gain on sales of assets	$ 1,299	$ 769
Customer fee income	1,097	1,288
Life insurance income	700	672
Net loss on LIHTCP	(311)	(1,074)
Other	216	128
Total	$ 3,001	$ 1,783

NOTE 14. NONINTEREST EXPENSE

The table below discloses the largest items included in other noninterest expense:

	Three Months Ended March 31,	
	2012	*2011*
	(dollars in thousands)	
Other Expense:		
Professional services	$ 4,082	$ 3,996
Software expense	2,292	1,518
Regulatory assessments	2,168	4,487
Increase in earnout liability for RIAs	2,160	
Customer deposit service and support	2,149	1,750
Other intangible expense	1,787	2,199
Furniture, fixtures and equipment, net	1,273	1,234
OREO expense	1,088	812
Loan servicing expense	1,047	648
Supplies and postage	1,003	955
Merger and acquisition expense	1,000	
Telephone and data	918	656
Other	1,101	1,385
Total	$ 22,068	$ 19,640

64

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

NOTE 15. SEGMENTS

The segments are aligned based on how the Company s Board of Directors has set performance goals for the Chief Executive Officer (CEO) and his management team. The financial results and determination of the operating segments were based on the major business lines of the Bank and the products and services offered to the clients of each segment, as well as how the chief operating decision maker of the Company measures performance and allocates resources. The Company has two operating business segments: Commercial & Community Banking and Wealth Management. The All Other segment is not considered an operating segment, but includes all corporate administrative support departments such as human resources, legal, finance and accounting, treasury, information technology, internal audit, risk management, facilities management, marketing, executive management and the Bank s holding company. The operations and expenses reported in the All Other segment cannot specifically be allocated to the operating segments based on the services provided. The administrative departments which specifically support the operating segments have been identified and reported within the operating segment.

A summary of the operating segments products and services and clients are below:

Commercial & Community Banking

The Commercial & Community Banking reportable segment is the aggregation of client sales and service activities typically found in a bank. This reportable segment includes all lending and deposit products of the Bank. Clients include small business and middle market companies as well as individuals in the communities which the Bank serves.

Loan products offered by the Commercial & Community Banking segment include traditional commercial and industrial (commercial) and commercial real estate loans, lines of credit, letters of credit, asset based lending, construction loans, land acquisition and development loans to small business and middle market commercial clients. Loan products offered to individual clients include residential real estate loans, home equity lines and loans, and consumer loans.

Deposit products offered by the Commercial & Community Banking segment include checking, savings, money market accounts, individual retirement accounts and certificates of deposit. Other products include foreign exchange services, treasury services and debit card services. The Commercial & Community Banking segment serves clients through traditional banking branches, loan production centers, Automated Teller Machines and through client contact call centers and online banking.

Included in the Commercial & Community Banking segment are the associated administrative departments to support their products and activities such as loan servicing, credit administration, special assets department, research, wire room, delinquency management unit, central vault operations, retail banking administration and retail and commercial lending administration departments.

Wealth Management

The Wealth Management reportable segment includes the trust and investment advisory services division and the two registered investment advisors, MCM and REWA which are subsidiaries of the Bank. The Wealth Management segment provides investment reviews, analysis and customized portfolio management for separately managed accounts, full service brokerage, trust and fiduciary services, equity and fixed income management and real estate and specialty asset management.

Table of Contents

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

NOTE 15. SEGMENTS - CONTINUED

All Other

This reportable segment consists of administrative support areas of the Company and is not considered an operating segment of the Company. The All Other segment is presented in the segment tables above to reflect unallocated operating segments to the consolidated totals of the Company s Consolidated Financial Statements. The administrative support units include the Company s executive administration, risk management, information technology operations, marketing, human resources, corporate real estate, legal, treasury, and finance and accounting areas of the Company. The income and expense generated by the All Other segment is from the investment securities portfolio and the borrowings which is managed by the treasury department and allocated to the operating segments as part of the allocation process in preparing segment balance sheets.

Indirect Credit/(Charge) for Funds

Included in Indirect credit/(charge) for funds is an allocation of net interest income between segments with the All Other segment being used for the funding center. The indirect credit/(charge) for funds is calculated by analyzing average earning assets and average interest bearing liabilities plus average noninterest bearing deposits. If a segment s average earning assets are greater, the net average assets are multiplied by the net cost of funds to calculate the indirect charge for funds as the segment does not have enough liabilities to fund the assets of the segment. If a segment has more interest bearing liabilities than assets, then the net average interest bearing liabilities are multiplied by the net cost of funds and the segment receives an indirect credit for funds.

The following tables present information for each specific operating segment regarding assets, profit or loss, and specific items of revenue and expense that are included in the measure of segment profit or loss reviewed by the CEO. Included in the table is an All Other segment which includes the administrative support units, the Bank s holding company, and balancing of the funding uses and sources activity that are not allocated to the two operating segments.

Table of Contents

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

NOTE 15. SEGMENTS - CONTINUED

	Three Months Ended March 31, 2012			
	Operating Segments			
	Commercial & Community Banking	Wealth Management	All Other	Total
	(dollars in thousands)			
Interest income	$ 58,170	$	$ 8,213	$ 66,383
Interest expense	5,128		3,587	8,715
Net interest income	53,042		4,626	57,668
Provision for loan losses	835			835
Noninterest income	8,245	5,335	355	13,935
Noninterest expense	45,049	7,305	782	53,136
Direct income/(loss) before tax	15,403	(1,970)	4,199	17,632
Indirect credit/(charge) for funds	8,905	(3)	(8,902)	
Net income/(loss) from continuing operations before tax	$ 24,308	$ (1,973)	$ (4,703)	$ 17,632
Total assets	$ 4,108,179	$ 27,257	$ 1,710,138	$ 5,845,574

	Three Months Ended March 31, 2011			
	Operating Segments			
	Commercial & Community Banking	Wealth Management	All Other	Total
	(dollars in thousands)			
Interest income	$ 59,765	$	$ 6,716	$ 66,481
Interest expense	6,300	(126)	6,010	12,184
Net interest income	53,465	126	706	54,297
Provision for loan losses	1,667			1,667
Noninterest income	8,025	5,466	(626)	12,865
Noninterest expense	42,041	5,169	1,053	48,263
Direct income/(loss) before tax	17,782	423	(973)	17,232
Indirect credit/(charge) for funds	7,983	43	(8,026)	
Net income/(loss) from continuing operations before tax	$ 25,765	$ 466	$ (8,999)	$ 17,232
Total assets	$ 3,988,814	$ 42,939	$ 1,911,443	$ 5,943,196

Pacific Capital Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

NOTE 16. REGULATORY MATTERS

On September 2, 2010, the Bank entered into the Operating Agreement with the Office of the Comptroller of the Currency (OCC), pursuant to which, among other things, the Bank agreed to maintain total risk-based capital at least equal to 12% of risk-weighted assets and Tier 1 leverage at least equal to 8% of adjusted total assets and to not pay any dividend or reduce its capital without the prior non-objection of the OCC and unless at least three years shall have elapsed since the effective date of the Operating Agreement. The Bank was in compliance with these minimum capital ratios at March 31, 2012, and December 31, 2011, with a Tier 1 leverage ratio of 11.7% and 11.2%, respectively, and a total risk-based capital ratio of 18.8% and 18.3%, respectively. In addition, as of March 31, 2012, the Bank was not permitted to pay dividends to the Company, because of the requirement for the non-objection of the OCC and because of legal limitations on the amount of dividends which may be paid by the Bank to the Company that are determined based on the Bank s capital and earnings.

On May 11, 2010, the Company entered into the Written Agreement with the Reserve Bank. The Written Agreement restricts the payment of dividends by the Company, as well as the taking of dividends or any other payment representing a reduction in capital from the Bank, without the prior approval of the Reserve Bank. The Written Agreement further requires that the Company and its nonbank subsidiaries not incur, increase, or guarantee any debt, repurchase or redeem any shares of its stock, or pay any interest or principal on subordinated debt or trust preferred securities, in each case without the prior approval of the Reserve Bank. The Written Agreement also requires the Company to develop a capital plan for the Company, which shall address, among other things, the Company s current and future capital requirements, including compliance with the minimum capital ratios, the adequacy of the capital, the source and timing of additional funds, and procedures to notify the Reserve Bank no more than thirty days after the end of any quarter in which the Company s consolidated capital ratios or the Bank s capital ratios fall below the required minimums. The Company will also be required to provide notice to the Reserve Bank regarding the appointment of any new director or senior executive officer. Finally, the Board of Directors of the Company is required to submit written progress reports to the Reserve Bank within thirty days after the end of each calendar quarter.

Any material failure to comply with the provisions of the Written Agreement or Operating Agreement could result in additional enforcement actions by the Reserve Bank and the OCC. While the Company and the Bank intend to take such actions as may be necessary to comply with the requirements of the Written Agreement and Operating Agreement, there can be no assurance that the Company will be able to comply fully with the provisions of the Written Agreement or that the Bank will be able to comply fully with the provisions of the Operating Agreement, that compliance with the Written Agreement and Operating Agreement will not be more time consuming or more expensive than anticipated, or that efforts to comply with the Written Agreement and Operating Agreement will not have adverse effects on the operations and financial condition of the Company or the Bank.

NOTE 17. SUBSEQUENT EVENTS

Management has evaluated the effects of events that have occurred subsequent to period end March 31, 2012, and there have been no material events that would require recognition in the March 31, 2012, Consolidated Financial Statements.

Table of Contents

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The Company provides a wide range of banking, investment and trust services to its clients primarily through its wholly-owned subsidiary, SBB&T, and its subsidiaries. For over 50 years, the Bank has served clients through relationship banking. The Bank combines the breadth of financial products typically associated with a larger financial institution with the type of individual client service that is found in a community bank. The Bank provides full service banking, including all aspects of checking and savings, private and commercial lending, investment advisory services, trust, and other banking products and services. Products and services are offered through retail branch offices, commercial and wealth management centers and other distribution channels to consumers and businesses operating throughout the Central Coast of California, in eight contiguous counties including Santa Barbara, Ventura, Monterey, Santa Cruz, Santa Clara, San Benito, San Luis Obispo and Los Angeles. The Company is headquartered in Santa Barbara, California.

The following discussion and analysis should be read in conjunction with the Company s 2011 Form 10-K and the Company s Consolidated Financial Statements and notes within this Form 10-Q, herein referred to as the Consolidated Financial Statements included and incorporated by reference herein. Bancorp or the Bank s holding company will be used in this discussion when referring only to the holding company as distinct from the consolidated company.

Financial Highlights

Net income for the three months ended March 31, 2012, was $16.6 million, or $0.50 per diluted share, a $122,000 decrease from net income from three months ended March 31, 2011, of $16.8 million, or $0.51 per diluted share. The financial highlights for the three months ended March 31, 2012, were as follows:

- On March 12, 2012, the Company announced that it had entered into a Merger Agreement with UnionBanCal Corporation (the Merger Agreement). Pursuant to the Merger Agreement, each outstanding share of the Company s common stock will be converted into the right to receive cash in the amount of $46.00 per share upon consummation of the Merger. The acquisition requires approval from banking regulators and is subject to other customary closing conditions, and is expected to be completed in the fourth quarter of 2012;

- Achieved a return on average assets of 1.15% and a return on average equity of 8.54% for the three months ended March 31, 2012;

- Improved net interest margins to 4.29% for the first quarter of 2012, compared with 3.99% for the first quarter of 2011; and

- Increased regulatory capital ratios to 12.8% and 20.6% for Tier 1 Leverage and Total Risk-Based Capital, respectively.

For more information regarding the Merger Agreement and the Merger, refer to Item 1. Business - Recent Developments in the Company s 2011 Form 10-K. Investors should read the definitive information statement when it becomes available because it will contain important information about the proposed merger and the Company.

Table of Contents

Results of Operations

Interest Income

The Company s primary source of revenue is interest income. The discussion below concerning interest income from loans relate to the Commercial & Community Banking segment, while the discussion below concerning interest income from investment securities and other interest income all pertain to the Company s treasury department activities, and are included in the All Other segment. The Wealth Management segment does not earn interest income. The accounting for interest income for loans and investment securities is explained in detail in Note 1, Summary of Significant Accounting Policies of the Consolidated Financial Statements.

The following table presents a summary of interest income for the periods indicated:

	Three Months Ended March 31,	
	2012	***2011***
	(dollars in thousands)	
Interest income		
Loans:		
Commercial	$ 5,321	$ 7,703
Real estate - commercial	35,500	33,739
Real estate - residential 1 to 4 family	16,090	16,480
Consumer loans	1,259	1,841
Total	58,170	59,763
Investment securities - AFS:		
U.S. Agency securities	247	415
Asset-backed securities		61
Collateralized mortgage obligations and mortgage-backed securities	5,321	3,460
State and municipal securities	2,154	2,160
Total	7,722	6,096
Other	491	622
Total interest income	$ 66,383	$ 66,481

Interest income was $66.4 million and $66.5 million for the three months ended March 31, 2012, and 2011, respectively. The slight decline in interest income is a result of a decrease in interest income from loans and other interest income offset by an increase in interest income from investment securities.

Interest income on loans decreased $1.6 million between the reported periods primarily as a result of declining carrying values primarily due to scheduled principal payments and repayments from the PCI Loan Pools of $637.6 million since March 31, 2011. In accordance with the decline in carrying values of PCI Loan Pools since March 31, 2011, accretion declined $7.9 million when comparing the three months ended March 31, 2012, to the same period in March 31, 2011. The PCI Loan Pools continue to perform favorably with a discount rate increasing from 5.87% at March 31, 2011, to 6.47% at March 31, 2012. The declines in balances from the PCI Loan Pools were offset by increased loan originations and purchases of primarily residential and commercial real estate loans during the three months ended March 31, 2012, of $247.5 million but at a lower yield of 4.85%.

Table of Contents

Interest income from investment securities was $7.7 million and $6.1 million for the three months ended March 31, 2012, and March 31, 2011, respectively. The $1.6 million increase was attributable to an increase in the average balance of $219.1 million and 14 basis points in interest rates primarily in MBS and CMO investment securities.

Interest Expense

The Company incurs interest expense from interest payments made to depositors and for other borrowings. Interest expense from deposits pertain to the Commercial & Community Banking operating segment, while interest expense from borrowings or debt almost all pertain to the Company s treasury department related activity and therefore are included in the All Other segment. Wealth Management incurs interest expense only for the capital lease on the building occupied by the Company s trust department. For more information regarding leases, refer to the section titled Leases in Note 1, Summary of Significant Accounting Policies of the Consolidated Financial Statements for an explanation of the accounting for a capital lease.

The following table presents a summary of interest expense for the periods indicated:

	Three Months Ended March 31, 2012	Three Months Ended March 31, 2011
	(dollars in thousands)	
Interest expense		
Deposits:		
NOW accounts	$ 436	$ 406
Money market deposit accounts	360	378
Savings deposits	442	430
Time certificates of deposit	4,180	5,892
Total	5,418	7,106
Securities sold under agreements to repurchase	2,463	2,102
Other borrowings:		
Long term debt	613	2,828
Other borrowings	221	148
Total	834	2,976
Total interest expense	$ 8,715	$ 12,184

Interest expense was $8.7 million and $12.2 million for the three months ended March 31, 2012, and 2011, respectively. The decline in interest expense was primarily attributable to the maturity of CDs with higher interest rates and the maturity and redemption of $53.0 million of subordinated debt in the third and fourth quarter of 2011.

Interest expense on deposits decreased by $1.7 million when comparing the three months ended March 31, 2012, to March 31, 2011. Interest expense on time CDs decreased to $4.2 million for the three months ended March 31, 2012, compared to $5.9 million for the same period in 2011. The decline was primarily a result of a decline of the average balances due to maturities of higher rate broker CDs, offset by lower premium amortization for CDs from the fair value adjustment from the purchase accounting for the Investment Transaction.

Table of Contents

The interest expense on securities sold under agreements to repurchase (repurchase agreements) increased due the contractual repricing of a $100.0 million repurchase agreement. Despite the market trend of declining interest rates, the Bank had a contractual agreement which required the interest rate to convert to a fixed rate of 4.12% during the first quarter of 2011 from an interest rate which had a floating rate of 3 month London Inter-Bank Offered Rate less 25 basis points which was significantly lower. Interest on other borrowings declined due primarily to the maturity and redemption of subordinated debt during 2011.

Net Interest Margin

An important measure of a financial institution s earning capacity is its net interest margin. This measure is computed by dividing the difference between interest income and interest expense, or net interest income, by average earning assets. As a financial intermediary, a bank earns money by borrowing from depositors and debt-holders and lending some of those funds to loan clients and by purchasing investments. By combining the average yield earned on interest earning assets with the average interest cost to hold those assets, the net interest margin measures both the institution s ability to earn its desired yield on its assets and its efficiency in obtaining the funding that supports those assets. The net interest margin differs from, and is lower than the net interest spread, which is the difference between the average yield earned on interest bearing assets and the average rate paid on interest bearing liabilities, because a portion of the Company s interest earning assets are funded by noninterest bearing liabilities.

The net interest margin is improved by higher yields earned on interest earning assets, lower rates paid on interest bearing liabilities, funding a larger proportion of earning assets with noninterest bearing liabilities, and by lowering the amount of nonearning assets that must be funded. Yields earned on assets and paid on liabilities tend to move in tandem with each other as the market interest rate environment changes, but it is generally harder to improve the net interest margin in a low interest rate environment because there is a point beyond which deposit rates cannot be reduced, and still retain clients, while yields on assets may continue to decline. Conversely, as market interest rates rise, deposit rates will generally not rise as fast or as much and the net interest margin may thereby be improved.

Table of Contents

The following table sets forth average balances, interest income and interest expense for the three months ended March 31, 2012, and 2011:

	For the Three Months Ended March 31,					
	2012			*2011*		
	Average Balance	*Interest / Expense (3)*	*Yield / Rate (3)*	*Average Balance*	*Interest / Expense (3)*	*Yield / Rate (3)*
	(dollars in thousands)					
Assets						
Interest bearing demand deposits in other financial institutions	$ 178,190	$ 94	0.21%	$ 462,552	$ 270	0.24%
Securities:						
Investment securities available for sale:						
Taxable	1,262,172	5,568	1.77%	1,057,366	3,936	1.51%
Non taxable	216,364	2,154	3.98%	202,109	2,160	4.27%
Total securities	1,478,536	7,722	2.09%	1,259,475	6,096	1.95%
Loans: (1)						
Commercial loans	195,236	5,321	10.96%	272,362	7,703	11.47%
Real estate - commercial (2)	2,108,994	35,500	6.73%	2,198,858	33,739	6.14%
Real estate - residential 1 to 4 family	1,316,967	16,090	4.89%	1,175,960	16,480	5.61%
Consumer loans	51,425	1,259	9.85%	59,254	1,841	12.60%
Total loans, gross	3,672,622	58,170	6.34%	3,706,434	59,763	6.47%
Other interest earning assets	75,898	397	2.10%	84,033	352	1.70%
Total interest earning assets	5,405,246	66,383	4.92%	5,512,494	66,481	4.84%
Noninterest earning assets	420,959			466,885		
Total assets	$ 5,826,205			$ 5,979,379		
Liabilities and shareholders equity interest bearing deposits:						
Savings and interest bearing transaction accounts	$ 1,935,720	1,238	0.26%	$ 1,700,883	1,214	0.29%
Time certificates of deposit	1,522,922	4,180	1.10%	2,029,495	5,892	1.18%
Total interest bearing deposits	3,458,642	5,418	0.63%	3,730,378	7,106	0.77%
Borrowed funds:						
Securities sold under agreements to repurchase	315,637	2,463	3.14%	321,573	2,102	2.65%
Other borrowings	66,655	834	5.03%	115,372	2,976	10.46%
Total borrowed funds	382,292	3,297	3.47%	436,945	5,078	4.71%
Total interest bearing liabilities	3,840,934	8,715	0.91%	4,167,323	12,184	1.18%
Noninterest bearing demand deposits	1,119,418			1,063,080		
Other noninterest bearing liabilities	82,161			94,468		
Shareholders equity	783,692			654,508		
Total liabilities and shareholders equity	$ 5,826,205			$ 5,979,379		
Net interest spread			4.01%			3.66%
Net interest income/margin		$ 57,668	4.29%		$ 54,297	3.99%

(1) Nonaccrual loans are included in loan balances. Interest income includes related net deferred fee income.
(2) Commercial real estate loans include multifamily residential real estate loans.
(3) Includes impact of accretion or amortization of discounts and premiums.

The following table sets forth the changes in interest income and interest expense attributable to changes in interest rates, and changes in average balances (volume) for the period indicated. Changes attributable to both rates and volume have been allocated in proportion to the respective rate and volume components.

Table of Contents

	Three Months Ended March 31, 2012 vs. March 31, 2011 Change due to Rate	Volume	Total Change
	(dollars in thousands)		
Assets			
Interest bearing demand deposits in other financial institutions	$ (30)	$ (146)	$ (176)
Securities:			
Investment securities available for sale:			
Taxable	768	864	1,632
Non-taxable	(152)	146	(6)
Total securities	616	1,010	1,626
Loans: (1)			
Commercial	(323)	(2,059)	(2,382)
Real estate - commercial (2)	3,171	(1,410)	1,761
Real estate - residential 1 to 4 family	(2,235)	1,845	(390)
Consumer	(363)	(219)	(582)
Total loans, gross	250	(1,843)	(1,593)
Other interest earning assets	81	(36)	45
Total interest earning assets	917	(1,015)	(98)
Liabilities			
Interest bearing deposits:			
Savings and interest bearing transaction accounts	(135)	159	24
Time certificates of deposit	(366)	(1,346)	(1,712)
Total interest bearing deposits	(501)	(1,187)	(1,688)
Borrowed funds:			
Securities sold under agreements to repurchase	399	(38)	361
Other borrowings	(1,181)	(961)	(2,142)
Total borrowed funds	(782)	(999)	(1,781)
Total interest bearing liabilities	(1,283)	(2,186)	(3,469)
Net interest income	$ 2,200	$ 1,171	$ 3,371

(1) Nonaccrual loans are included in loan balances. Interest income includes related net deferred fee income.
(2) Commercial real estate loans include multifamily residential real estate loans.

Interest income and interest expense have been impacted by purchase accounting adjustments, resulting from the Investment Transaction. Specifically, the accretion of discounts, and amortization of premiums, that were recorded on the Company s loans, investment securities, deposits, and borrowings, as well as other interest earning assets, is reflected in the amounts for interest income and expense disclosed in the tables above.

The net interest margin is usually adversely impacted by nonperforming loans, with the exception of PCI Term Pools, because the Company generally ceases the accrual of interest on nonperforming loans, while those balances continue to be included in the average balances for loans. Interest income recognized on PCI Term Pools is based on an expected cash flows model; and, the Company recognizes accretion based on expectations of future cash flows.

The net interest margin improved by 30 basis points during the first quarter of 2012, when compared to that reported for the first quarter in 2011. The primary driver behind the increase was a decline in the cost of interest bearing liabilities of 27 basis points, as well as a slight increase in the yield on earning assets of 8 basis points. The decline in the cost of interest bearing liabilities was driven in large part to the absence of $53.0 million of subordinated debt, which matured and was redeemed by the Bank during the third and fourth quarters of 2011. Additionally, the cost of interest bearing liabilities benefited from the continuation of the planned runoff of higher cost brokered time deposits, as well as the maturity and re-pricing of higher cost retail time deposits.

The yield on interest earning assets benefited from an increase in the average yield earned on the investment securities portfolio of approximately 14 basis points, as well as a 40 basis point increase in the yield earned on other interest earning assets. However, these improvements were slightly offset by a decline in the average overall yield on the loan portfolio of 13 basis points. The year over year decline in the average yield on the loan portfolio was driven in large part by a decline in the balance of higher yielding commercial loan balances primarily in PCI Loan Pools. At the same time, the discount rate on the PCI Term Loans increased by 60 basis points when comparing the discount rate in March 2012 to March 2011. Additionally, the balance of the Company s newly originated and purchased loan portfolio increased approximately $574.7 million from that reported at March 31, 2011. Of this increase approximately $348.8 million can be attributed to originations and purchases of residential 1 to 4 family loans, which were originated and purchased at rates lower than the rates earned on commercial loans within PCI Loan Pools that experienced some attrition.

Provision for Loan Losses

Quarterly, the Company determines the amount of ALLL that is adequate to provide for losses inherent in the Company s loan portfolio. The provision for loan losses is determined by the net change in the ALLL from one period to another for loans originated or purchased since the Transaction Date. The Company may establish an additional ALLL for PCI Term Pools through a charge to the provision for loan losses when projected cash flows are lower than previous expectations. If, through the Company s quarterly evaluation of expected cash flows, it determines there has been a significant and probable increase in expected cash flows, the Company may reverse any previously established allowance for PCI Term Pools through an adjustment to the provision for loan losses, to the extent that any previous allowance has been established.

For PCI Revolving Pools, quarterly the Company evaluates credit performance to determine if there has been a further deterioration in the credit quality of the underlying loans beyond the purchase discount. To the extent that the credit performance is worse than previously expected, the Company may establish an allowance for PCI Revolving Pools through a charge to provision for loan losses. If credit performance is better than previously expected, the Company will begin to accrete the purchase discount for PCI Revolving Pools into interest income. During the three months ended March 31, 2012, the Company determined that the underlying credit performance of PCI Revolving Pools had improved from prior periods, and as a result, began to accrete the purchase discount related to those loans. Accretion related to PCI Revolving Pools totaled $286,000 during the three months ended March 31, 2012. During the three months ended March 31, 2011, the Company did not establish an allowance for PCI Revolving Pools, nor did the Company accrete any portion of the purchase discount.

For a detailed discussion of the Company s ALLL, refer to the Allowance for Loan and Lease Losses section of this document, Note 1, Summary of Significant Accounting Policies, and Note 6, Allowance for Loan and Lease Losses and Credit Quality within the Consolidated Financial Statements on this Form 10-Q.

Table of Contents

The provision for loan losses for the three months ended March 31, 2012, and 2011, totaled $835,000 and $1.7 million, respectively, and related solely to loans originated and purchased after the Transaction Date. Provisions for loan losses for the three months ended March 31, 2012, and 2011, are attributable to an increase in loan originations, as well as purchases of new loans offset by lower historical loss rates. All of the provision for loan losses is reported in the Commercial & Community Banking operating segment.

Noninterest Income

Noninterest income primarily consists of fee income received from the operations of the Bank and gains or losses from sales of assets. Fee income is generated by servicing deposit relationships, trust and investment advisory fees, and fees and commissions earned on certain transactions from Bank operations. The service charges and fees and gains and losses on asset sales relate to the Community & Commercial Banking segment while the trust and investment advisory fees are from the Wealth Management segment. Gains and losses from the sales of securities are from the treasury department s management of the investment securities and are reflected in the All Other segment.

The following table presents a summary of noninterest income for the periods presented:

	Three Months Ended March 31,	
	2012	*2011*
	(dollars in thousands)	
Noninterest income		
Service charges and fees	$ 5,636	$ 5,751
Trust and investment advisory fees	5,311	5,335
Loss on securities, net	(13)	(4)
Other	3,001	1,783
Total noninterest income	$ 13,935	$ 12,865

Noninterest income was $13.9 million for the three months ended March 31, 2012, and $12.9 million for the three months ended March 31, 2011. The largest portions of noninterest income are from service charges and fees and trust and investment advisory fees. Service charges and fees consist of service charges on deposit and loan accounts. These fees are generated from the Commercial & Community Banking segment. For the three month periods ended March 31, 2012, and 2011, service charges and fees from deposit accounts were $3.1 million and $3.3 million, respectively. Other service charges and fees include charges for a wide range of services provided to clients such as ATMs, safe deposit boxes, bank card fees, loan servicing fees, late charges for loans and wire transfer fees. These fees have remained relatively steady during the reported periods.

Trust and investment advisory fees are primarily from the management of clients assets and are included in the Wealth Management segment. As the balance and the value of the assets under management increase, fees generally increase.

Other Noninterest Income

The table below discloses the largest items included in other noninterest income:

	Three Months Ended March 31, 2012	2011
	(dollars in thousands)	
Other Income:		
Net gain on sales of assets	$ 1,299	$ 769
Customer fee income	1,097	1,288
Life insurance income	700	672
Net loss on LIHTCP	(311)	(1,074)
Other	216	128
Total	$ 3,001	$ 1,783

Other noninterest income was $3.0 million and $1.8 million for the three months ended March 31, 2012, and March 31, 2011, respectively. Net gain on sale of assets increased by $530,000 when comparing the three months ended March 31, 2012, to the three months ended March 31, 2011. Net loss on LIHTCPs declined due to the reduction in the investment in these partnerships since several of the Bank s investments were sold during the latter half of 2011 and during the first quarter of 2012, which reduced the current and future losses from these investments. Gains on securities, life insurance income, and monthly losses from the Bank s investment in LIHTCP are recorded in the All Other segment.

NONINTEREST EXPENSE

The following table presents a summary of noninterest expense for the periods presented:

	Three Months Ended March 31, 2012	2011
	(dollars in thousands)	
Noninterest expense		
Salaries and employee benefits	$ 24,810	$ 22,947
Net occupancy expense	6,258	5,676
Other	22,068	19,640
Total noninterest expense	$ 53,136	$ 48,263

Noninterest expense increased to $53.1 million for the three months ended March 31, 2012, compared to $48.3 million for the three months ended March 31, 2011, an increase of $4.9 million. The increase in noninterest expense is attributed to an increase in salaries and benefit expense, net occupancy expense and other noninterest expense.

Salaries and benefits increased by $1.9 million when comparing the three months ended March 31, 2012, to the same period in 2011, due to the increase in full-time equivalents. Net occupancy expense increased by $582,000 when comparing the three months ended March 31, 2012, to the same period in 2011, primarily due to the acceleration of depreciation of assets related to two planned branch closures in the beginning of April 2012.

Table of Contents

Other Noninterest Expense

The table below summarizes the significant items included in other noninterest expense:

	Three Months Ended March 31, 2012	2011
	(dollars in thousands)	
Other Expense:		
Professional services	$ 4,082	$ 3,996
Software expense	2,292	1,518
Regulatory assessments	2,168	4,487
Increase in earnout liability for RIAs	2,160	
Customer deposit service and support	2,149	1,750
Other intangible expense	1,787	2,199
Furniture, fixtures and equipment, net	1,273	1,234
Other real estate owned expense	1,088	812
Loan servicing expense	1,047	648
Supplies and postage	1,003	955
Merger and acquisition expense	1,000	
Telephone and data	918	656
Other	1,101	1,385
Total	$ 22,068	$ 19,640

Other noninterest expense increased by $2.4 million when comparing the three months ended March 31, 2012, to the three months ended March 31, 2011. This increase is mostly attributable a $2.2 million increase in the estimated earnout liability for the Bank s two RIAs and $1.0 million in UNBC merger related costs. These increases are partially offset by a $2.3 million decrease in regulatory assessments due to the Bank s improved financial condition.

Provision for Income Taxes

As required by GAAP, the Company uses the asset and liability method for reporting its income tax provision expense or benefit. Under this method, income tax expense is recorded for events that increase the Company s tax liabilities and benefit is recorded for events that decrease them. The provision is recorded in the form of deferred tax expense or benefit as the temporary basis differences arise, with the accumulated amount recognized as a deferred tax liability or asset. Deferred tax assets represent future deductions in the Company s income tax return, while deferred tax liabilities represent future payments to tax authorities.

Management s determination of the realization of net deferred tax assets is based upon management s judgment of various future events and uncertainties, including the timing and amount of future income, as well as the implementation of various tax planning strategies to maximize realization of the deferred tax assets. A valuation allowance is provided when it is more likely than not that some portion of the deferred tax asset will not be realized. The Company currently has a valuation allowance of $241.3 million against net deferred tax assets of $243.6 million (excluding the deferred tax liability related to the indefinite-lived trade name intangible of $5.2 million). Management continues to assess the impact of Company performance and the economic climate on the realizability of its deferred tax assets on a quarterly basis. The amount of deferred tax assets considered realizable is subject to adjustment in future periods. Management will continue to monitor all available evidence related to the Company s ability to utilize its deferred tax assets. The income tax expense or benefit in future periods will be reduced or increased to the extent of offsetting decreases or increases to the deferred tax asset valuation allowance.

Table of Contents

For the three months ended March 31, 2012, a $994,000 income tax provision was recognized. The tax provision for the three months ended March 31, 2012, is primarily attributable to a current state AMT offset by a favorable settlement of $204,000 with the California Franchise Tax Board s examination of the Company s 2002-2006 claim for refund.

For the three months ended March 31, 2011, income tax expense was $472,000 on pretax income of $17.2 million. The $472,000 tax expense was primarily attributable to a federal AMT payable.

For additional information related to the Company s provision for income taxes, refer to Note 9, Deferred Tax Assets and Tax Provision of the Consolidated Financial Statements and the discussion of income taxes and deferred tax assets in the Critical Accounting Policies section of the Company s 2011 Form 10-K.

Balance Sheet Analysis

Cash and Cash Equivalents

The Company s cash and cash equivalents decreased by $29.8 million or 13.4% since December 31, 2011, to $193.0 million at March 31, 2012. The decrease in cash and cash equivalents was primarily due to the use of funds to purchase $89.9 million of loans, offset by principal payments of $70.0 million on investment securities, and a decline of $28.6 million in deposit balances.

Investment Securities

The Company s security portfolio is utilized as collateral for borrowings, required collateral for public agencies and trust clients deposits, CRA support, and to manage liquidity, capital and interest rate risk.

The balance of AFS securities was $1.44 billion at March 31, 2012, compared to $1.50 billion at December 31, 2011, a decrease of $62.4 million. This decrease is attributable primarily to principal paydowns of $54.4 million and $11.9 million of CMO securities and MBS securities, respectively.

For additional information on impairment of investment securities and credit ratings of investment securities, and the Company s FHLB stock and other investments refer to Note 3, Investment Securities of the Consolidated Financial Statements of this Form 10-Q.

Loan Portfolio

The Company offers a full range of lending products and banking services to households, professionals, and businesses including commercial and residential real estate loans, commercial and industrial loans, and consumer loans. All assets, income, and expenses related to these activities are reported in the Commercial & Community Banking operating segment.

Table of Contents

The tables below summarize the distribution of the Company s loans held for investment:

	March 31, 2012	*December 31, 2011*
	(dollars in thousands)	
Real estate:		
Residential - 1 to 4 family	$ 1,103,650	$ 1,040,126
Multifamily	425,910	344,643
Commercial	1,586,687	1,588,852
Construction and land	156,531	185,400
Revolving - 1 to 4 family	239,657	249,857
Commercial loans	173,489	189,226
Consumer loans	47,438	49,977
Other loans	13,107	12,880
Total loans held for investment	$ 3,746,469	$ 3,660,961

Percent of loans to total loans		
Real estate:		
Residential - 1 to 4 family	29.5%	28.4%
Multifamily	11.4%	9.4%
Commercial	42.4%	43.4%
Construction and land	4.2%	5.1%
Revolving - 1 to 4 family	6.4%	6.8%
Commercial loans	4.6%	5.2%
Consumer loans	1.3%	1.4%
Other loans	0.2%	0.3%
Total loans held for investment	100.0%	100.0%

The loans in the table above include PCI Loan Pools, and loans originated or purchased since the Transaction Date. Included in the PCI Loan Pools are purchase accounting adjustments, as more fully discussed in Note 1, Summary of Significant Accounting Policies of the Consolidated Financial Statements on this Form 10-Q. At the Transaction Date, all of the loans in the Company s loan portfolio were aggregated into pools of loans, and recorded at their fair values, which significantly impacted the carrying amounts for the PCI Loan Pools. Additionally, the amounts presented above include deferred loan origination fees and costs, extension fees, and commitment fees.

To assist the reader with understanding of the PCI Term and PCI Revolving Pools versus the loans originated or purchased since the Transaction Date the following table provides a summary of the carrying balance and unpaid principal balance of the loans held for investment at March 31, 2012, and December 31, 2011.

Table of Contents

The tables below summarize the distribution of the carrying value of the Company s loans held for investment:

	March 31, 2012			
	Originated or Purchased Since Transaction Date	*PCI Term Pools*	*PCI Revolving Pools*	*Total*
	(dollars in thousands)			
Real estate:				
Residential - 1 to 4 family	$ 394,159	$ 648,131	$ 61,360	$ 1,103,650
Multifamily loans	243,306	181,237	1,367	425,910
Commercial	137,625	1,433,193	15,869	1,586,687
Construction	4,327	142,029	10,175	156,531
Revolving - 1 to 4 family	5,042	2,384	232,231	239,657
Commercial loans	17,189	46,967	109,333	173,489
Consumer loans	5,492	21,501	20,445	47,438
Other loans	4,008	5,583	3,516	13,107
Total loans held for investment	$ 811,148	$ 2,481,025	$ 454,296	$ 3,746,469
Total unpaid principal balance	$ 820,153	$ 2,718,384	$ 529,930	$ 4,068,467

	December 31, 2011			
	Originated or Purchased Since Transaction Date	*PCI Term Pools*	*PCI Revolving Pools*	*Total*
	(dollars in thousands)			
Real estate:				
Residential - 1 to 4 family	$ 296,257	$ 679,282	$ 64,587	$ 1,040,126
Multifamily loans	151,417	191,850	1,376	344,643
Commercial	114,307	1,454,837	19,708	1,588,852
Construction	1,793	179,646	3,961	185,400
Revolving - 1 to 4 family	3,890	5,949	240,018	249,857
Commercial loans	11,622	56,806	120,798	189,226
Consumer loans	6,404	22,342	21,231	49,977
Other loans	2,335	5,838	4,707	12,880
Total loans held for investment	$ 588,025	$ 2,596,550	$ 476,386	$ 3,660,961
Total unpaid principal balance	$ 594,386	$ 2,841,625	$ 557,023	$ 3,993,034

At March 31, 2012, loans held for investment were $85.5 million higher than that reported at December 31, 2011. PCI Term and Revolving Pools declined by $115.5 million, and $22.1 million, respectively, during the first quarter of 2012 primarily due to scheduled principal paydowns and payoffs. Loans originated or purchased since the Transaction Date increased $223.1 million or 37.9%, and now represent $811.1 million or 21.7% of total loans held for investment at March 31, 2012. During the three months ended March 31, 2012, the Company purchased approximately $89.9 million of residential 1 to 4 family, and multifamily loans, and originated approximately $157.6 million of new loans. New originations during the first quarter of 2012 were primarily in the residential 1 to 4 family, multifamily, and commercial real estate categories, and totaled approximately $62.1 million, $58.1 million, and $22.4 million, respectively. For additional information concerning loans the Company purchased during the three months ended March 31, 2012, see Note 4, Loans of the Consolidated Financial Statements of this Form 10-Q.

Allowance for Loan and Lease Losses

The Company has established an ALLL, representing Management s best estimate of probable credit losses inherent in the loan portfolio as of the date of the balance sheet. The ALLL is increased by charges to current period earnings and recoveries on previously charged-off loans, and is reduced by charge-offs related to loan balances deemed by Management to be uncollectable.

The ALLL of $6.3 million and $5.5 million at March 31, 2012, and December 31, 2011, respectively, relate primarily to loans originated and loans purchased since the Transaction Date. At March 31, 2012, and December 31, 2011, $864,000 and $867,000 of the ALLL related to one PCI Term Pool, which is reflective of the Company s revised estimate for future cash flows from the pool being below previous expectations. Management performs quarterly assessments of cash flows for PCI Term Pools. To the extent revised estimates for cash flows are below previous expectations, the Company may record additional provisions for loan losses, further increasing the allowance for PCI Term Pools. However, if Management s periodic assessment indicates there has been a probable and significant increase in the level of expected future cash flows, the Company may record a credit to the provision for loan losses, reducing the allowance for PCI Term Pools to the extent that an allowance was previously established.

The ALLL attributed to loans originated or purchased after the Transaction Date, also referred to as new and purchased loans, represented 0.67% of the new and purchased loans portfolio at March 31, 2012, compared to 0.79% at December 31, 2011. Although the ALLL for new and purchased loans increased $747,000 during the three months ended March 31, 2012, the ratio of ALLL for these loan balances declined. The decline in this ratio primarily relates to lower historical loss rates at March 31, 2012, compared to December 31, 2011, as well as greater diversification across the new and purchased loans portfolio among loan types for which the Company has historically experienced lower loss rates. During the first quarter of 2012, the Company primarily originated and purchased residential 1 to 4 family, and multifamily loans, which require a lower ALLL, due to a decline in historical loss rates the Company has experienced on such loans. The underlying credit quality for new and purchased loans also remained high during the three months ended March 31, 2012. At March 31, 2012, $801.3 million or 98.8% of loans originated or purchased since the Transaction Date were considered current, while $4.0 million or 0.5% were 30-89 days past due, and $5.6 million or 0.7% were on nonaccrual.

ALLL Model Methodology

The Company has continued to use the ALLL methodology used in prior periods, including prior to the Investment Transaction. The ALLL model uses quantitative and qualitative factors to estimate the required level of the ALLL. Quantitative factors are based primarily on historical credit losses for each portfolio of similar loans over a time horizon or look-back period. The Company generally uses historical credit losses over the past six quarters as a basis for its quantitative factors.

Qualitative factors are generally used to increase historical loss rates based on the Company s estimate of the losses inherent in the outstanding loan portfolio that may not be fully captured by the quantitative factors alone. Qualitative factors taken into consideration in the ALLL model are: concentrations of types of loans, loan growth, control environment, delinquency and classified loan trends, Management and staffing experience and turnover, economic conditions, results of independent loan reviews, underlying collateral values, competition, regulatory, legal issues, structured finance and syndicated national credits, and other factors. These qualitative factors are applied as adjustments to the historical loss rates when Management believes they are necessary to better reflect current conditions.

Loan Losses

Net charge-offs of $91,000, and $56,000 were recorded during the three months ended March 31, 2012, and 2011, respectively. These net charge-offs relate to loans that were originated subsequent to the Transaction Date, and are attributable to overdraft loans, and consumer loans with small outstanding balances.

The Company s policy for the accounting for PCI Term Pools is based on expectations of future cash flows, and as a result the Company only records losses related to such loans to the extent that periodic projections for future cash flows are lower than the Company s previous expectations. If projections for future cash flows are lower than previous expectations, the Company establishes an allowance for estimated losses in PCI Term Pools. The Company records charges against the allowance for PCI Term Pools to the extent the carrying balance for those pools are no longer deemed collectable. At March 31, 2012, the allowance for PCI Term Pools was $864,000, and related to one PCI Term Pool. The Company did not record any charge-offs against that allowance during the three months ended March 31, 2012. No allowance was established, and no charge-offs were recorded for PCI Term Pools during the three months ended March 31, 2011.

Nonperforming Assets

Nonaccrual and Restructured Loans

When a borrower discontinues making payments as contractually required by the note, the Company must determine whether it is appropriate to continue to accrue interest. Generally, the Company places loans in a nonaccrual status and ceases recognizing interest income when the loan has become delinquent by more than 90 days and/or when Management determines that the repayment of principal and collection of interest is unlikely. The Company may decide that it is appropriate to continue to accrue interest on certain loans more than 90 days delinquent if they are well secured by collateral and collection is in process. While still accruing interest, these loans are normally regarded as nonperforming and therefore are reported as such.

When a loan is placed in a nonaccrual status, any accrued but uncollected interest for the loan is reversed out of interest income in the period in which the status is changed. Subsequent payments received from the client are applied to principal and no further interest income is recognized until the principal has been made current or until circumstances have changed such that payments are again consistently received as contractually required. In the case of commercial clients, the pattern of payment must also be accompanied by a positive change in the financial condition of the borrower.

A loan may be restructured when the Bank determines that a borrower s financial condition has deteriorated, but still has the ability to repay the loan. A loan is considered to be TDR when the original terms have been modified in favor of the borrower such that either principal or interest has been forgiven, contractual payments are deferred, or the interest rate is below a market rate. Once a loan has been restructured for a client, the Bank considers the loan to be nonaccrual for a minimum of six months. Once the borrower has made their payments as contractually required for six months, the loan is reviewed and a determination is made whether the loan can begin to accrue interest. Additional information regarding nonperforming loans is in Note 6, Allowance for Loan and Lease Losses and Credit Quality of the Consolidated Financial Statements of this Form 10-Q.

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 OREO. OREO is originally recorded in the Company s financial records at the fair value of the property, 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 foreclosure, the difference is charged-off against the ALLL or PCI Loan Pool s valuation adjustment before recording the asset as an OREO. OREO are maintained in the Company s Consolidated Financial Statements at lower of the carrying value or fair value of the OREO, less estimated costs to sell.

Once the collateral is foreclosed on and the property becomes an OREO, Management periodically obtains valuations to determine if further valuation adjustments are required. OREO is carried at fair value less the estimated costs to sell. If there is a decrease in the fair value of the property on the valuation date, the decrease in value is charged to noninterest income as a valuation adjustment. During the time the property is held, all related operating and maintenance costs are expensed as incurred. All income produced from OREOs is included in noninterest income. All gains and losses on sale of OREO is recorded in noninterest income within the other income line item of the financial statements. Additional information regarding nonperforming loans is in Note 8, Other Real Estate Owned of the Consolidated Financial Statements of this Form 10-Q.

Nonperforming Loans

At March 31, 2012, and December 31, 2011, there were \$23.1 million and \$17.4 million of nonperforming loans. These nonperforming loans are mostly from the PCI Revolving Pools with exception of two commercial loans from the loans originated or purchased since the Transaction Date. The reporting for nonperforming loans was significantly impacted by the purchase accounting adjustments and the application of ASC 310-30 for PCI Term Pools. The accounting for PCI Term Pools and PCI Revolving Pools is described in Note 1, Summary of Significant Accounting Policies and Note 5, Purchased Credit Impaired Pools of the Consolidated Financial Statements of this Form 10-Q. At the Transaction Date, all loans were written down to their fair value. Therefore, only loans in the PCI Revolving Pools can be classified as nonaccrual or TDRs in accordance with ASC 310-20.

If interest due on nonaccrual loans and TDRs had been accrued under the original terms of the loans, \$391,000 would have been recorded as interest income during the three months ended March 31, 2012. Interest income recognized on nonaccrual loans and TDRs during the three months ended March 31, 2012, was \$25,000.

OREO

The balance of OREO as of March 31, 2012, was \$58.8 million, an increase from December 31, 2011, of \$6.5 million. This is the result of the addition of \$12.8 million of OREO properties, sales of \$5.5 million and an increase in the valuation allowance of \$800,000.

Impaired Loans

A loan is identified as impaired when based on current information and events, it is probable that interest and principal will not be collected according to the contractual terms of the loan agreement. Generally, impaired loans are classified as nonaccrual. However, there are some loans that are deemed impaired, because of doubt regarding collectability of interest and principal in accordance with the contractual terms of the loan, but are both fully secured by collateral and are current with interest and principal payments. These impaired loans may not be classified as nonaccrual. After Management determines a loan is impaired, it obtains the fair value of the collateral securing the loan if the loan is deemed collateral dependent, or an observable market price for the loan, to measure the extent to which the loan is impaired. If the loan is not deemed collateral dependent or an observable market price for the loan cannot be obtained, Management measures impairment based on expectations of future cash flows from the loan, discounted at the loan s effective interest rate. If the fair value of the collateral, an observable market price for the loan, or estimates for discounted future cash flows from a loan is less than the Company s recorded investment in the loan, a valuation allowance is established through a charge to provision for loan losses.

Impaired loans purchased as part of the Investment Transaction are accounted for under ASC 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality* (ASC 310-30), using an accounting policy based on expected cash flows, and are, therefore, not given recognition in the financial statements as individually impaired loans. These loans are also referred to as PCI Term Pools. Should the Company determine that it can no longer reasonably estimate the amount and timing of future cash flows from such loan pools the Company would cease accretion on these loan pools. As of March 31, 2012, there were no PCI Term Pools for which the Company believed it could not derive a reasonable estimate for future cash flows from those pools.

Impaired loans that are revolving in nature, acquired as part of the Investment Transaction, have certain attributes that meet the definition of a PCI loan, but are specifically excluded from the scope of ASC 310-30. Such loans, referred to as PCI Revolving Pools, are no longer considered impaired loans because the loans were recorded at fair value on the Transaction Date in accordance with ASC 310-20 and an estimate of future credit losses was included in the purchase discount recorded for those loan pools. However, since loans from the PCI Revolving Pools are specifically excluded from the accounting for PCI loans under ASC 310-30, the Company is required under current accounting guidance to include the underlying loans in the PCI Revolving Pools within its credit quality disclosures for impaired loans. Therefore, impaired loan credit quality disclosures, including those related to nonaccruing loans and TDRs, include loans from the PCI Revolving Pools.

At March 31, 2012, and December 31, 2011, the Company had impaired loans of $7.3 million and $1.0 million, respectively. Impaired loans at March 31, 2012, consist of $1.7 million of TDRs within PCI Revolving Pools, and two commercial real estate loans in the amount of $5.6 million within the new and purchased loans portfolio. Impaired loans at December 31, 2011, consisted solely of TDRs within the PCI Revolving Pools.

Deposits

Deposits by type are summarized in the table below:

	March 31, 2012	*December 31, 2011*
	(dollars in thousands)	
Noninterest bearing deposits	$ 1,120,826	$ 1,175,532
Interest bearing deposits:		
NOW accounts	1,002,077	954,621
Money market deposit accounts	391,988	384,989
Other savings deposits	595,633	542,935
Time deposits	1,477,876	1,558,963
Total deposits	$ 4,588,400	$ 4,617,040

Deposits were $4.59 billion and $4.62 billion as of March 31, 2012, and December 31, 2011, respectively, a decrease of $28.6 million. The decline in deposits was primarily from the maturities of higher rate brokered and client time deposits that matured and were not renewed. There was also a decline in the noninterest bearing deposit balances which were offset by increases in NOW, money market deposit and other savings deposit account balances as customers placed deposits in interest earning accounts which were attributed to interest rate promotions along with strong branch deposit gathering results.

Other Borrowings and Contractual Obligations

Other borrowings increased $5.2 million, or 7.8% since December 31, 2011, to $71.7 million as of March 31, 2012. This increase was due primarily to the addition of a capital lease for the Bank s ATM machines of $5.3 million during 2012. This increase is due to a five year capital lease that the Company entered into for the purpose of replacing and upgrading the Bank s ATMs throughout its branch system and off-site locations.

Table of Contents

Capital Resources

Capital Adequacy Standards

PCBC and SBB&T 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 Consolidated Financial Statements. For additional information regarding the Company s capital refer to Note 16, Regulatory Matters of this Form 10-Q and Note 18, Shareholders Equity and Note 20, Regulatory Capital Requirements of the Consolidated Financial Statements of the 2011 Form 10-K .

PCBC and SBB&T s regulatory capital ratios as of March 31, 2012, and December 31, 2011, were as follows:

	Total Risk-Based Capital	*Tier 1 Capital*	*Risk-Weighted Assets*	*Tangible Average Assets*	*Total Risk-Based Capital Ratio*	*Tier 1 Risk-Based Capital Ratio*	*Tier 1 Leverage Ratio*
			(dollars in thousands)				
March 31, 2012							
PCBC (consolidated)	$ 756,040	$ 734,050	$ 3,671,877	$ 5,724,154	20.6%	20.0%	12.8%
SBB&T	688,373	666,383	3,671,868	5,722,122	18.8%	18.2%	11.7%
December 31, 2011							
PCBC (consolidated)	$ 736,816	$ 715,062	$ 3,657,172	$ 5,768,824	20.2%	19.6%	12.4%
SBB&T	667,405	645,651	3,657,180	5,766,623	18.3%	17.7%	11.2%
Minimum Capital Ratios required by the Operating Agreement					12.0%	N/A	8.0%
Generally required minimum ratios to be classified as well-capitalized					10.0%	6.0%	5.0%
Generally required minimum ratios to be classified as adequately capitalized					8.0%	4.0%	4.0%

The minimum capital ratios required to be considered well-capitalized and adequately capitalized under generally applicable regulatory guidelines are included in the table above. As of March 31, 2012, and December 31, 2011, both the Company and the Bank met the minimum levels for the three regulatory ratios to be considered well-capitalized.

On September 2, 2010, the Bank entered into the Operating Agreement with the OCC, pursuant to which, among other things, the Bank agreed to maintain total risk-based capital at least equal to 12.0% of risk-weighted assets, and Tier 1 capital at least equal to 8.0% of adjusted total assets, and to not pay any dividend or reduce its capital without the prior non-objection of the OCC and unless at least three years have elapsed since the effective date of the Operating Agreement. The Bank was in compliance with these minimum capital ratios at March 31, 2012, with a Tier 1 leverage ratio of 11.7% and a total risk-based capital ratio of 18.8%.

Additional Capital

In order to ensure adequate levels of capital, the Company conducts an ongoing assessment of projected sources and uses of capital in conjunction with projected increases in assets and the level of risk. As part of this ongoing assessment, the Board of Directors reviews the various components of capital, the costs, benefits and impact of raising additional capital and the availability of alternative sources of capital. Based on the Board of Directors analysis of the Company s capital needs (including any capital needs arising out of its financial condition and results of operations) and the input of the regulators, the Company could decide or be required by its regulators to raise additional capital.

The Company s ability to raise additional capital if and when needed will depend on conditions in the capital markets, which are outside the Company s control, and on the Company s financial performance. Accordingly, the Company cannot be certain of its ability to raise additional capital on acceptable terms. If the Company cannot raise additional capital if and when necessary, its results of operations and financial condition could be materially and adversely affected, and it may be subject to further supervisory action. In addition, if the Company were to raise additional capital through the issuance of additional shares, its stock price could be adversely affected, depending on the terms of any shares it were to issue and the percentage ownership of existing shareholders would be reduced.

Dividends from the Bank

The principal source of funds from which the Bank s holding company services its debt and pays its obligations and dividends is the receipt of dividends from the Bank. The availability of dividends from the Bank is limited by various statutes and regulations. Pursuant to the Operating Agreement, the Bank may not pay a dividend or make a capital distribution to the Bank s holding company without prior approval from the OCC or until September 2, 2013. The Written Agreement also restricts the taking of dividends or any other payment representing a reduction in capital from the Bank, without the prior approval of the Reserve Bank. At March 31, 2012, the Bank s holding company held $65.7 million in cash, which is sufficient to service its debts for the foreseeable future.

Dividends on Common Stock

In the second quarter of 2009, the Board of Directors elected to suspend the payment of cash dividends on its common stock to preserve capital and liquidity. As a result of the Written Agreement, Reserve Bank approval will be required before the Company can resume paying cash dividends on its common stock. In addition, under the terms of the Merger Agreement, the Company may not pay cash dividends on its common stock without the prior approval of UNBC.

Trust Preferred Securities

The Company ended the deferral period on its outstanding Trust Preferred Securities on December 15, 2011. Pursuant to the Written Agreement between the Company and the Reserve Bank, the Company is also required to obtain approval from the Reserve Bank to service the Trust Preferred Securities for the interest payments due. Approval was obtained from the Reserve Bank to service the Trust Preferred Securities during the three months ended March 31, 2012.

Liquidity

Liquidity risk is the risk of an institution being unable to meet obligations when they come due and includes an inability to manage unplanned decreases or changes in funding sources. Liquidity risks can be segmented into two categories, either exogenous or endogenous risks. Exogenous risks are systemic in nature and typically outside the control of an organization and affect all market participants to varying extents (e.g. the disruptions in the overall asset securitization market). Endogenous risks are localized to a specific organization and are usually within its control (e.g. poor liquidity management).

The Company believes that maintaining a strong liquidity position, including in stressed conditions, is imperative for it to operate in a safe and sound manner. The Company s policy is to hold enough cash on hand to meet its daily cash needs and to withstand estimated daily cash outflows under a severe stress scenario. In addition, the Company s policy is to meet long term cash flow needs through its available funding capacity and liquid investment securities and to withstand future cash outflows under a severe stress scenario. The Company also maintains a conservative and diversified funding base to the extent possible, and holds high credit quality investment securities that can be quickly turned into cash. A key component of the Company s liquidity risk management framework is the development of a sound and accurate process to identify and measure liquidity risk.

The Company believes that it is important to have in place comprehensive liquidity and funding policies that are intended to maintain significant flexibility to address specific liquidity events and to address broader industry or market liquidity events. The Company has policies in place regarding liquidity to ensure that the Company is following sound liquidity risk management principles. In putting together these policies, the Company has considered recent guidance provided by the Basel Committee and the FDIC.

The Company measures liquidity risk through the use of projected cash flow models that identify potential future net funding shortfalls by estimating expected cash inflows and outflows arising from assets, liabilities, derivatives, operations, and off-balance sheet arrangements over a variety of time horizons, under normal conditions and a range of stress scenarios, including scenarios of severe stress. These models allow the Company to effectively manage the timing of incoming cash flows with outgoing cash flows, and to identify and remediate potential future net funding shortfalls below the Board of Directors approved risk tolerances.

Given the importance of being able to rapidly respond to negative liquidity events, the Company maintains a formal contingency funding plan (CFP) that clearly sets out the strategies to be taken if certain negative liquidity events were to occur. The Company s CFP identifies negative liquidity triggering events; establishes clear lines of responsibility for action; describes the specific procedures or actions to be taken, in priority order, for the initial response; and documents the communication and escalation procedures if initial responses do not resolve the problem. The Company believes that it is currently maintaining sufficient liquidity to meet its cash needs and to withstand a severe stressed liquidity event.

Current Liquidity Status

At March 31, 2012, the Bank had a total facility and unused borrowing capacity of $1.46 billion at the FHLB. The Bank had unused borrowing capacity with the Reserve Bank of $320.5 million at March 31, 2012.

Maturity of Liabilities

At March 31, 2012, the Bank had a total of $113.0 million of brokered CDs. The CDs have maturities from April 2012 through January 2014, with no more than $42.8 million maturing in any one month and no more than $44.7 million maturing in any one quarter. The retail CDs of $1.36 billion at March 31, 2012 have maturities through 2019. The Bank expects that most maturing retail CDs will roll over into new certificates.

A summary of retail CDs by maturity is as follows:

	March 31, 2012 *(dollars in thousands)*
90 days or less	$ 217,635
91 - 180 days	173,858
181 - 270 days	282,010
271 - 365 days	181,730
One to three years	247,288
Three to five years	258,538
Over five years	743
Total	$ 1,361,802

Liquidity Ratio

A prevailing liquidity ratio used in the banking industry is the net non-core funding dependence ratio as defined by regulatory practice. This ratio measures the proportion of long term assets such as loans and securities with remaining maturities of over one year that are funded by non-core funding sources and short term non-core funding sources. The Company s net non-core funding dependency ratio was 8.68% at March 31, 2012.

Table of Contents

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk is the risk of the change in the value of financial instruments due to movements in market factors. The preponderance of market risk that the Company assumes is from interest rate risk. Interest rate risk is the risk to earnings or capital arising from movements in interest rates. The economic perspective for market risk focuses on the value of assets or liabilities in today s interest rate environment and the sensitivity of those values to changes in interest rates.

Interest rate risk arises from differences between the timing of rate changes and the timing of cash flows (repricing risk); from changing rate relationships between different yield curves affecting assets or liabilities (basis risk); from changing rate relationships across the spectrum of maturities (yield curve risk); and from interest-related options embedded in assets or liabilities (option risk). The evaluation of interest rate risk also considers the potential effect on fee income that is sensitive to changes in interest rates.

For financial instruments that are recorded at fair value, their positions are marked-to-market and changes in the market value of the financial instrument are immediately identified through either earnings or other comprehensive income, both of which impact capital. As with most commercial banks, the Company records most of its financial instruments at historical cost. A separate approach is used to identify market risks for all financial instruments. The Company uses Economic Value of Equity (EVE) shock simulation model to identify the impact of market risk to capital and forecasted Net Interest Income (NII) shock simulation to identify the impact of interest rate risk to earnings.

EVE shock simulations model the effects of an instantaneous, sustained and identical change in all market interest rates (in increments of +/- 100 basis points) on assets and liabilities, and measures the resulting increase or decrease to the Company s equity position. EVE is the discounted value of future cash flows of all interest rate sensitive assets minus the discounted value of all interest rate sensitive liabilities, plus the book value of tangible noninterest rate sensitive assets minus tangible noninterest rate sensitive liabilities.

NII shock simulations model the impact of an instantaneous, sustained and identical change in all market interest rates (in increments of +/- 100 basis points) on future NII. NII simulates the effects that repricing has on both interest rate sensitive assets and liabilities. Shock analysis is objective and facilitates comparability. It is not entirely realistic in that it assumes an instantaneous and equal impact on all market rates and not all market rates respond in a parallel fashion to rising or falling interest rates. This causes asymmetry in the magnitude of changes in NII and net economic value resulting from the hypothetical increases and decreases in interest rates. Also, the current low rate environment with implied zero rate floors prevents a true parallel shift for downward rate shocks.

The Company measures its market risk exposure by performing +/- 200 basis point EVE shock simulations and measures the increase or decrease to the Company s EVE position. The Company s Board of Directors has set a 15% limit for the change in equity in such simulation. The Company measures interest rate risk by performing +/- 200 basis point NII shock simulation and measures the increase or decrease in NII against the projected NII assuming the forward curve over the next twelve months. The Board of Directors has set a 10% limit for the change in NII in such simulation. At March 31, 2012, and December 31, 2011, the Company met the Board of Directors approved limits for both EVE and NII.

Financial instruments respond differently from each other in a rising or falling interest rate environment. The response of each instrument depends on its structure including the contractual term, repricing features, amortization or bullet features, expected prepayments or runoff rates, rate indices, caps, floors, etc. The mismatch of these types of features between interest rate sensitive assets versus interest rate sensitive liabilities may significantly impact market risk exposure.

The Company manages its interest rate exposure by monitoring potential asset and liability mismatches and when necessary, reduces them. This may include changing the mix of repricing features as financial instruments come due, product pricing and buying or selling financial instruments with offsetting features.

Table of Contents

The Company can also manage its financial instrument exposure by entering into derivative contracts such as futures, forwards, swaps, or option contracts. Accordingly, the Company s evaluation of market risk considers both derivative positions along with the non-derivative positions intended to be hedged. While derivative instruments are effective hedging tools, the Company generally has been successful at maintaining its interest rate risk profile within policy limits strictly from proactive asset/liability strategies without the use of derivatives.

EVE Summary

The results of modeled EVE interest rate shock for March 31, 2012, and December 31, 2011, are as follows:

At March 31, 2012, and December 31, 2011, the Company s modeled EVE was $691 million and $707 million, respectively. Assuming an instantaneous 200 basis points increase in interest rates, the Company s projected EVE would increase by approximately $57 million or 8.2% from the $691 million base amount at March 31, 2012, and increase $106 million or 15.0% from the $707 million base amount at December 31, 2011. Assuming an instantaneous 200 basis point decrease in interest rates, the Company s projected EVE would decrease by $64 million or 9.2% at March 31, 2012, and decrease by $100 million or 14.2% at December 31, 2011. These changes are within the Company s policy limit of a 15% decline in EVE. Note, the current low rate environment prevents a true parallel shock analysis in a downward interest rate environment, which distorts EVE results.

Table of Contents

NII Summary

The results of modeled NII interest rate shock for the forward twelve months beginning March 31, 2012, and December 31, 2011, are as follows:

At March 31, 2012, the Company s modeled projection for net interest income over the next twelve months was $229 million. Assuming an instantaneous 200 basis point increase in interest rates, the Company s projected NII would increase by approximately $11 million or 4.9% from the $229 million base amount. Assuming an instantaneous 200 basis point decrease in interest rates, including a rate floor at zero percent, the Company s projected NII would decrease by $5 million or 2.3%. These changes are within the Company s policy limit of a 10% decline in NII.

At December 31, 2011, the Company s modeled projection for net interest income over the next twelve months was $207 million. Assuming an instantaneous 200 basis point increase in interest rates, the Company s projected NII would increase by approximately $15 million or 7.0% from the $207 million base amount. Assuming an instantaneous 200 basis point decrease in interest rates, including a rate floor at zero percent, the Company s projected NII would decrease by $3 million or 1.4%. These changes are within the Company s policy limit of a 10% decline in NII.

The above factors impacted overall sensitivity of the Company s EVE and NII to changes in interest rates by increasing the proportion of assets and liabilities that are either insensitive to rate changes or by lengthening the average maturity so that the effect of rate changes would be delayed.

The model utilizes certain assumptions that address optionality. These assumptions include the following:

- Clients have the option to prepay their loans or withdraw their non-maturing deposits;
- Issuers have the option to prepay or call their debt, on some of the securities held by the Company;
- The Company has the option to prepay or call certain types of its debt;
- The Company has the option to re-price its administered deposits; and
- Loans include features such as interest rate resets, imbedded caps and floors, and other aspects of loan terms and conditions.

There are various limitations inherent in modeling both EVE and NII sensitivity analyses. Certain assumptions may not reflect the manner in which actual yields and costs respond to market changes. Similarly, prepayment estimates and similar assumptions are subjective in nature, involve uncertainties and therefore cannot be determined with precision. Changes in interest rates may also affect the Company s operating environment and operating strategies as well as those of the Company s competitors. In addition, certain adjustable rate assets have contractual limits on the magnitude of rate changes over specified periods of time. The Company s NII sensitivity analyses may provide a strong indication of the Company s interest rate risk exposure however, actual performance may differ from modeled results. There are no material positions, instruments or transactions that are not included in the modeling nor do any included instruments have special features that are not included.

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Based on their evaluation of the Company s disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act), the Company s Chief Executive Officer and Chief Financial Officer have concluded that as of the end of the period covered by this Form 10-Q, such disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms and is accumulated and communicated to the Company s management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosures.

Changes in Internal Control Over Financial Reporting.

During the fiscal quarter ended March 31, 2012, there was no change in the Company s internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

Table of Contents

GLOSSARY

Accretion: The recognition as interest income of the excess of the par value of a security over its cost at the time of purchase.

AOCI: Accumulated Other Comprehensive Income

AFS: Available for sale

AICPA: American Institute of Certified Public Accountants

ALLL: Allowance for loan and lease losses

All Other: Segment which includes the Company s executive administration, risk management, information technology operations, marketing, human resources, corporate real estate, legal, treasury, and finance and accounting areas of the Company.

AMT: Alternative Minimum Tax

ASC: Accounting Standards Codification

ASU: Accounting Standards Update

ATM: Automated Teller Machine

Average balances: 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.

Bancorp: (Also the Bank s holding company) Referring only to the holding company as distinct from the consolidated company which is referred to as PCBC or the Company .

The Bank: Refers to Santa Barbara Bank & Trust, N.A.

Basis Points: A percentage expressed by multiplying a percentage by 100. For example, 1.0% is 100 basis points.

Basis risk: The risk that financial instruments have interest rates that differ in how often they change, the extent to which they change, and whether they change sooner or later than other interest rates.

BOLI: Bank Owned Life Insurance
CD: Certificate of Deposit

CDI: Core Deposit Intangible

CEO: Chief Executive Officer

CFP: Contingency Funding Plan

CMO: Collateralized Mortgage Obligation

Commercial: The Bank s commercial and industrial lending products.

The Company: Refers to Pacific Capital Bancorp (PCBC)

Coupon rate: The stated rate of the loan or security.

CRA: Community Reinvestment Act

CRI: Customer Relationship Intangible

Credit risk: The risk that a debtor will not repay according to the terms of the debt contract.

Dodd-Frank: Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010

Economic Value of Equity (EVE): A cash flow calculation that takes the present value of all asset cash flows and subtracts the present value of all liability cash flows.

FDIC: Federal Deposit Insurance Corporation

FHLB: Federal Home Loan Bank

FHLMC: Federal Home Loan Mortgage Corporation

FNMA: Federal National Mortgage Association

Form 10-Q: Quarterly Report Form filed with the United States Securities and Exchange Commission

Form 10-K: Annual Report Form filed with the United States Securities and Exchange Commission

GAAP: Generally Accepted Accounting Principles in the United States.

Table of Contents

GLOSSARY CONTINUED

GNMA: Government National Mortgage Association

Interest rate risk: The risk of adverse impacts of changes in interest rates on financial instruments.

Investment Agreement: An agreement dated April 29, 2010 between the Company, the Bank, and SB Acquisition Company LLC.

Investment Transaction: The Company issued common and preferred stock to the Investor for the aggregate consideration paid to the Company by the investor of $500 million in cash.

Investor: SB Acquisition Company LLC, a wholly-owned subsidiary of Ford Financial Fund, L.P.

LIBOR: London Inter-Bank Offered Rate

LIHTCP: Low Income Housing Tax Credit Partnership

Management: The executive management team of the Company and its subsidiaries.

Market risk: The risk 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.

MBS: Mortgage-Backed Securities

MCM: Morton Capital Management

MD&A: Management s Discussion and Analysis

Merger Agreement: On March 12, 2012, the Company announced that it had entered into a Merger Agreement with UnionBanCal Corporation.

MMDA: Money Market Demand Accounts

Net Interest Income (NII): The difference between the interest earned on the loans and securities portfolios and the interest paid on deposits and wholesale borrowings.

Net interest margin: Net interest income 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.
NOW: Negotiable Order of Withdrawal

OCC: Office of the Comptroller of the Currency

OCI: Other Comprehensive Income

OREO: Other Real Estate Owned

OTC: Over the counter

OTTI: Other-than-temporary impairment

PCBC: Pacific Capital Bancorp

PCI: Purchased Credit Impaired loans

PCI Term Pools: An accounting policy to apply expected cash flows accounting guidance to all loans subject to the business combination, and push-down accounting requirements for loan portfolios acquired in a business combination.

PCI Revolving Pools: Pools of impaired revolving lines of credit purchased through the Investment Transaction.

The Report: Quarterly report on Form 10-Q

Registrant: PCBC or the Company

Repurchase Agreements: A form of lending or borrowing whereby the legal form of the transaction is the purchase or sale of securities with the later re-sale or re-purchase at a higher price than the original transaction. The excess of the re-sale or re-purchase price over the original price represents interest income or expense.

Reserve Bank: Federal Reserve Bank of San Francisco

RIA: Registered Investment Advisors

REWA: R.E. Wacker Associates

SB Acquisition: SB Acquisition Company LLC

SBA: Small Business Administration

SBB&T: Santa Barbara Bank & Trust

SEC: Securities and Exchange Commission

Table of Contents

GLOSSARY CONTINUED

TDR: Troubled debt restructured, restructured loans

Transaction Date: The close of business on August 31, 2010 when the purchase accounting adjustments were reflected in the Consolidated Financial Statements, following the investment transaction.

TT&L: Treasury tax and loan

UNBC: UnionBanCal Corporation

U.S. Treasury: United States Department of the Treasury

Table of Contents

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The Company has been named in lawsuits filed by clients and others. These lawsuits are described in Note 11, Commitments and Contingencies, of the Consolidated Financial Statements of this Form 10-Q beginning on page 62. The Company does not expect that these suits will have any material impact to its financial condition or operating results.

The Company is involved in various other litigation of a routine nature that 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 to the Company s financial condition or operating results.

ITEM 1A. RISK FACTORS

There are a number of factors that may adversely affect the Company s business, financial condition or results of operations. Refer to Risk Factors in the 2011 Form 10-K for discussion of these risks. Such risks have not materially changed since the filing of the 2011 Form 10-K.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS ON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

Table of Contents

ITEM 6. EXHIBITS

Exhibit Number	Description
2.1	Agreement and Plan of Merger dated as of March 9, 2012, by and among UnionBankCal Corporation, Pebble Merger Sub Inc. and Pacific Capital Bancorp, incorporated herein by reference to Exhibit 2.2 to the Annual Report on Form 10-K of Pacific Capital Bancorp for the fiscal year ended December 31, 2011.
10.1	Termination of Consent Orders dated December 28, 2010, issued by the Comptroller of the Currency in the matter of Santa Barbara Bank & Trust, National Association, incorporated herein by reference to Exhibit 10.20.2 to the Annual Report on Form 10-K of Pacific Capital Bancorp for the fiscal year ended December 31, 2011.
10.2	Pacific Capital Bancorp 2012 Annual Incentive Plan, as amended, incorporated herein by reference to Exhibit 10.1 to the Current Report on Form 8-K of Pacific Capital Bancorp filed March 19, 2012. x
31.	Certifications pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. 31.1 Certification of Carl B. Webb. 31.2 Certification of Mark K. Olson.
32.	Certifications pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. 32.1 Certification of Carl B. Webb and Mark K. Olson.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

x Indicates management contract or compensatory plan or arrangement.

Table of Contents

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

Carol Zepke, Corporate Secretary

Pacific Capital Bancorp

P.O. Box 60839

Santa Barbara, CA 93160

Table of Contents

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/ Carl B. Webb	May 10, 2012
Carl B. Webb	Date
Chief Executive Officer	

(Principal Executive Officer)

By /s/ Mark K. Olson	May 10, 2012
Mark K. Olson	Date
Chief Financial Officer	

(Principal Financial Officer)